

# FINANCIAL SERVICES COMMISSION

## 2<sup>nd</sup> Annual Financial Crimes Mitigation Workshop

Terra Nova Hotel, Kingston

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George Roper  
Acting Executive Director

### **The Regulatory Ambit of the FSC**

#### **INTRODUCTION**

Good morning, ladies and gentlemen, I am pleased to be afforded this opportunity to address you at the 2<sup>nd</sup> Annual Financial Crimes Workshop organized by the Financial Services Commission (“FSC”). I am gratified at the turnout as it evidences the level of commitment and interest on the part of our stakeholders to confront the issues related to strengthening the ability of our financial institutions and regulators to prevent, detect, monitor and prosecute financial crimes.

#### **THE ROLE OF THE FSC IN COMBATING FINANCIAL CRIMES**

Ladies and gentlemen, during the next two days you will be provided with, what I hope will be, useful details on various aspects of the legislative and regulatory framework relating to financial crimes in Jamaica and with some guidance on how you might improve compliance with regulatory requirements. My task here is simply to provide a brief overview of the role of the FSC in the prevention, detection and prosecution of financial crimes.

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Undoubtedly, you will be aware that there are five sets of statutes and associated regulations, which provide the specific legislative framework for FSC's regulatory and supervisory activities within the insurance, securities and pensions sectors. These five statutes are:

- 1) *The Financial Services Commission Act*;
- 2) *The Insurance Act*;
- 3) *The Securities Act*;
- 4) *The Pensions (Superannuation Funds and Retirement Schemes) Act*; and
- 5) *The Unit Trust Act*.

The statutes, together with other more "general purpose" statutes such as the Companies Act and the Proceeds of Crime Act, provide a comprehensive legislative framework for the provision of financial services and the regulation of capital markets in Jamaica.

The FSC Act, which outlines the responsibilities of the FSC with respect to all prescribed financial institutions states, in Section 6(1), that "For the purpose of protecting customers of financial services, the Commission shall-

- (a) supervise and regulate prescribed financial institutions;
- (b) promote the adoption of procedures designed to control and manage risk, for use by the management, boards of directors and trustees of such institutions;
- (c) promote stability and public confidence in the operations of such institutions;
- (d) promote public understanding of the operation of prescribed financial institutions;

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- (e) promote the modernization of financial services with a view to the adoption and maintenance of international standards of competence, efficiency and competitiveness.

The duties highlighted in (b) and (c) above – namely, the promotion of risk management and control and the promotion of stability and public confidence in financial institutions – speak directly to the FSC’s responsibilities with respect to **financial crimes**. In addition, in carrying out the duties specified above, Section 6(2)(f) provides a specific mandate for the FSC to “*implement measures designed to reduce the possibility of a prescribed financial institution being used for any purpose connected with an offence involving fraud, theft or money laundering*”.

Financial crimes impair the operation and development of financial institutions and markets in at least two ways:

- (1) First, financial crimes pose a risk to financial institutions themselves. There is often a correlation between financial crimes (such as money laundering) that are facilitated by legitimate financial institutions and financial crimes perpetrated within these institutions in the form of fraudulent activities by employees and officers.<sup>1</sup> This is partly because both the external and internal criminal activity makes use of the same lax internal controls and corrupt channels. In addition, where financial crimes are perpetrated through financial enterprises that are expressly set up for the purpose of committing the crime, the funds of investors and legitimate enterprises (both financial and non-financial) that have done

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<sup>1</sup> Brent L. Bartlett “*The Negative Effects of Money Laundering on Economic Development*” **Platypus Magazine**, No. 77, December 2002.

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business with this criminal enterprise is at severe risk. Examples of these include fraudulent Ponzi investment schemes that are established for the purposes of laundering the proceeds of criminal activity or for defrauding targeted groups of investors.

- (2) Second, financial crimes perpetrated through or actively facilitated by financial institutions and markets leads to an erosion of public trust in the financial system thereby undermining economic stability.

The FSC has issued detailed guidelines on the procedures for compliance with anti-money laundering (“AML”) requirements. However, the regulatory framework for combating financial crime is not limited to these AML requirements. In a sense, the FSC’s entire risk-based supervisory arsenal can be brought to bear on this issue. Briefly, I will highlight four areas of particular relevance, namely:

1. Fit and Proper Assessments;
2. Filing and Disclosure Requirements;
3. Supervisory Examinations; and
4. Licensing & Registration Requirements.

- **Fit & Proper Reviews**

Directors, senior management and certain other staff of regulated institutions are required to submit background information which allows the FSC to conduct background checks in order to ensure that the applicants are eligible to perform their fiduciary duties. The objective of the FSC’s fit and proper assessment is to ensure that the applicant is a person of sound probity and is able to exercise competence, diligence and sound judgment in fulfilling their responsibilities. The “fit & proper” screening process affords protection against financial crimes

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to the extent that it increases the probability that only suitably qualified persons who have a track record of competence and integrity are licensed to provide services related to insurance, securities or pensions.

- **Filing and Disclosure Requirements**

Entities licensed under any one of the FSC's governing statutes must comply with the FSC's filing requirements which include the filing of periodic detailed reports such as audited and unaudited financial statements, other financial filings describing the composition of asset and liability portfolios, entity control reports which describe an entity's internal governance systems and procedures, actuarial reports and Management Discussion and Analysis ("MD&A") reports. These reports facilitates both quantitative and qualitative assessments of the health of licensed entities and allows the FSC to ensure that remedial action, where required, is taken by the company's directors and business owners before deficiencies and weaknesses in a company's financial health develop into deeper problems with adverse consequences for investor clients. For the purposes of combating financial crimes, these reports provide useful information on an entity's sources and uses of funds. Large inflows, which typically mirror the creation of a liability or the liquidation of assets, must be accounted for by a corresponding accumulation of assets or reduction of liabilities. Periodic verification of asset and liability registers is also required.

