



Guernsey Financial
Services Commission

« **BACK** Bordeaux Services (Guernsey) Limited, Peter Gordon Radford, Neal Anthony Meader, Geoffrey Robert Tostevin

The Financial Services Commission (Bailiwick of Guernsey) Law, 1987, as amended (“the

Financial Services Commission Law”)

The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended (“the Protection of Investors Law”)

The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2000, as amended (“the Fiduciaries Law”)

The Banking Supervision (Bailiwick of Guernsey) Law, 1994, as amended (“the Banking Law”)

The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002, as amended (“the Insurance Managers and Insurance Intermediaries Law”)

The Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended (“the Insurance Business Law”) (together “the Regulatory Laws”)

Bordeaux Services (Guernsey) Limited (“Bordeaux”)

Peter Gordon Radford

Neal Anthony Meader

Geoffrey Robert Tostevin

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Contact

TELEPHONE

+44 1481 712706 / 712801

Telephone calls are recorded.

FAX

+44 1481 712010

CONTACT US »

On 28 July 2015, the Commission decided:

1. To impose a financial penalty of £150,000 on Bordeaux under section 11D of the Financial Services Commission Law;
2. To impose a financial penalty of £50,000 on Mr Radford under section 11D of the Financial Services Commission Law;
3. To impose a financial penalty of £30,000 on Mr Meader under section 11D of the Financial Services Commission Law;
4. To impose a financial penalty of £30,000 on Mr Tostevin under section 11D of the Financial Services Commission Law;
5. To make orders under the Regulatory Laws prohibiting Mr Radford, Mr Meader and Mr Tostevin (together “the Bordeaux Directors”) for a period of five years from becoming or continuing to hold the function of controller, partner, director or manager in relation to business carried on by an entity licensed under the Regulatory Laws;
6. To disapply the exemption set out in section 3(1)(g) of the Fiduciaries Law in respect of Mr Radford, Mr Meader and Mr Tostevin.
7. To issue a Public Statement under section 11C of the Financial Services Commission Law.

The Commission considered it reasonable, necessary and proportionate to make this decision and impose these penalties having concluded that Bordeaux and the Bordeaux Directors failed to fulfil the criteria in Schedule 4 of the Protection of Investors Law.

The Bordeaux Directors failed to ensure Bordeaux carried on its business with appropriate systems to enable it to function properly and as a result it did not act with prudence nor exercise professional skill appropriate to the nature and scale of its activities.

The Bordeaux Directors demonstrated a consistent and serious lack of appropriate competence, judgement and diligence. Their conduct demonstrated a lack of understanding and attention to the legal obligations of Bordeaux. These failings suggest that the interests of investors and the reputation of the Bailiwick as a financial centre are, or are likely, to be jeopardised by their holding a position of director, controller, partner or manager of a licensee in the immediate future.

Background

Bordeaux is licensed under the Protection of Investors Law and the Fiduciaries Law.

During the period 1 January 2007 to 31 December 2009 ("the Relevant Period"), Bordeaux was the Designated Manager and Administrator of Arch Guernsey ICC Limited, now known as SPL Guernsey ICC Limited ("the ICC") and its incorporated cells ("the ICs"). The ICs owned special purpose vehicles ("SPVs"), which held assets ultimately owned by the fund structure. At its largest, the ICC had 26 ICs, the majority of which were listed on the Channel Island Stock Exchange ("CISX"). The ICC and the ICs are referred to collectively as "the Fund".

The Bordeaux Directors were at all material times the directors, the ultimate beneficial owners and the controllers of Bordeaux. Mr Radford and Mr Meader were also directors of the Fund. Mr Tostevin was the Compliance Officer at Bordeaux between 2000 and 2003 and again between August 2007 and January 2010.

Two United Kingdom Open-Ended Investment Companies, CF Arch Cru Investment Funds and CF Arch Cru Diversified Funds ("the UK OEICs"), whose Investment Manager was Arch Financial Products LLP ("Arch FP"), invested a significant proportion of their scheme property into the ICs of the Fund. Over 2007 and 2008 total investments in the Fund approximated £595 million.

