

**Industry Seminar – 17 November 2015**

**Enforcement Division**

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Good afternoon everybody. For this year's presentation I intend to touch upon a number of areas and provide you with some important updates. The areas I intend to cover include updates on the Division, Outsourcing, Conflicts of interest, Cases, and finally just talk very briefly about external relationships, both domestically and internationally. So if we start with .....

**Division News**

I am very pleased to see a number of new faces within the Division this year as a result of some movement of staff externally. The staff we have recruited come with some excellent skill sets to compliment the already experienced staff members we have, and with their addition we have strengthened the Division considerably.

Of the appointments made I will now have a Deputy Director in Callum McVean, which is the only addition in numerical terms, but this is required due to the ever increasing workload on the Division.

I am also pleased to announce the appointment of our new regulatory lawyer who will be providing assistance to Enforcement, and Financial Crime. He arrives in Guernsey at the end of this Year from New Zealand, where he was a Senior Solicitor for the Financial Markets Authority, and we all look forward to working with him in the future.

**Outsourcing**

If I could next move on to outsourcing. Last year I talked about the outsourcing of functions and the rules that a licensee is bound by in that regard. Regrettably, we have seen a number of instances again this year in the cases we have brought to fruition, in that too much reliance is being placed not only on the compliance function being outsourced, but on the outsourcing of investment functions without sufficient recognition of the fact that overall responsibility still remains with the licensee, which again I will come onto shortly. In some cases, a relatively small number of hours were being allocated to consultants to carry out this function compared to the size of the firm, with the firms' focus being on the cost involved of the compliance function rather than its overall effectiveness.

I would ask you as the professionals in this audience this; what is worse, spending a little extra funding on resourcing your Risk and Compliance functions or running the greater risk and costs of sanctions and large fines being imposed and a public statement issued and in the worst case scenario individual directors facing potentially lengthy prohibitions. Contrary to popular opinion, imposing sanctions, fines and prohibitions is not something we relish doing, we take no pleasure out of it, but equally we will not avoid taking such action where the circumstances require this in order to protect the reputation of our industry and for the protection of investors.

It is not only compliance functions being outsourced that firms need to be conscious of. This year, as many of you will know, we have embarked on some extensive and complex fund investigations, which have been well documented by numerous media including Offshore Alert, Bloomberg, and the Wall Street Journal. Their published articles include extracts from the 1100 page affidavit of Paul Yabsley of my division, who, as a consequence of open court proceedings, found himself in the unwanted limelight and as some sort of international celebrity. As you can imagine, not only are these proceedings lengthy but are fraught with many challenges. It is therefore imperative that the Commission always gives careful consideration to the consequences when taking such action, due to the impact on the investors first and foremost, but also the public interest test and the reputational risk to the Bailiwick if we do nothing. We have only brought these actions when others, who may have been in a better position to make a call on the future of these investment vehicles have, in our view, done little to resolve the issues underlying these funds. To date the courts have shown support to the applications we have made, which can be costly but which we concluded gave the investors the best opportunity to receive something back from their investment.

I would now like to touch on one issue that has been highlighted in investigations both past and present and that is .....

### **Investment Management**

Please remember that this is only with regard to the cases we investigate after having been referred to us, which represents a minute percentage of the sector as a whole. During the course of investigations, the operation of the investment management of collective investment schemes has come under scrutiny.

The particular structure that has been causing us concern is where the principal manager delegates management to an investment manager, which are sometimes not domiciled in the Bailiwick of Guernsey.

Such a structure is widely used in the fund industry however the Commission has seen circumstances where those responsible for the governance of the fund, including investment management, have totally abrogated their responsibility for the investment management decisions, which is something we believe to be unacceptable.

During our investigations we have seen inappropriate and ineffective governance, monitoring and oversight of the investment management decisions, these being exploited by individuals and institutions who have conducted themselves in a highly ill-advised manner. As I have stated just now, such individuals and institutions are most likely not to be domiciled in Guernsey. However our focus will be on the licence holder here and they will be assessed against the Bailiwick's rules and regulations accordingly.

To be clear, I am not saying that such a fund structure is inappropriate. However, where it is used the Commission expects an active role to be played by the principal manager in supervising the investment decisions.

In addition the Commission will require certain minimum standards of due diligence and monitoring by the administrator and, if an open-ended collective investment scheme, then also a designated custodian. Whilst each administrator/designated custodian has to put in place monitoring and supervision procedures appropriate for the size and complexity of the business, the

Commission would also expect to see regular reports from the investment manager being considered with such reports including:-

- Fund Overview
- Performance Statistics
- Performance chart with comparison against a recognised benchmark
- Investment Composition Breakdown which may include:
  - Breakdown of Assets
  - Underlying Fund Breakdown Analysis (name of Fund, Invests in, Liquidity, Benchmark, Fund Overview)
- Market Value
- Allocation as a percentage of the NAV per investment
- Asset Class

The Commission consider that were the Scheme and Supplementary Scheme Particulars to define broad investment objectives, the administrator and designated custodian should still subject investment decisions to careful monitoring - which may necessitate identifying the true nature of the funds' investments beyond the first tier, which is typically a special purpose vehicle (SPV).

