Economy

COMBATTING FINANCIAL CRIME **TOGETHER**

National Statement on Financial Services and Financial Crime: Activities, Risk Appetite and Mitigation

SEPTEMBER 2022

Government of Jersey

National Statement on Financial Services and Financial Crime: Activities, Risk Appetite and Mitigation

Purpose of this Document

The vision of Jersey's Financial Services Policy Framework is to create the environment required to enable the continued success of Jersey's financial services industry by facilitating its digital transformation, its continued compliance with global standards, and its transition into being a leading centre for sustainable finance.

Central to protecting Jersey's position as one of the world's most stable and successful international finance centres is its effective management of risk, underpinned by a mature ecosystem of legislation, regulation and enforcement in which bodies work together to promote and enforce high standards.

This document sets out Jersey's approach to risk relating to its finance sector. It:

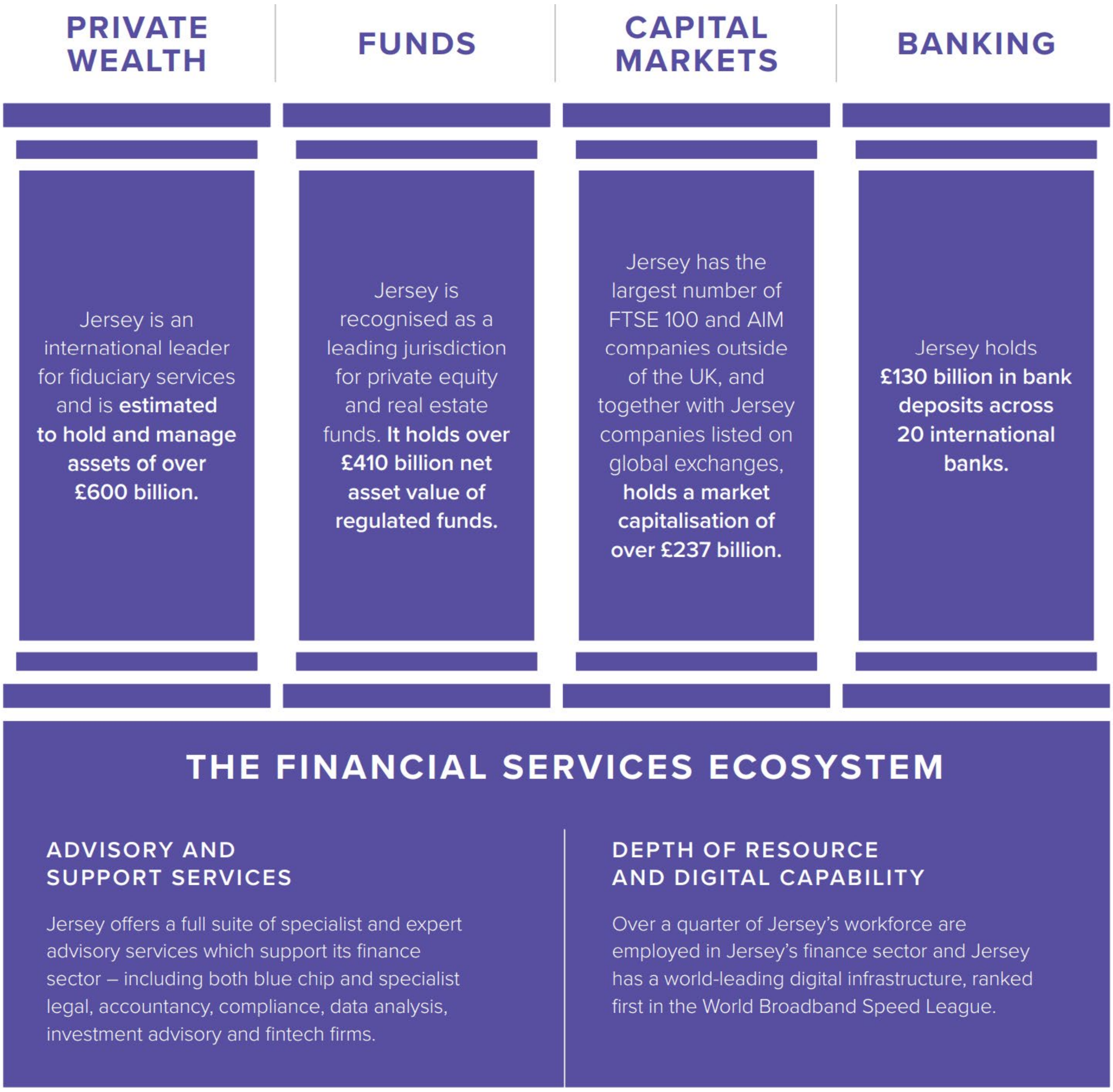
- Outlines, at a high level, the main sources and types of risk Jersey's finance centre presents consistent with its vision
- Articulates the boundaries of Jersey's appetite for financial services related activities
- Sets out the framework for how Jersey identifies, sets tolerance and mitigates risk.