On 13 March 2009 operation of the UK OEICs was suspended by the UK Financial Services Authority over liquidity concerns following increased redemptions.

On 21 December 2010, the Fund's consolidated net asset value was calculated at £234 million, this represented a significant loss to investors.

Findings

Conflicts of interest

Any properly organised entity operating a business of financial services should ensure that there were procedures for dealing with conflicts of interest. Bordeaux should have done so and the Bordeaux Directors should have ensured that it did. It is no answer to this criticism to rely upon the Articles of Association or any Investment Management Agreement. There was no evidence that the Bordeaux Directors managed a conflict of interest appropriately within the Fund structure.

In failing to put in place and implement procedures for dealing with conflicts of interest Bordeaux acted in breach of paragraph 2(1) of Schedule 4 of the Protection of Investors Law under which Bordeaux was required to carry on business with prudence and integrity and with professional skill appropriate to the nature and scale of its activities.

Calculation of net asset values and their notification to CISX

The Fund's Scheme Particulars and the IC Particulars state that the IC's Directors had delegated the responsibility for the determination of the net asset value ("NAV") to the Administrator, i.e. Bordeaux. Bordeaux was required to calculate the IC's NAV on a monthly basis and to notify CISX of the prices as soon as practicable after calculation.

During 2008 the timetable for the production of NAVs by Bordeaux slipped and NAVs for the end of March 2008 were finalised on 31 July 2008, an interval of four months from the required date of completion. Correspondence between Bordeaux and Arch FP stated that Bordeaux had resourcing issues and were looking to add to those resources to speed up the production of the NAVs. There were further delays in 2009.

As a result of the delay in producing NAVs during 2008 and 2009 investors and potential investors were not given up to date information on which to base their decisions. Furthermore, as most of the ICs were listed on CISX, this could have led to the creation of a false market as independent investors would have dealt, or considered dealing, on indicative sale prices that were not properly reflective of NAV, but the Investment Manager who was undertaking inter-cellular trades would have been aware of a more accurate, up to date, value of the ICs.

The Fund's auditors also referred to a delay to valuations for 31 March 2009 which were not finalised until September 2009 and identified substantial weaknesses in the Fund's records for which Bordeaux was responsible.

The delays appear to be in part attributable to failures of Bordeaux to organise its business with the appropriate degree of diligence and professionalism in breach of paragraphs 1(1)(b), 2(1)(a) and 2(1)(b) of the Protection of Investors Law.

NAV Methodology

The listed ICs acquired significant assets in the form of loan notes, many of which were issued by the IC Arch Treasury IC Limited ("AT1"). The terms of these varied but many included a coupon with a fixed rate of interest. Many were asset backed, for example by ships, or were otherwise related to assets held either by the investing IC or by AT1. Many effectively permitted the borrower to defer the payment of the coupon for a period of time (i.e. to capitalise the interest).

Prior to October 2008, Bordeaux valued these loan notes at "par plus accruals". Thus, in effect, from one month to the next, in calculating an IC's NAV, where that IC held a loan note, Bordeaux increased the NAV by the income due that month, irrespective of whether that income had been paid, and irrespective of any change in the risk of the investment, such as a change in the value of the underlying asset upon which the note was secured. The increase in NAV by the income due in the month may be an appropriate method of valuation but it does require the valuer to investigate the underlying asset from time to time.

The NAVs at the end of February 2009 were significantly higher than the NAVs as at the end of March and April 2009, much of which was attributable to the overvalued loan notes. The substantial fall in the NAVs of the ICs that occurred subsequent to the suspension of the Fund and the appointment of a new administrator may demonstrate the inaccuracy of the pricing up to that point.

There is no evidence that Bordeaux or Mr Radford and Mr Meader, as Fund Directors, raised issues with the Investment Manager as to the performance of the Fund in comparison to other funds within the same sector during the Relevant Period when it would have been prudent to undertake such a comparison or raised any questions in respect of the valuations or the method of valuation.

There were no adequate procedures in place at Bordeaux for the valuation of unlisted securities in the Fund and Bordeaux was totally reliant on the Investment Manager to provide such valuations. In a compelled interview, Mr Radford was asked what valuation methodologies Bordeaux was employing for non-quoted assets, Mr Radford replied, "we didn't discuss non-quoted assets."

