

UPDATE

GFSC issues public statement and imposes civil penalty for failure to fulfil the minimum criteria for licensing

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The Guernsey Financial Services Commission (the **GFSC**) has published a detailed and thorough assessment of its decisions in relation to Criteria Wealth Management Limited (**CWML**) and two of that firm's officers. The GFSC concluded that CWML and the officers concerned (the **CWML Directors**) had failed to fulfil the minimum criteria for licensing under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the **POI Law**) and the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 (the **IMII Law**).

CWML was licensed under the IMII Law as an insurance intermediary and under the POI Law to carry on the restricted activities of *advice* and *promotion* in connection with *Category 1 Controlled Investments* (Collective Investment Schemes).

As a result of on-site visits and a client complaint, the GFSC concluded that CWML had been conducting unlicensed business in carrying out the restricted activity of *management* and also advising on and promoting certain Structured Notes (the **Notes**), which the GFSC found were *Category 2 Controlled Investments* (General Securities and Derivatives) as they comprised of derivative instruments.

There was no disagreement as to the scope of CWML's licence. Rather the dispute was the categorisation of the Notes, which were not *Category 2 Controlled Investments* in the opinion of the CWML Directors. While the CWML Directors considered the categorisation of the Notes a 'grey area', they did not seek legal/expert advice for clarification/confirmation at any stage.

CWML and the CWML Directors were also found to have breached the Licensee (Conduct of Business) Rules, 2009, 2014 and 2016 (the **Licensee Rules**).

The Notes were complex and high risk investments. However the CWML Directors wrongly classified the Notes as low risk, resulting in unsuitable recommendations to retail clients who had low risk appetites. Clients were not made aware of the true risks of the Notes, in particular the risk of loss of up to 100 per cent of capital invested.

CWML failed to give prior disclosure of all charges and remuneration, including the basis or amount of its charges.

CWML failed to ensure that each of its financial advisers (the CWML Directors), who should only provide advice on matters that they were competent and qualified to advise on to the minimum standard required by the GFSC, held appropriate qualifications. Specifically, the CWML Directors did not have the requisite qualifications relating to *Category 2 Controlled Investments*.

The CWML Directors themselves failed to observe high standards of integrity and act with due skill, care and diligence in relation to numerous matters (including failure to keep records of provision of suitable advice). These various failings, the GFSC found, resulted in their failure to ensure CWML adhered to the Licensee Rules, the Code of Conduct for Authorised Insurance Representatives (until 31 December 2014),

the Code of Conduct for Financial Advisors (from 1 January 2015), and Principle 2 (skill, care and diligence) of the Principles of Conduct of Finance Business.

There were further significant breaches of the fiduciary duties of one of the CWML Directors. In relation to a transaction to sell his shares in CWML the director omitted to declare his interests to the board of CWML, failed to inform the client purchaser that he was dealing in his own personal capacity (not in his capacity as the client's financial advisor nor on behalf of CWML) and that he, rather than CWML, would receive the consideration. This coupled with a failure to inform the client of the risks attaching to the shares and the likelihood of returns led the GFSC to determine that the CWML Director concerned did not act in an open and transparent manner in relation to the sale.

In determining the appropriate penalties, the GFSC took into consideration relevant aggravating and mitigating factors. The GFSC considered the following to be aggravating factors:

- (i) other than the few complaints received, no other breaches were brought to the attention of the GFSC (i.e. no self-reporting);
- (ii) CWML had a poor regulatory history dating back through previous visits;
- (iii) the unqualified advice given to a complainant resulted in 15-20 per cent of CWML's income in one financial year;
- (iv) deliberately improper conduct resulted in substantial financial gain for one of the CWML Directors; and
- (v) failures by one CWML director to check, challenge or report the failings of another CWML Director resulted in failures to protect clients.

The GFSC, however, looked at the aggravating factors above on balance with the following mitigating factors:

- (a) both CWML and the CWML Directors co-operated with the investigation;
- (b) one of the CWML Directors did not make any personal gain from the sales of shares and took into account the GFSC's direction following a previous visit;
- (c) early admission that the conflicts of interest policies at CWML were inadequate were subsequently addressed; and
- (d) a third party consultant was appointed following a historic visit and a remediation plan was formulated to the satisfaction of the GFSC.

CWML was put into compulsory winding up on 31 January 2019. As a result of CWML's insolvent liquidation, the GFSC decided not to impose a financial penalty on CWML but it is noted that a discretionary penalty of £50,000 would have been imposed had CWML not been insolvent.

Financial penalties of £40,000 and £20,000 respectively were imposed on the CWML Directors along with Prohibition Orders prohibiting them from holding various positions under the POI Law, the IMII Law, the Insurance Business (Bailiwick of Guernsey) Law, 2002 and the Banking Supervision (Bailiwick of Guernsey) Law, 1994 for a certain period.

The GFSC also disapplied section 3(1)(g) of the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000, which would otherwise exempt directorships of up to six companies from the licensing requirement, for each of the CWML Directors for a certain period.

The moral of the story: if there is any doubt as to whether a licence extends to a proposed business activity, take legal/expert advice **beforehand**. The consequences of conducting unlicensed business are serious and to do so will expose a licensee to reputational risks, legal risks and regulatory risks as well as jeopardising the reputation of the Bailiwick as a reputable finance centre.

A full copy of the public statement released by the GFSC can be found [here](#).

Our recent guide in relation to director's duties can be found [here](#).

If we can assist to provide clarification in relation to any concerns or queries arising from this public statement, please do get in touch with our team.

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