STATES OF JERSEY

JERSEY FINANCIAL SERVICES COMMISSION: IMPOSITION OF FINES

Lodged au Greffe on 19th October 2010
by Senator A. Breckon

STATES GREFFE

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PROPOSITION

THE STATES are asked to decide whether they are of opinion –

to request the Minister for Economic Development to bring forward for approval by the States no later than 30th June 2011 proposals to allow the Jersey Financial Services Commission to impose fines for breaches of the Commission's regulations as recommended in the recent report of the International Monetary Fund following its assessments of Jersey's regulatory and anti-money laundering regimes as part of the Financial Sector Assessment Programme.

SENATOR A. BRECKON

REPORT

Over the last few years I have noted that the Jersey Financial Services Commission (JFSC) have investigated and publicised a number of issues and cases regarding the conduct, capability and performance of individuals and organisations that are licensed by them.

I understand that these investigations can take a long time to conclude and can be very costly and take a great deal of time and effort. As well as in-house officers, outside specialised assistance is used for legal advice and areas like forensic accounting or computer or other information technology searching.

Some of these costs can be recovered by making those investigated pay for say an independent report to be produced, however, as the Law stands the JFSC have no powers to impose fines on those who transgress. In many other jurisdictions regulators have powers to fine and in my opinion this is an option which the JFSC should have.

The unsatisfactory situation became obvious to me with the Press Release issued by the JFSC on 28th July 2010, regarding the conduct of the Belgravia Financial Services Group Limited. Contained in the Press Release is the following –

> "**2008 Onwards**
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> The Commission conducted an on-site examination of BAM in January 2008. BAM's then management failed to provide satisfactory answers to questions relating to its financial standing and organisation. As a result, by Notice under Article 32(1)(a) of the FS Law dated 2 May 2008, BAM was required to provide answers. In addition, Directions were issued to BAM under Article 23(1) of the FS Law preventing the take-on of any new business and required BAM to provide advance notice to the Commission of any intention to sell, transfer, dispose or acquire any asset of the funds to which it provided services.
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> **Summary of Findings**
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> As a result of the Commission's on-site examination and information received, the Commission considers it appropriate to set out the matters of concern identified to date, namely:
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> - Inadequate and inappropriate corporate governance of BAM.
> - Significant monies were loaned on an unsecured and interest-free basis to related parties without regard to the intended use of monies or ability to repay.
> - Records were not maintained identifying the source of certain monies received or payments made.
> - Lack of proper accounting records and oversight contributed to BAM failing to maintain adequate financial resources.
> - The Commission was not notified of the true financial position of BAM.

- Intermediaries and introducers were appointed and acted in relation to the funds without procedures in place and there was no effective oversight by BAM of certain activities performed in relation to the funds.
- Land sites were included in valuation when legal title had not been acquired.

In addition to the above concerns, the Commission is not satisfied BAM complied with the following principles of the Codes of Practice in that a registered person must:

1. Conduct its business with integrity.
2. Have due regards for the interests of the Fund.
3. Organise and control its affairs effectively for the proper performance of its business activities and be able to demonstrate the existence of adequate risk management systems.
4. Maintain, and be able to demonstrate the existence of, both adequate financial resources and adequate insurance.
5. Deal with the Commission and other authorities in Jersey in an open and co-operative manner.

Present Position

The Commission's investigations are multi-jurisdictional, which has added to the complexity and time taken. BAM's licence has now been revoked. The Commission's investigations into the former activities of BAM and associated person continues."

Note BAM is Belgravia Asset Management a company wholly owned by Belgravia Financial Services Group.

A day earlier, 27th July 2010 the JFSC had issued a public statement, part of the content was –

"Standard Bank Jersey Limited (the 'Custodian'),
and
Standard Bank Fund Administration Jersey Limited
(the 'Administrator') (together, the 'Functionaries')

1.1 The Functionaries are authorised by the Commission to conduct Fund Services Business as defined in the FS Law. Such business includes, or has included, the provision of services to the following collective investment funds:

Belgravia European Property Funds Limited
Belgravia Funds PPC
Belgravia IFN Funds PCC
Belgravia Property Funds Limited
(collectively, the '**Belgravia Funds**')…

1.4 The Review is separate from the Commission's ongoing investigation into Belgravia Asset Management Limited, which is currently in liquidation.