The answer above is consistent with Bordeaux relying entirely upon Arch FP in relation to illiquid assets; albeit it might have been entitled to rely on Arch FP to provide valuations it should have taken steps to understand the methodology employed and put in place a procedure to check on the valuations produced by Arch FP. Failure to understand valuations placed on unquoted assets by Arch FP resulted in Arch FP being unsupervised in relation to the provision of valuations of unlisted securities.

Compliance with Fund Documentation

On several occasions requests for the release of funds to the SPVs comprised of no more than a one side of A4 letter faxed to Bordeaux. The request would then be forwarded to the custodian, sometimes within a very short period of time of receipt of the fax, suggesting that little or no analysis of the request had taken place. No evidence was provided to demonstrate that any subsequent analysis or review of the transactions had taken place by Bordeaux.

It was apparent that Bordeaux did not have adequate procedures in place relating to the making of payments. These functions were not adequately understood by staff resulting in a gap surrounding the review of payments contributing to a failure to ensure compliance with the Fund's documentation and to protect the interests of investors.

From 15 December 2008, Bordeaux, as Designated Manager and Administrator of the Fund, was required by Rule 2.01(c) of the Authorised Closed Ended Investment Scheme Rules, 2008 (“the ACEIS Rules”) to administer the Fund in accordance with the most recently published information particulars.

Whilst there were no transactions undertaken by the Fund following the implementation of the ACEIS Rules, it appears that during the Relevant Period Bordeaux had failed to monitor investments made by Arch FP to ensure that the Fund was administered in accordance with the scheme documents, this continued until the eventual suspension of the Fund in July 2009.

The failure to monitor whether investments complied with the scheme particulars manifested a lack of competence and soundness of judgement, diligence and prudence and appropriate professional skill.

Record Keeping

Principle 9 of the Licensees (Financial Resources, Notification, Conduct of Business and Compliance) Rules, 1998 (“the FNCC Rules”), the rules in force during the Relevant Period, required a licensee to organise and control its internal affairs in a responsible manner, keeping proper records, and where the firm employs staff or is responsible for the conduct of investment business by others, should have adequate arrangements to ensure that they are suitable, adequately trained and properly supervised and that it has well defined compliance procedures.

Rule 5.02 of the FNCC Rules required Bordeaux to have in place record keeping procedures and keep records for five years. The Commission found that original documents relating to the Fund were not kept in Guernsey; transaction documents were missing for up to a year and a half.

Bordeaux’s level of control or oversight over the role of the Investment Manager was significantly reduced by not maintaining or having sight of original documentation. The Commission saw no evidence that Bordeaux took steps to ensure that the Investment Manager provided Bordeaux with all original documentation. It is noteworthy that Bordeaux’s requests for original documents to the Investment Manager did not take place until the Commission had requested sight of the documentation.

Payment of Fees

A large proportion of the Fund’s trading was between ICs. This included multiple instances of a listed IC subscribing into another IC’s offering of shares. The explanation put forward by Arch FP for the inter-cellular trading was that it was more advantageous to investors to cross invest rather than leaving cash in an IC. As a result of inter-cellular trading between ICs, significant fees were generated for the benefit of the Investment Manager.

The IC Particulars state that Arch FP would be paid a 2% initial charge for any subscription money received and a 1.5% - 2% management fee based upon the NAV (to be amortised over a five year period). The net effect of cross trading was not only a payment to the Investment Manager based on the amount subscribed from one IC to another but an overall increase in the NAV of the investing IC. This resulted in increased subscription and management fees payable to Arch FP.

Whilst at all material times Bordeaux was aware of the transactions being entered into on behalf of the ICs, albeit after the event, the structure of these transactions and the fees being taken by Arch FP, any enquiry by Bordeaux was limited and insufficient. Bordeaux should have ensured that procedures were in place to prevent the fees being charged or paid as opposed to having to recover the fees after they have been paid.

Board Minutes

As company secretary to the Fund, one of Bordeaux’s responsibilities was to create and maintain minutes of meetings of the Fund boards. A review of the minutes kept by Bordeaux has shown that they are perfunctory in their nature considering the number and depth of issues discussed.