This risk statement is owned by the Minister for Treasury and Financial Services. The risk statement will be updated as needed but will be published on at least an annual basis.

Background - Jersey's Financial Services Industry

Jersey's Financial Services Policy Framework outlines the four key pillars on which Jersey's financial services industry is centred: private wealth, funds, capital markets and banking. It sets out ten strategic priorities for the financial services industry:

1. Maintain and develop the four pillars of Jersey's financial services industry
2. Enable Jersey to be a leading international financial centre for sustainable finance
3. Harness the opportunities created by fintech and digitalisation
4. Maintain an attractive and agile operating environment
5. Maintain strong adherence to international standards
6. Review and refresh Jersey's strategy for combatting financial crime
7. Enhance Jersey's profile internationally
8. Grow and deepen Jersey's footprint in new and existing markets
9. Deliver strong and effective stakeholder cooperation
10. Deepen and broaden the skills and expertise of Jersey's workforce



Source: Government of Jersey, Financial Services Policy Framework, December 2021

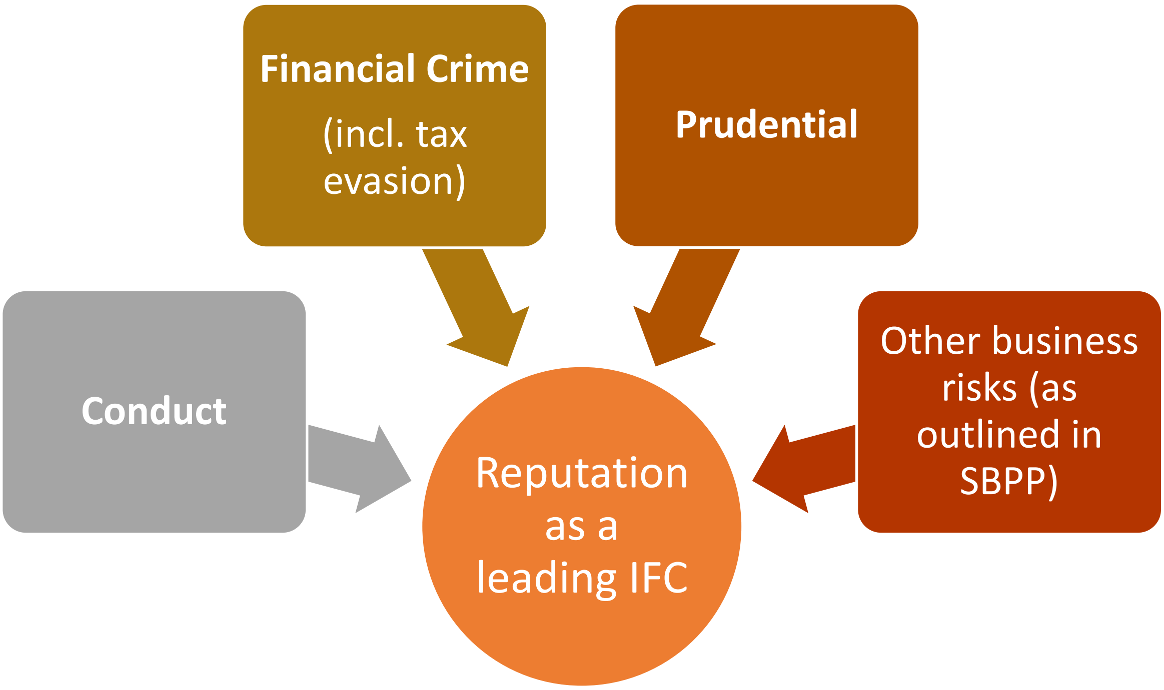
Jersey's Framework for Risk Management

In common with other International Finance Centres ("IFCs"), risks relating to Jersey's finance sector derive from activities, products and interaction with other jurisdictions, and relate to the areas of financial crime; prudential; and conduct. Jersey also considers the impact of wider reputational risks to the island that do not fit within these three categories.

As an IFC with global reach, Jersey recognises financial crime as its greatest risk and calibrates its risk mitigation approach accordingly. Jersey's overall framework for managing financial crime risk is set out below.

Jersey also has risks from prudential mismanagement and misconduct in the financial services industry. Jersey's approach to managing these risks is often informed by international standards but is also informed by public statements of regulatory bodies, the reports of public bodies and agencies to the States Assembly, and intelligence regarding emerging market trends.

There are also a range of business risks which are outlined in the Sound Business Practice Policy (the "SBPP"), and heightened risks associated with activity in certain jurisdictions. Collectively, the mitigation of these risks protects Jersey's reputation as a leading IFC.