1.5 The Functionaries have co-operated with the Commission and are undertaking a remediation plan to address the findings of the Review.

2 Summary of findings

2.1 In respect of the Belgravia Funds, the Functionaries failed to conduct Fund Services Business in compliance with the Codes. In certain instances there were breaches of the constitutive documents attributable to the conduct of the Functionaries.

2.2 Key failings:

2.2.1 There was a failure to adequately understand the complexity of the structures underlying the Belgravia Funds. As a result, the Functionaries failed to identify all risks and implement an appropriate risk management process.

2.2.2 Corporate governance was deficient and included a risk system that placed over-reliance on individual reporting. There was a failure to institute adequate independent checks to ensure procedures and controls were followed.

2.2.3 There was a failure to engage sufficient resources and employees were not appropriately qualified or experience for the roles undertaken.

2.2.4 Staff appointed as directors of the Belgravia Funds and underlying corporate vehicles lacked appropriate experienced and understanding of their legal and fiduciary responsibilities.

2.2.5 Deficiencies in internal controls and procedures resulted in an unclear division of responsibilities, failure to manage conflicts of interest, a lack of control over certain payments in respect of the Belgravia Funds, and insufficient monitoring of investment restrictions.

2.2.6 There was a failure to maintain appropriate accounting records. Too much reliance was placed on third party administrators outside Jersey to provide accurate information in a timely manner.

2.2.7 Funds valuations were undertaken by staff lacking requisite skills and experience of complex property funds with numerous underlying special purpose vehicles ('**SPVs'**) in multiply jurisdictions. The lack of appropriate accounting information resulted in dealing valuations being prepared on the basis of estimates.

2.2.8 Some land sites were included in valuations when legal title had not been confirmed.

2.2.9 More emphasis was placed on the wishes and instructions of the managers and investment advisors of the Belgravia Funds than the interests of unitholders.

2.2.10 In respect of one uintholder, owning a significant percentage of a Fund, there was a failure to obtain adequate Know Your Customer or Customer Due Diligence information as soon as reasonably practicable. In the Commission's opinion this constituted a breach of the Money Laundering (Jersey) Order 1999, as amended."

The findings are pretty damning of Standard Bank Jersey Limited and Standard Bank Fund Administration Jersey Limited.

As the Law stands the JFSC has not got the option of imposing a fine on the above, similar to the Financial Services Authority in the United Kingdom.

However, the International Monetary Fund's (IMF) recent Report recommends that the JFSC's power should include the ability to impose fines for breaches of regulations.

Recommendations from Financial System Stability Assessment (FSSA) –

- Recommendation – Strengthen the JFSC powers to impose fines for breach of JFSC regulations.
- Agency to do – Government.
- Amendment type required – Legislation.
- Action – Once ongoing work on the introduction of a power to allow the Commission to recover certain of its costs is complete, consideration will be giving to the merits of allowing the JFSC to impose fines.
- Timescale (where determined) – NONE.

I believe this needs to be put in train now bearing in mind the time that can be taken to bring the Regulations into place.

The United Kingdom Financial Services Authority has, as I earlier mentioned the powers to fine and regularly does so, Companies and individuals who transgress.

Set out below are a number of examples –

"FSA fines JPMorgan record £33.32 million
By Kirstin Ridley | LONDON | Thu Jun 3, 2010 6:34pm BST

(Reuters) - U.S. investment bank JPMorgan Chase & Co has been fined a record 33.32 million pounds in Britain for failing to protect billions of dollars of client money over almost seven years.

Issuing a stark warning to other banks operating in Britain, the Financial Services Authority said on Thursday that JPMorgan Securities Ltd, a UK unit

of the bank, had failed to adequately protect between $1.9 billion (1.3 billion pounds) and $23 billion of client money between November 2002 and July 2009.

'This penalty sends out a strong message to firms of all sizes that they must ensure client money is segregated in accordance with FSA rules. Firms need to sit up and take notice of this action – we have several more cases in the pipeline,' said Margaret Cole, the FSA's head of enforcement.