Minutes should be an accurate and clear record of the discussion and decisions made at a meeting. Mr Meader understood that the corporate secretarial department of Bordeaux was “very poor”. This should have prompted the Bordeaux Directors to take action to remediate this

failing. During the Relevant Period, the board was responsible for ensuring compliance with Principle 9 of the FNCC Rules which states that a licensee should be controlled and organised in a responsible manner so as to keep proper records, it is clear that this was not the case with Bordeaux.

Mr Meader confirmed during a compelled interview that Bordeaux used template minutes for meetings in relation to listing of cells on the CISX rather than minuting the discussion that had taken place. There is no evidence that Mr Meader, as a director of Bordeaux, queried or challenged this procedure for drafting minutes ahead of meetings. Mr Tostevin was not aware that minutes were being produced in respect of meetings that had not taken place.

As a result of the failure, the records of the company would not have been accurate and complete and represented a misleading record of affairs. The conduct of the Board of Bordeaux demonstrates a failure to understand the requirement to keep full, proper and not misleading records in respect of the controlled investment business undertaken.

Deficiencies in Bordeaux's Compliance Function

Rule 5.01(5) of the FNCC Rules required a licensee to appoint a compliance officer in Guernsey to be responsible for compliance. Rule 5.01(3)(b) required a licensee to review its written compliance procedures at least annually and to ensure that its employees are at all times aware of the current procedures.

The compliance monitoring programme of Bordeaux during the relevant period was deficient and no serious attempt was made to improve it. Bordeaux did not ensure that its compliance officer, or any member of staff or director of Bordeaux, from the date of licensing until 2012 had the relevant experience or qualifications to fulfil the role.

Mr Tostevin estimated that he spent 10-15% of his time on compliance matters during his tenure as compliance officer, with the remainder of his time being taken up by IT and accountancy tasks. Mr Tostevin also explained to the Commission in an interview that he did not consider that the role of a compliance officer, or his role as a director of Bordeaux, included a responsibility to assess the status of Bordeaux's internal rules and procedures against the changing external regulatory environment.

It is apparent that there was no clear delineation of responsibility for ensuring Bordeaux complied with external regulatory changes. Mr Tostevin conceded that to his knowledge no individual had checked Bordeaux's internal documents for continued compliance with the external regulatory scheme between the time of the creation of the documents in 2006 or 2007 and the end of the Relevant Period.

As a result, Bordeaux's procedures were not updated to reflect the important changes brought about by the introduction of the ACEIS Rules following the amendment of the Protection of Investors Law to bring closed ended schemes with the remit of that law. The Fund became an authorised closed ended fund as it was grandfathered through the transitional provisions of those rules therefore this was particularly pertinent to Bordeaux.

The compliance monitoring programme did not identify any of the issues that have been identified above. The programme should have revealed that conflicts of interest were not being mitigated or managed, that the Fund was not being administered in accordance with the Scheme Particulars, that there were not adequate record keeping procedures in place and other such breaches as identified within this Public Statement.

Mr Radford signed a letter to the Fund's auditors certifying that the Fund was complying with the laws and regulations dated 15 December 2009 when he was in no position to do so, as evidenced above. Bordeaux did not have sufficient compliance procedures in place to be able to conclude that there were no issues of non-compliance. As a result, the auditor may have been materially misled as to the true position of the scheme.

Client Take On Procedures

Prior to the launch of the Fund, Bordeaux had not had a relationship with Arch FP. Arch FP had not previously managed a Guernsey closed ended scheme. Arch FP was taken on as a new client

on or around November 2006. Bordeaux's relationship with Arch FP was not subject to any new client take-on procedures.

Although Arch FP was authorised and regulated by the Financial Services Authority, Bordeaux should have taken appropriate steps to monitor Arch FP, particularly as they were a new client to Bordeaux and Arch FP had not previously managed a Guernsey closed-ended fund before. Bordeaux should have ensured that appropriate client take-on procedures were in place to identify potential risks with new business. Failure to do so was (amongst other matters) a failure to fulfil paragraph 3(2)(f) of schedule 1 to the Fiduciary Law. It also showed a failure to act with the appropriate level of skill and competence and diligence.