Whatever monitoring and supervision systems the licensee puts in place the Commission will, even in the case of discretionary agreements, hold the licensee accountable for any failures in compliance with the rules and regulations.

So I would reach out to the sector and ask them to think;

If it doesn't look right, query it. If pushed back, query it again. If you are still not getting information that is to your satisfaction you then have choices to make;

1. do I risk my firm?
2. do I risk my career?
3. do I report it internally?
4. do I report it to the Commission?
5. do we, as a firm cease the relationship?

These are big decisions to make in a competitive market place, but we only ask that you look at the consequences if it goes wrong.

### **Conflicts of Interest**

Carrying on with the same theme, during recent investigations involving firms within the fund sector, we again found that conflicts of interest are not being managed as effectively as we would expect. , I am unable to provide more detail about the individual cases at this moment in time for obvious reasons, albeit there is much that has been placed in the public domain, either by Offshore

Alert, Bloomberg or the Wall Street Journal, as I have already stated. All I will say is that when you have individuals that sit as director of the administrator (designated manager), or director of the investment manager, on the board of the fund and have either placed investors' money into other entities under their control or act as controller of the underlying PCC/ICC, this has to be declared, properly documented and carefully managed going forward. If it is not documented then, from a regulator's perspective, we inevitably find it difficult to accept that it happened, and even if it has been documented, we will carefully scrutinise how the conflicts were managed in practice by the firm.

There also appears to be a total reliance on broadly drafted scheme particulars, which may be appropriate on occasion, but such particulars cannot abrogate the responsibilities expected of our licensees and their directors.

## Cases

Turning now to case work, the Division has concluded 9 cases to date this year in addition to spending many months of hard work making applications to the court seeking to either place funds into administration or liquidation. Such action is taken where there are strong indicators that this is in the best interests of the investors, the public interest, or for the protection of the Bailiwick. This has been achieved using powers that the Commission holds but has never really used before, and much new ground has been broken over the last twelve months in that regard.

There have also been several cases placed before the Commission's Senior Decision Makers who are selected from a panel of eminent UK based QCs, and we have received three decisions to date. One of these supported the proposed sanctions, one supported the findings but amended the proposed sanctions slightly and very recently a QC found in favour of the licensee on 3 out of 4 allegations made by the Commission. We currently have one outstanding matter with a Senior Decision Maker, for which we are awaiting a decision upon.

It is also the case that some referrals to the Enforcement Division are, following initial consideration, referred back to the relevant Supervisory Division. This is usually because such cases are better resolved through enhanced supervision. Chief amongst our considerations when deciding whether or not to refer them back to the Supervisory Division is the protection of investors, and the reputation of the Bailiwick, for example; would there be a serious loss to investors if we did not act immediately through enforcement and, of course, the severity of the alleged failings that have been identified. The bottom line is we cannot investigate everything, and nor should we, but careful consideration is given to each and every case that is referred. Having said all of this rest assured that if a new matter is referred that is equally as serious as those already under investigation the Commission will investigate the matter accordingly.

There have also been two other cases this year where, after thorough investigation, the Commission decided that it was appropriate and proportionate to issue warnings to individuals that will remain on their file for future consideration, should anything further come to light, as opposed to any serious sanction being brought which would involve a public statement. This was due to the fact that after receiving full co-operation from them and them responding to requests for the relevant information the Commission was of the opinion that the matter was not as serious as initially thought and could act accordingly.

### **Slide: Enforcement cases outcomes**

This gives you an idea of the outcomes of the cases that have been concluded to date. I have highlighted one portion of this chart for no other reason but to show that in 21% of cases (it was 15% until the recent case) we have recommended no sanctions be brought or as in the recent case the allegations were rejected. This is important for you all to understand that just because a matter has been referred it does not mean that automatically a licensee is being sent to the gallows!

### **Slide: Types of enforcement cases**

This slide gives you the breakdown of the types of enforcement cases. Most cases, in fact 69% of them, have had an element of Corporate Governance failings which have then led to either AML breaches or poor conduct, however, as you can see, on some occasions the issues have been either purely down to poor conduct or AML breaches. This highlights the importance of the role played by the Board in ensuring that they have adequate appropriately qualified resources to properly deal with compliance issues within their respective organisations.

### **Slide: Completed enforcement cases per sector**

Of the completed cases to date, this slide shows a breakdown of the sectors from which the Enforcement cases have arisen. If this highlights anything it shows that we have had very little dealings in the banking sector apart from the one case to date for which there has been a public statement, that being Ahli United Bank. The insurance sector being the highest was primarily as a result of two thematic reviews which highlighted repeat failings by some firms.