Under FSA rules, companies have to ringfence client money from the firm's money and keep it in segregated accounts with trust status to protect it in the event of an insolvency.

However, JPMorgan failed to segregate client money held by its futures and options business (F&O) with JPMorgan Chase Bank N.A. (JPMCB) following the merger of JPMorgan & Co and Chase Manhattan Corporation in 2000. The error remained undetected for nearly seven years.

Lawyers voiced surprise at the size of the penalty, which one said should serve as a 'wake up call' to senior managers.

'This is a staggering fine for what is in effect an administrative oversight,' said Simon Morris of law firm CMS Cameron McKenna. 'The one surprise is that FSA hasn't also gone against the senior managers responsible for this mistake, which is now its normal practice.'

JPMorgan has performed due diligence checks in its futures business globally since uncovering the error in Britain, a person familiar with the bank said. The internal checks indicate the mistake was a one-off issue resulting from the Chase merger, the person said.

The second-largest U.S. bank by assets, JPMorgan was profitable during the financial crisis and won market share in part by acquiring troubled Bear Stearns Cos in March 2008 and failed Seattle thrift Washington Mutual Inc, just days after Lehman Brothers filed for bankruptcy in September 2008.

JPMorgan declined comment.

No clients suffered any losses from the breach. But the FSA has been keen to prove its mettle after battling accusations of failing to spot and halt the excessively risky banker behaviour that helped trigger the worst credit crisis since World War Two.

In handing down the record fine, its largest since penalising oil company Royal Dutch Shell 17 million pounds in 2004 for overstating oil and gas reserves, the FSA said it took into account that the misconduct was not deliberate.

It also noted JPMorgan reported the error to the regulator after spotting it last July during conversations between senior staff in its compliance and treasury departments, that it immediately rectified the problem and cooperated with the FSA.

JPMorgan's cooperation with the FSA earned it a 30 percent discount on its original 47.6 million pound fine, in line with FSA practice.".

"FSA fines Aon Limited £5.25m for failings in its anti-bribery and corruption system controls – FSA/PN/004/2009 – 8th January 2009

The Financial Services Authority (FSA) has today fined Aon Limited (Aon Ltd) £5.25 million for failing to take reasonable care to establish and maintain effective systems and controls to counter the risk of bribery and corruption associated with making payments to overseas firms and individuals.

Between 14 January 2005 and 30 September 2007 Aon Ltd failed to properly assess the risk involved in its dealings with overseas firms and individuals who helped it win business and failed to implement effective controls to mitigate those risks. As a result of Aon Ltd's weak control environment, the firm made various suspicious payments, amounting to approximately US $7 million, to a number of overseas firms and individuals.

Margaret Cole, director of enforcement, said:

'This is the largest financial crime related imposed by the FSA to date, it sends a clear message to the UK financial services industry that it is completely unacceptable for firms to conduct business overseas without having in place appropriate anti-bribery and corruption systems and controls.

The involvement of UK institution in corrupt or potentially corrupt practices overseas undermines the integrity of the UK financial services sector. The FSA has an important role to play in the steps being taken by the UK to combat overseas bribery and corruption. We have worked closely with other law enforcement agencies in this case and will continue to take robust action focused on firms' systems and controls in this area.'

Aon Ltd cooperated fully with the FSA and agreed to settle at an early stage of the FSA's investigation. The firm qualified for a 30% discount under the FSA's settlement discount scheme. Without the discount the fine would have been over £7.5 million.

Since the discovery of its failings in 2007, Aon Ltd and its current senior management have demonstrated that they treat this matter with the utmost seriousness. The FSA considers that the pro-active determination of Aon Ltd's current senior management to identify past issues and improve the firm's systems and controls in this area is a model of best practice that other firms may wish to adopt.".