Anti-Money Laundering Awareness

Bordeaux did not have relevant or effective sanctions training during the Relevant Period. Mr Radford confirmed that the sanctions training at Bordeaux did not cover the types of considerations raised by the nature of investments invested in by Arch FP, such as a ship, which may be hired or chartered by a party subject to a sanction.

This is a breach of Rule 351 of the Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("the Handbook") which requires financial services businesses to consult the full list of financial sanctions targets on the sanctions committee list. Investments in the Fund were multi-jurisdictional and assets held by, or for the Fund, may have been chartered by Iranian companies and there is no evidence that the financial sanctions targets were reviewed at any time or consideration as to the potential breach of UN, EU or Guernsey sanctions had been undertaken.

Staff Training Deficiencies at Bordeaux

There was insufficient staff training undertaken at Bordeaux during the Relevant Period, with the result that some staff did not possess adequate knowledge or skills to fulfil their duties.

No external book-keeping, accounts or valuation training was given to the staff member responsible for the Fund's book-keeping. All that the staff member received was in-house training for posting securities and book-keeping. The member of staff received no training relating specifically to closed-ended funds, again only in-house instruction was provided.

The member of staff also confirmed that she did not receive any formal compliance training or training on conflicts of interest.

Paragraph 5(3)(a) of schedule 4 to the Protection of Investors Law requires the Commission to consider whether a licensee has staff of adequate number, skills, knowledge and experience to undertake and fulfil their duties. From the review undertaken by the Commission it would appear that Bordeaux failed to ensure that staff were adequately trained or experienced and as a result this criteria was not satisfied.

Aggravating Factors

Although the Investment Manager was authorised by the FSA, Bordeaux should have undertaken appropriate due diligence and on-going monitoring of the Investment Manager particularly as Arch FP had not been previously known to Bordeaux and the Investment Manager had not previously managed a closed-ended collective investment scheme in any jurisdiction.

Bordeaux was aware and paid "structuring fees" to Arch FP regarding shipping transactions without adequate questioning of the purpose of the shipping transactions.

The Bordeaux Directors were aware of the fees taken by AT1 regarding shipping transactions despite the fact that AT1 was owned by Arch FP, the Directors of Bordeaux did not question the validity of these fee payments.

The Bordeaux Directors failed at all material times to consider the conflicts of interest arising from the ownership of AT1 in entering into transactions with the ICs.

The issues identified indicate a systemic and serious weakness of the management systems and internal controls within Bordeaux, throughout the Relevant Period and more recently.

The Commission has received a number of complaints from investors in the UK OEICs and their MPs.

The Bailiwick of Guernsey as a reputable finance centre has been put at risk by the adverse media attention.

Bordeaux had been subject to heightened supervision by the Commission.

Bordeaux requested an extension to the first request for information and documents under section 27 of the Protection of Investors Law after 5pm the day before the submission was originally due to the Commission.

On 5 August 2013, Bordeaux's legal advisor notified the Commission that there were approximately 75,000 further documents which have not yet been reviewed in order to determine whether they are responsive to the Commission's Notice dated 24 January 2012. The failure to review these documents and submit them to the Commission, if relevant to the investigation and as part of the section 27 Notice served upon them, is a breach of the Protection of Investors Law.

The failure by Bordeaux to identify the additional 75,000 documents also calls into question whether the record keeping procedures utilised by Bordeaux are in compliance with section 6.1.4 of the Licensees (Conduct of Business) Rules, 2009.

Mitigating Factors

Bordeaux no longer acts as the Designated Manager and Administrator of the Fund.

Bordeaux did not double charge its administration fee on the cross investments therefore it did not gain monetarily from the inter-cellular trading.

Bordeaux was entitled to place a degree of reliance upon the FSA authority conferred upon the Investment Manager and a degree of reliance on the Commission who confirmed that it would accept an application from Arch FP as a new promoter having undertaken its own due diligence.

The Directors and staff of Bordeaux attended the Commission's offices when required to do so for interview.

There is no allegation of dishonesty against Bordeaux or the Bordeaux Directors.