Financial Crime

Jersey has wide ranging legislation and structures in place to mitigate the risks of financial crime. This recognises that the *inherent* risk of proceeds of crime passing through Jersey is relatively high. As a jurisdiction which provides services globally, the breadth of activities being carried out across a range of other jurisdictions is significant. For example, by its nature, the activity of providing private structures for high value overseas persons and companies to protect and invest assets raises the risk that a proportion of these funds will be the proceeds of crime. However, the *inherently* higher risk is mitigated through the application of preventative measures, systems and controls, in line with the Financial Action Task Force (FATF) Methodology. Therefore, the *residual* risk that the jurisdiction is exposed to, is less than the *inherent* risk.[1]

Managing Financial Crime Risks

For Jersey to maintain its leading role as a well-regulated International Finance Centre, it is critical to protect its reputation and therefore its prosperity, through its support for the global fight against financial crime, money laundering and the financing of terrorism. Money laundering is the process through which criminals give the appearance of legitimacy to proceeds of crime. It is an expanding

[1] See: ID Bailiwick of Jersey National Risk Assessment of Money Laundering September 2020.pdf (gov.je)

and increasingly international phenomenon, with current estimates of money laundered worldwide ranging from $500 billion to $1 trillion, with disastrous effects on the global economy and society.[2]

The international community and society at large, including the people of Jersey, are exposed to the severe negative consequences of money laundering (ML) and terrorist financing (TF) from an economic, security, and social perspective. In order to prevent these negative consequences as far as possible, the Government of Jersey has made several critical commitments to combat financial crime and illicit finance whilst protecting the integrity of the international financial system from misuse. These efforts are based on the standards developed by the FATF. The FATF is the global money laundering and terrorist financing watchdog. The inter-governmental body sets international standards that aim to prevent these illegal activities and the harm they cause to society.