Another example is set out below from 2007 –

> **"FSA fines mortgage firm and its chief executive for re-mortgage and PPI selling failures –** FSA/PN/009/2007 – 6th September 2007
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> The Financial Services Authority (FSA) has fined Hadenglen Home Finance Plc (Hadenglen) £133,000, and its chief executive £49,000, for inadequate systems and controls when recommending re-mortgages and Payment Protection Insurance (PPI) to customers. This is the first time the FSA has fined both a firm and chief executive for re-mortgage and PPI failings.
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> The failing were discovered as a result of the FSA's second phase of PPI work in May 2006. The FSA found that Hadenglen exposed approximately 2,000 re-mortgage and 1,900 PPI customers to the unacceptably high risk of being sold a product which was not suitable.
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> Hadenglen's Chief Executive Richard Hayes was responsible for the firm's business practices and for ensuring that its systems and controls for selling re-mortgages and PPI were appropriate. He implemented a sales strategy for re-mortgages without regard to the risk that customers would have to pay an early redemption charge and other fees when re-mortgaging may have been unsuitable.
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> Mr Hayes also failed to ensure that the sales practices for PPI were adequate. Hadenglen did not gather sufficient information from customers and did not take into account the costs of PPI when making a recommendation.
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> As a result re-mortgage customers incurred significant charges that may not have been in their best interests and PPI customers were advised to purchase a product that may not have been suitable for their needs or under which they were not able to claim.
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> Margaret Cole, FSA Director of Enforcement, said:
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> 'Firms must develop and maintain systems and controls that minimise the risk of providing unsuitable advice to customers. The penalty imposed on Mr Hayes should leave senior management within firms in no doubt that the FSA will hold them to account if they fail to treat their customers fairly.'
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> The FSA has previously fined five firms over poor PPI selling practice- Regency Mortgage Corporation Limited £56,000 (PN 88/2006), Loans.co.uk £455,000 (PN 105/2006), Redcats (Brands) Limited £270,000 (PN 136/2006), GE Capital Bank £610,000 (PN/015/2007) and Capital One Bank (Europe) Plc £175,000 (PN/22/2007) and has imposed a public censure on Eastern Western Motor Group (PN/137/2006) and Cathedral Motor Company Limited. Two other cases have been concluded where problems relating to PPI also featured- Capital Mortgage Connections Limited Ltd £17,500 (PN/ 119/2006) and Home and Country Mortgages Limited £52,500 (PN/ 132/2006). Other PPI enforcement investigations are underway. (PPI is Payment Protection Insurance).
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> The FSA regulates the financial services industry and has four objectives under the Financial Services and Markets Act 2000: maintaining market

confidence; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; and fighting financial crime.

The FSA aims to promote efficient, orderly and fair markets, help retail consumers achieve a fair deal and improve its business capability and effectiveness.".

So as will be seen from the above, the UK Financial Services Authority has for years been able to use fines as a sanction for those that do not stick to the rules.

I believe Jersey's Financial Services Commission should have similar powers, as opposed to some publicity and perhaps a football equivalent of a yellow card.

The Jersey Competition Regulatory Authority has powers within the Law to use fines as a sanction. (Article 39 attached below).

I am suggesting that the JFSC has something similar in line with many other Regulators.

Competition (Jersey) Law 2005 (c.05.070)

"39 Financial penalties

(1) The Authority must not impose a financial penalty under Article 36(4), 37(4) or 38(7) unless it is satisfied that the breach of the prohibition was committed intentionally, negligently or recklessly.

(2) The amount of the penalty must not exceed 10% of the turnover of the undertaking during the period of the breach of the prohibition up to a maximum period of 3 years.

(3) The Minister may prescribe the manner in which the turnover is to be calculated for the purposes of paragraph (2).

(4) An order imposing a penalty on an undertaking must be in writing and must specify the date before which the penalty is required to be paid.

(5) If the penalty has not been paid and the specified date has passed the Authority may apply to the Court for an order to enforce the Authority's order against the undertaking concerned.

(6) The order of the Court may provide for all of the costs of, or incidental to, the application to be borne by all or any of the following –

(a) the person required to pay the penalty; or

(b) where the person required to pay the penalty is a commercial entity, a shareholder or officer of the entity whose actions led to the imposition of the penalty.

(7) The Authority shall pay to the Treasurer of the States any money received by it in payment of a financial penalty.".

I believe that attached proposals are a necessary requirement for a modern regulator who can impose a fine – but allow the entity to continue to trade.

Financial and manpower implications

I believe that the effect of this Proposition would have a positive effect on the Jersey Financial Services Commission income. I do NOT see a downside.

The manpower implications are minimal and again have a positive financial outcome.