- **Supervisory Examinations**

The FSC conducts supervisory examinations of regulated institutions to ensure that the provisions of the law are being complied with, that the institution is in sound financial health and that appropriate standards of conduct are maintained.

Two broad types of examinations are conducted:

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- i) On-site Examinations (which may be targeted or full scope) and
- ii) Off-site or Desk Examinations using frameworks which we call “CAMEL” (for securities examinations) and “CARAMELS” (for insurance examinations).

Off-site examinations utilize the detailed information available from statutory filings described above to develop a risk assessment of the individual entities. The onsite are primarily focused on looking at the market conduct of licensed entities to ensure that they are complying with the requirements of the relevant acts and regulations. These examinations typically identify areas potential risk exposure, for example, exposures to operational risk due to a breakdown in internal controls. When these deficiencies are identified the dealer is required to put in place effective corrective measures. Compliance with AML guidelines has become an important area of focus of these on-site examinations.

- **Licensing and Registration Requirements**

The FSC’s governing statutes prohibits the provision of specified financial services without the approval of the FSC. The approval process involves “fit & proper” checks on the principals and prospective senior officers of the applicant as well as a review of the applicant’s business plan and sources of capital.

In addition to licensing requirements for entities applying to provide financial services, issuers of securities must also be registered with the FSC in respect of those securities, under Section 26 of the Securities Act. Among other things, this requires that, before issuing or offering a security to the public, issuers should submit to the FSC a registration statement (in the form set out in the Guidelines

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for Issuers of Securities) and a prospectus which must disclose all material information about the issuer and should contain among other things:

- A description of the issuers business;
- Its audited and un-audited interim financial statements and;
- A Management Discussion and Analysis (“MD&A”)

Issuers of equity securities are also required to comply with parts I and II of the Third Schedule of the Companies Act.<sup>2</sup>

The benefit of these licensing and registration requirements is not just in the volume or quality of information that is to be supplied to the regulator and the public. The FSC’s governing statutes provides that breaches of these licensing/registration requirements are offences and provide for enforcement action against violations. From the perspective of combating financial crime these enforcement provisions against unauthorized entities are of critical importance because they potentially provide the FSC with tools to interdict criminal activity by “nipping it in the bud”.

However, you will be aware that in the securities sector, the FSC’s enforcement powers against unauthorized financial entities have come under judicial challenge from entities such as OLINT and LEWFAM. It is encouraging that the FSC has, thus far, won key judicial battles and the legal basis for the FSC’s regulatory jurisdiction is being progressively clarified. This provides important ammunition for future battles.

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<sup>2</sup> The Third Schedule of Companies Act deals with Matters to be specified in Prospectus and Reports to be set out therein

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## **THE ROLE OF THE PUBLIC IN COMBATING FINANCIAL CRIME**

The FSC has a statutory mandate to preserve the integrity of the financial system and to take measures to prevent financial institutions and financial markets from being used as conduits for money laundering, terrorist financing and the proceeds of other criminal activity. However, each member of the public has a vested interest in ensuring the safety of his or her own financial interests. The FSC's governing statutes prohibits the provision of specified financial services without the approval of the FSC. The approval process involves "fit & proper" checks on the principals and prospective senior officers of the applicant as well as a review of the applicant's business plan and sources of capital.

The financial risks are clear: **investors who, without proper due diligence or on an otherwise imprudent basis, vest their funds with fraudulent or criminal enterprises are at severe risk of loss.**

But besides this financial risk the public needs to be aware of the legal risk that arises from facilitating or participating in the financing of criminal activity or the laundering of criminal proceeds. Sections 92(2) and 93(3) of the Proceeds of Crime Act make it an offence for a person to (a) enter into or "become concerned in" an arrangement that the person knows or has reasonable grounds to believe facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person; (b) acquire, use or have possession of criminal property and the person knows or has reasonable grounds to believe that the property is criminal property. These are some of the issues that hopefully will be clarified in ensuing sessions over the next two days but suffice it say that there is a certain symmetry in the Proceeds of Crime Act with respect to requiring safeguards against financial crimes: **Financial institutions have "know your customer" requirements but customers of financial**

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**institutions are equally obligated to know their financial intermediaries.**

## **CONCLUSION**

I close with a variation on one of the FSC's persistent themes over the last year. The FSC carries out its functions by increasing the likelihood that financial institutions make prudent decisions in the acquisition and use of their customers' funds and also tries to ensure that the customers of these entities receive all the information they need in order to make prudent financial decisions. The efforts of the FSC (and other regulators) alone are insufficient to ensure that customer's funds are safe. By far the best way for the customers of financial institutions and investors in financial markets to protect their monies is to do research and ask questions.

However, in the battle against financial crime, financial prudence must also be combined with a heavy dose of financial ethics. It should not be sufficient that an investment opportunity is attractive from the point of view of its financial risk vs. reward trade-off. It should also be divorced from criminality.

Ladies and gentlemen, I hope this workshop will help us, both as fiduciaries within financial institutions and as customers ourselves of these institutions, to more clearly understand the requirements for financially ethical decision-making.

Thank you

George Roper  
Acting Executive Director  
Financial Services Commission

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