The FATF has developed and revised 40 Recommendations[3] (the "Recommendations"), which ensure a co-ordinated global response to prevent organised crime, corruption, terrorism and proliferation financing and more than 200 countries and jurisdictions, including Jersey, committed to implementing the Recommendations. At the top of Government's commitments is the commitment of the Chief Minister of the day to the FATF President to implement, in full, the revised Recommendations and the FATF Methodology post their development and adoption in 2012 and 2013 respectively. This makes compliance with the Recommendations a national commitment and therefore of national interest.

As part of its efforts, the Government of Jersey established in 2020 a National Financial Crime Policy and Strategy Cooperation and Coordination Structure (the "National Structure"). The National Structure puts effective mechanisms in place which support the implementation of risk assessment findings and serves as a permanent platform for cooperation and coordination at policymaking and operational levels between the competent authorities in the jurisdiction's continuous fight against financial crime and illicit finance, in line with FATF Recommendation 2. The National Structure also serves as an allocation mechanism which allows the jurisdiction to focus its resources in the most effective, risk-based way in the fight against financial crime.

The Core Values of the National Structure are as follows:

- Maintaining Jersey's leading position on financial crime prevention with a hostile environment to criminals and dissuasive towards non-compliance with relevant legislation
- Ensuring that financial crime legislation and regulation is fit-for-purpose, creating a highly effective environment for preventing financial crime
- Acting as an effective communication and coordination platform across competent authorities to enable and improve the efficient exchange of information and the effective coordination of preventative measures
- Increasing understanding across both competent authorities and industry of current and emerging financial crime risks and facilitating a coordinated approach to combat and mitigate those risks
- Considering, implementing and monitoring all international standards relevant to financial crime to ensure Jersey continues to play its part in the global fight to combat financial crime

[2] See: The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism – MONEYVAL: Annual Report 2020.

[3] See: The FATF Recommendations (2012).

- Upholding the position of Jersey as a cooperative international financial centre, cooperating effectively with international partners to exchange information to combat financial crime.

Additionally, Government is currently preparing a National Financial Crime Strategy and Associated Action Plan which will look to further develop the Core Values.

In order to assess and better understand the AML/CFT risks at a national level, Jersey published its first National Risk Assessment of Money Laundering[4] in 2020 and its first National Risk Assessments of Terrorist Financing[5] in 2021 (together the "NRAs"). FATF Recommendation 1 calls on countries to identify, assess and understand their ML and TF risks, and to take action to effectively mitigate those risks. Hence, the NRAs and their findings represent the current understanding of ML and TF risks and whilst there is a statutory obligation for financial services businesses under the Money Laundering (Jersey) Order 2008 (the "MLO") to account for the risks outlined in the NRAs within their AML/CFT policies and procedures, Government encourages businesses to use the NRAs as a fundamental tool when making commercial decisions about activities, products, and jurisdictions, where this is not already the case. The combination of findings provided by the NRAs and this document should serve businesses as a tool to navigate the boundaries between the different levels of ML/TF risks in a consistent and transparent manner. Considering all national-level risk documents[6] will serve businesses as a well-founded compass to determine their own business plans whilst applying a risk-based approach.

Money Laundering/Terrorist Financing Risk Factors

The main ML/TF risk factors for businesses to consider are activities, including delivery channels and customer types, products and jurisdictions. These risk factors can be rated from low to medium to high. Jersey has a sophisticated AML/CFT regime to manage those risks in line with their ratings. Businesses are not restricted from engaging in high-risk activities, products, or jurisdictions unless any of those would be outside of the national risk appetite or reflected in the SBPP[7]. However, where businesses do engage in high-risk activities, products, or jurisdictions, they must be able to effectively manage the risks arising from the risk factors in line with their risk rating. In order to manage the risks effectively, businesses need to be able to properly identify, assess and understand the risks. This is where businesses should refer back to and build upon the findings of the NRAs as vital building blocks for their own business risk assessments and which entities are obliged to undertake. Once the risks are identified, assessed, and understood, businesses are expected to fully manage and mitigate the risks in line with their rating, i.e. apply a risk-based approach. It is important to note that ultimately, where risks, following a complete assessment, cannot be fully managed or mitigated, businesses ought not to enter into the business relationship, or, if already established, unwind the existing relationship or commercial activity.