With regards to the Fiduciary sector, these cases have primarily highlighted instances of AML breaches and poor corporate governance issues.

### **Slide: Referrals from Financial Crime/other Supervisory Divisions**

This gives a very simple breakdown of the % of work that my Division receives from our Financial Crime Division as opposed to all of the Supervisory Divisions put together. Of course, cases of financial crime are predominantly focussed on breaches of the AML/CFT provisions which are taken seriously, however they will also report on any corporate governance failings identified as a result of their findings. The rest of the divisions will be a combination of poor corporate governance and poor conduct.

### **External Relationships**

The Enforcement Division continues to build on its existing relationships as well as developing new ones with both regulatory and law enforcement agencies both domestically and at international level. There exists a strong healthy relationship between the Enforcement Division and the Guernsey Financial Investigation Unit, and we have had occasion to make referrals from the Commission to the FIU where we believe that the facts before are criminal in nature, which we believe would require a full criminal investigation as opposed to any sanctions being imposed by the Commission. We meet on a regular basis to ensure that we are not working in a 'blue on blue' situation. By this I mean that we want to ensure that we do nothing that will impact on a criminal investigation and to avoid any embarrassment of us both turning up on the doorstep of the same licensee investigating similar facts.

This year has also seen the Enforcement Division take the lead and reach out to several jurisdictions involved in a global investigation and to make efforts to try and maintain a co-ordinated approach to matters pertaining to that investigation. This was felt to be imperative for many reasons not least of which was to learn from our respective colleagues globally, share experiences and more importantly to move matters along in a co-ordinated fashion. It also gave each jurisdiction the best chance of bringing their respective investigations to a successful conclusion based on each other's assistance. It was found to be an efficient way of progressing matters, and one that I look forward to building on with these new found relationships in the future.

On a separate note, I have been invited to join an International 'Twinning' Projects Team from the UK's Ministry of Justice to provide assistance to Turkey in developing its regulatory, law enforcement and legal financial crime framework so as they are in a better position to be next evaluated by FATF and hit the expectations and requirements of the 4th EU Money laundering directive. This project is scheduled to last two years with ad hoc visits to Turkey for short periods of time to complete tasks that have been set. This is paid for in its entirety by the international bodies sponsoring the programme and is at no cost to the Commission. I have recently had my first visit there and the differences in the approach to how the respective jurisdictions do things, is going to make it an interesting project moving forward. This is a good opportunity for Guernsey to be seen to assist with a project of international dimensions.

## **Summary**

As we have worked through the cases that have been referred to us for investigation, it would be naive of me to say that we are not learning things during the process.

I would also like to reiterate the comments I have made on previous occasions concerning our enforcement processes. We are not trying to catch anybody out with what we do, we want everybody to understand the process and to be able to work with licensees and their legal counsel as opposed to wasting time and considerable amounts of money on attempting to derail the process, which let's face it, costs me an e-mail or a letter but costs the licensee hundreds, if not thousands of pounds, in legal costs, which could be avoided. The Commission believes that justice should be timely and attempts made again this year to delay matters or to break the process have been dealt with appropriately by the Commission's Senior Decision Makers who, as you know, are all eminent UK based QCs. The Commission will not flinch from taking appropriate steps where we feel that serious wrongdoing has taken place and we will resist all and any attempts to derail the process as happens all too often at present, which in some respects understandable but nevertheless disappointing.

It was interesting to read a recent Guernsey Press article where our industry of days gone by was being referred to and reference made, to none other than former Blue Peter presenter John Noakes climbing Nelson's Column with no safety equipment or safety regulator in sight. Although I am not saying I agree with the whole content of that article, I do agree with the general point which was being made. The author, Horace Camp, was making the point that some 30 years ago, climbing the Column without any safety equipment was deemed to be acceptable and made the analysis of how working practices in financial services businesses of that era would also look differently from today's. The fact remains that businesses have to keep up with the changing environment, whether it is a better 'world order' as it was put is always open to debate, but it is one that we all have to embrace if we want to survive and succeed.

To conclude then. I completely understand that, for those under its microscope, the Enforcement Division is about as popular as Christmas is to a Turkey. However if there is a message from me to follow on from what the Director General talked about earlier, it is that firms need to have people with the requisite qualifications and skill set to carry out roles as Director, or within Risk and Compliance functions, and that even though it is a cost to firms, effective compliance should be maintained in order to ensure that the Bailiwick's reputation is protected and all of the good business we have can prosper accordingly thereby providing wealth and a vast array of employment opportunities.

Finally, let me reiterate one more thing if I may. The staff in my Division, in common with all of the Commission's Divisions, are always approachable and willing to listen to your views and receive constructive feedback regarding the way we carry out our tasks. What we do, we do for the Bailiwick in ensuring that our businesses remain healthy, strong, and more importantly fit for purpose.

Thank you for listening to me.