[4] See: National Risk Assessment of Money Laundering in Jersey (gov.je)
[5] See: National Risk Assessment of Terrorist Financing (gov.je)
[6] Including any other National or Sectoral Risk Assessments and the National Financial Crime Strategy to be published by Government.
[7] See: Sound Business Practice Policy — Jersey Financial Services Commission (jerseyfsc.org)

Accumulation of Risk Factors

Notwithstanding the existing statutory and regulatory requirements, the Government of Jersey is committed to continue to develop and enhance the existing AML/CFT regime where vulnerabilities are identified.

Since the publication of the NRAs, Government, in co-operation with authorities and industry representatives, continued the work on sector and product-specific risk assessments which will be published in due course. These workstreams have been data-driven and significantly increased the understanding of certain risks and vulnerabilities in focused areas.

One of these vulnerabilities is caused by the accumulation of risks through the combination of high-risk factors ("accumulation risks") within particular businesses which may result in material ML/TF accumulation risks for the jurisdiction. These accumulation risks are created by combining several risk factors which are rated as high risk. For example, engaging in high-risk activities across high-risk jurisdictions. Another example would be a single entity accumulating so much risk through different relationships, it might become impossible to manage those risks under the current regime. Thus, accumulation risks can be accumulated at an entity, group, or sector level as well as at a national level and therefore can pose a systemic threat to the jurisdiction if not managed properly. Where the accumulation of ML/TF risks at a national level cannot be actively and effectively managed or mitigated, those accumulation risks would be outside of the national risk appetite.

Whilst it is important to note that not all accumulation risks are necessarily outside of the national risk appetite, however, it is Government's intention to continue to develop our financial crime regime to enable businesses, and therefore the jurisdiction as a whole, to manage ML/TF accumulation risks more effectively going forward in order to stay within the limits of the national risk appetite. This approach could therefore be considered the AML/CFT-equivalent approach to macroprudential regulation.

New High-risk Activities

There are activities that pose additional reputational risks, either linked to, or separate to, the risks of financial crime. The key document setting out Jersey's risk appetite around such activities is the SBPP. Whilst the current list of activities which might pose a reputational risk to Jersey is relatively narrow, activities undertaken in countries which are under increased monitoring ("grey-listed") by the FATF will be added.

Business relationships with jurisdictions under increased monitoring by the FATF will naturally involve heightened risks. This is due to strategic deficiencies identified in the regime of the jurisdiction to counter money laundering and terrorist financing. Whilst it is not prohibited to engage in business relationships with such jurisdictions, it is important that the risks are properly assessed and understood in the context of the commercial opportunity. Due to the shortcomings in the financial crime mitigation framework overseeing such jurisdictions, it is appropriate that additional oversight is applied by firms carrying out business with such persons or entities, in line with the requirements of the MLO, applying a risk-based approach regarding client due diligence.

The Government, working with the JFSC, will continue to update the SBPP[8] to include activities which are considered to constitute higher ML/TF risks on the basis of national and international research and data, including but not limited to research by the FATF, the OECD and other reliable, independent source information.

In order to monitor the level of higher risk activity being undertaken, the authorities will continue to collect and analyse more granular data on these activities and relationships as part of further National Risk Assessments with a view to further develop more advanced systems and controls which will enable Jersey to manage the national ML/TF risk exposures more effectively at all times.

Ultimately, Government expects entities to consider their level of exposure to higher risk business, including the accumulation of risk by any one entity, and their ability to manage that risk. This is considered and balanced in light of the jurisdiction's strong commitment to international financial crime standards and the importance of preventing Jersey from being used as a location for financial crime and protecting the reputation of Jersey.

Jurisdictions

As an IFC, Jersey's financial services sector is marketed to a wide range of jurisdictions. Whilst financial services firms within Jersey will carry out their own marketing activities, at a jurisdictional level this is carried out by Jersey Finance[9]. A number of factors could impact on the risk of carrying out business in a particular jurisdiction, including a jurisdiction being added to FATF's list of jurisdictions under increased monitoring. The JFSC maintains a list of countries and territories identified as presenting higher risks within the AML/CFT Handbook. Further statements are made when the assessment of risk heightens, for example in March 2022, the Government and the JFSC published a statement noting the heightened risk of customer relationships with links to Russia and Belarus.

Where a jurisdiction's risk is considered as having increased, this does not mean that marketing and business activities linked to those jurisdictions should automatically cease, albeit any business should take into account the heightened risk of carrying out business in that jurisdiction. At the national level, the impact of jurisdictional risk is factored in by a co-ordinated assessment which informs the necessary adjustments to Government strategies.

[8] Whilst the SBPP is currently maintained by the JFSC, responsibility will be transferred to the Government at some future point to enable a closer management of activities in line with Jersey's national risk appetite which is set by the Government.

[9] Jersey Finance Limited acts as the promotional body of Jersey's finance industry.

Business Activity Risks: Sound Business Practice Policy

As already mentioned, the SBPP articulates which activities are considered to be of higher risk and therefore will warrant additional attention from the JFSC when carrying out its functions through the Registry. Jersey regulated entities are also required through the codes of practice to have regard to the principles of the SBPP.

As an IFC, Jersey provides services to a range of non-resident businesses and investors. As such, as well as reflecting activities with heightened risks including that of financial crime, the SBPP can outline a number of activities which Jersey considers pose additional risks to Jersey's reputation in and of themselves. It remains the prerogative of the Minister for Treasury and Financial Services to outline such activities.

The SBPP has developed over time and in 2022/2023 will be refreshed from a first principles perspective. This will include restructuring the SBPP to clearly set out what is considered higher risk, and more explicitly link these activities to the financial crime mitigation strategy, where appropriate. It will also for the first time set out prohibited activities.

Activities outside of the National Risk Appetite

There are activities which the Government considers should not be taking place in or from Jersey. These include:

- Any dealing with persons or legal entities subject to sanctions applied in Jersey or which contravene UK foreign policy
- Any dealing with FATF blacklisted jurisdictions
- Citizenship by investment schemes operated in Jersey
- Aggressive/Abusive Tax Avoidance – in line with previous statements made by the Government of Jersey - Statement on abusive tax schemes (gov.je)

Regulatory Risks: Prudential and Conduct

Jersey has implemented tailored frameworks to manage the prudential and conduct risks it is exposed to. These frameworks have been developed to consider the specific nature of Jersey's financial services industry whilst delivering in line with recognised international standards such as those of the Basel Committee on Banking Supervision and the International Organization of Securities Commissions. As international standards evolve to propose effective measures to address emerging risks, Jersey has and will continue to develop these frameworks to meet international standards.

Prudential: Prudential risks can include credit risk, market risk, liquidity risk and operational risk, and are those which can reduce the adequacy of a business's financial resources, adversely affecting confidence in the islands financial system or prejudicing the end consumer.

Whilst Jersey has not experienced an unmanaged bank failure, this risk cannot be discounted. The risk of contagion across the sector due to prudential risk is relatively concentrated in a small number of banking and large financial services entities. Jersey's banking sector is generally made up of branches of international banking groups, and there is no wholesale market infrastructure operating from Jersey. Whilst the risk of contagion from regional or global financial instability will always remain, the risk of inherent prudential risk within the jurisdiction is relatively contained. Notwithstanding, prudential risk may lead to contagion into other areas of the industry.

Jersey has introduced infrastructure to assess and mitigate prudential risks including:

- A legislative and supervisory framework overseeing the activities of banks, and setting prudential requirements for non-banks
- The establishment of the Depositors Compensation Scheme and Jersey Resolution Authority to reduce the risk of uncontrolled bank failure and manage its consequences
- a Financial Stability Board which will consider wider financial stability risks including those outside of the banking sector.

The Financial Services Policy Framework committed to a review of the approach to overseeing banking risk, recognising the additional protections embedded into the banking framework in recent years through enhanced supervisory requirements, and the establishment of depositor protection and a resolution authority. This review will inform decisions as to whether any adjustments are required in respect of prudential risk.

On an ongoing basis, the Jersey Resolution Authority chairs the Bank Resolution and Planning Group. This group consists of representatives of the Government Economy and Treasury Departments, the JFSC, and the Depositors Compensation Scheme. The group exists to cooperate in planning for and coordinating a bank failure in Jersey. In doing so it considers and stress tests the risk of bank failures and makes recommendations to the Government and the authorities to strengthen framework for mitigating the risks of bank failure.

Conduct: Ensuring appropriate conduct across all sectors of the financial services industry is essential to maintaining consumer trust and supporting sustainable growth for the future. As an IFC Jersey provides services to financially sophisticated investors, both individuals and corporates. Jersey offers a range of flexible structures which present opportunities for investors to tailor arrangements to suit their particular needs. The industry does not generally target non-domestic retail investors. Conduct principles and requirements designed with such investors in mind are not therefore always appropriate.

It is recognised that there have been a number of conduct related shortcomings within the industry.[10] This has a direct impact on the investors in these structures, posing wider risks to the reputation of Jersey as an IFC, and even the use of taxpayer funds[11]. Sufficient attention to this area is therefore vital. Central to this can be the risk of products originally being designed for financially sophisticated investors filtering into the retail market in search of scalability.

Notwithstanding the most apparent conduct risks being in retail markets, the risk of conduct risk not being appropriately mitigated extends across the IFC. Many of the incidence referred to above have, to differing extents, been harmful to the reputation of the industry as well as those directly impacted.

[10] https://www.jerseyfsc.org/news-and-events/lumiere-committed-serious-catalogue-of-failures/
https://www.jerseyfsc.org/news-and-events/horizon-trustees-jersey-limited/
[11] https://statesassembly.gov.je/assemblyreports/2015/r.26-2015.pdf

Whilst it is appropriate to provide a greater degree of protection to retail investors, it is nonetheless crucial to the industry's reputation to ensure that, where appropriate, governance standards, regulation, conflicts of interest management, and accountability apply to all structures regardless of investor type. The ultimate users of Jersey products may sometimes be less financially sophisticated than the initial structuring of an arrangement could suggest – for example young or vulnerable beneficiaries of trusts, or EBTs.

Changes in the industry alter the types of risk that mitigation frameworks were initially built to manage. For example, Jersey's trust industry grew out of family businesses, whereas in recent years there has been consolidation, acquisitions by private equity firms, and a trend towards multi-jurisdictional offices.

Jersey has introduced infrastructure to assess and mitigate conduct risks including:

- A regulatory regime overseeing financial services providers, supervised by the JFSC
- Free at the point of use dispute arbitration through the Channel Islands Financial Ombudsman ("CIFO")
- Ongoing work to introduce consumer protection regulation, including over the pensions and consumer lending industries.

This is supported by policy teams in Government and the JFSC, who review the approach against prevailing risks on a regular basis. This is kept under review and is informed by events such as public statements from the JFSC, the annual reports of bodies such as the CIFO and the JFSC, the development of international standards, and the outcome of legal actions setting case law in Jersey and elsewhere.

Jersey intends to periodically review its overarching assessment of conduct risk, to ensure it remains fit for purpose. This will happen at least when the Financial Services Policy Framework is updated, and more frequently as necessary.