



Guernsey Financial
Services Commission

Investment and Long Term Insurance Sales Practice

Thematic Review 2017



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1. Executive Summary

The Commission is pleased to present the findings of its 2017 Thematic Review of “Investment and Long Term Insurance Sales Practice”.

This topic was chosen to help consider the effectiveness of two factors designed to have a positive influence on industry behaviour in relation to advice being given to retail clients.

Firstly, the Commission’s 2014 thematic report on this subject identified key areas requiring attention across the sector.

Secondly, the implementation in January 2015, of the Guernsey Financial Advice Standards introduced the requirement for firms to authorise qualified and competent individuals to provide advice to retail clients. With firms being able to charge commission, the requirement for disclosure was enhanced to facilitate a clear and informed decision by clients to whom this advice is given. The Commission also streamlined the conduct of business rules and related codes for the investment and insurance intermediary sectors.

This thematic review has allowed engagement with firms which do not form part of the Commission’s structured engagement plans. These firms have been identified as having the lowest potential adverse impact under the Commission’s risk based approach to supervision. We would like to thank the licensees who have taken the time to contribute to this review, especially those who hosted site visits.

This thematic review has again highlighted the diversity of the investment and insurance intermediary sectors in Guernsey and provided assurance that industry has, on the whole, responded well to the Commission’s messaging. The review shows the efforts made by the majority of licensees to design effective and proportionate procedures in order to treat their customers fairly, complying with the regulatory requirements on the manner in which they conduct their businesses. Elements of good practice and areas for improvement were both identified during our review.

Nevertheless, the Commission was disappointed by some of the responses received to the sector-wide questionnaire which commenced the review and issues found during subsequent onsite visits. The most concerning matters are outlined below.

Responses to the questionnaire highlighted the following:

- **Details of benefits being lost**

24% of respondents, who confirmed that they provide advice to retail clients where that advice must be given by a Financial Adviser, stated that they did not provide details of benefits being lost when a product is replaced.

Without further discussion with these 7 licensees, we are unable to assess if there is a systemic weakness in this area. We acknowledge that, where advice is being given on controlled investments, this may be less of an issue. Nevertheless, where long term insurance is involved this could have a significant impact, for example incurring a liability to tax or loss of life insurance cover. Relevant firms should therefore review their approach to this subject.

- **Training and Competency schemes**

24% of respondents stated that their training and competency schemes are not role specific.

In this case, it is unclear how these firms are able to make an ongoing assessment of the competency of their Financial Advisers. Relevant firms should therefore consider their approach to this issue.

- **Churning and/or switching**

30% of respondents stated that they do not gather any management information that would identify churning and/or switching.

From this response, it is unclear how these firms are able to identify the potential for either the abuse of the client by the Financial Adviser or any wrongdoing by the clients themselves. Relevant firms should therefore consider their approach to this issue.

Turning now to our onsite visits to licensees, these focussed on the review of a number of client files and substantiated responses given to the questionnaire. Each file was assessed for the suitability of the advice that had been given using a scale of suitable, unsuitable or unclear. Files were considered to be unclear where an element of the advice process was missing, inadequate or records were incomplete. Disappointingly, the majority of advice on the client files reviewed was considered to be unclear. No file reviewed was considered to be unsuitable.

The main recurring reasons for an unclear file were:

- **Capacity for loss**

Either capacity for loss was not correctly explained or had not been considered as a factor in the written recommendation. The explanation of capacity for loss was often found to have been confused with risk tolerance. This meant that rather than assessing what the client could afford to lose, some licensees were considering clients' concerns over fluctuations in market prices of investments.

The Commission would expect to see a documented assessment, based on, for example, the client's personal circumstances, assets, liabilities, and potential future needs. The financial adviser should then, using factual data, where available, establish if the client is in a position to absorb any potential investment losses without detrimentally impacting on their standard of living. It is not sufficient to simply ask the client how much they could afford to lose.

Capacity for loss was previously highlighted by the Commission following its 2013 thematic. Furthermore specific requirements for capacity for loss were introduced in January 2015 in the Licensees (Conduct of Business) Rules 2014 and the Code of Conduct for Financial Advisers.

- **Clarity re fees, charges and remuneration**

The 2013 thematic identified that improvements were required to the disclosure of costs to clients. Although the majority of licensees disclosed the fees or commissions they received, some licensees were not disclosing the costs of the product itself.

During the current thematic onsite visits, whilst it was largely felt that the firms were providing details of all remuneration, fees and costs in the written advice, further clarity around where these are taken/funded from and whether they are ongoing should be provided. It was not always clear how the payment of fees or the funding of remuneration operated. Instances were found that failed to clarify how the client was bearing the cost and the impact this may have. Clients should be given clear information of all potential fees, charges and any other remuneration for the services to be provided prior to the provision of those services.

Lack of clarity in terms of fees, charges and remuneration has also been reported by the Financial Conduct Authority as one reason for unclear files from their own reviews.

- **Attitude to risk**

This subjective area was also highlighted in the 2013 thematic and should be assessed both at the outset of advice being given and on an ongoing basis. Whilst it is difficult to assess a client's risk appetite, clients need to understand their risk categorisation in order to consider whether it accurately meets their own perceived attitude to risk. Indeed, it may be that this is only accurately identified on the crystallisation of an adverse risk.

Firms should ensure that clear and consistent terminology is used in all communication with clients with each party sharing a common understanding of its meaning.

Questionnaire responses also raised concern on this subject with a significant proportion of licensees solely relying on the use of a profiling tool without taking further steps to identify with the client if the result is truly reflective.

If the client does not fully understand the assessed attitude to risk and what this means in practice, an unsuitable investment may be recommended. This could result from being invested in a riskier product that fails to perform or conversely by failing to obtain a greater return where the client is willing to accept a higher level of risk.

Further information on these issues and other key findings and observations can be found in Section 6 of this report.

Action required

Whilst the questionnaire and onsite visits have provided assurance that progress has been made, further improvements in a number of areas are required. We recommend that licensees review this thematic paper to consider how they fare and implement changes to their policies, procedures and controls where required. Conclusions and action taken in this regard, will be a consideration for the Commission in respect of the self-assurance that has been provided to the licensee's board by undertaking this review.

In addition, the Conduct Unit will be hosting separate workshops for Financial Advisers and Compliance Officers focussing on the observations and conclusions of this thematic. Invitations will follow in due course.

2. Background

The Banking and Insurance Supervision and Policy Division's prime objective in selecting the theme for this thematic review was to consider the effectiveness of measures to improve the provision of suitable advice to retail clients and if sufficient steps had been taken by the sector. These measures include:

- In July 2012 a thematic review was carried out to specifically assess licensed long term insurance intermediaries' compliance with the Code of Conduct for Authorised Insurance Representatives and aspects of the relevant conduct of business rules. Concerns raised from that review were circulated by the Commission in an industry paper in January 2013 which called for improvements to be made.
- In Q4 2013 a thematic review of advice provided to retail clients by insurance intermediaries was undertaken, resulting in a report published in June 2014 ("the 2014 Thematic Report"). On this occasion, advice provided by these firms on controlled investments was also reviewed. 3 of the onsite visits resulted in further investigations by the Commission's Enforcement Division and sanctions being imposed.
- In January 2015 the Guernsey Financial Advice Standards were implemented through new sets of conduct of business rules and new codes of conduct for Financial Advisers and Authorised Insurance Representatives¹. Time has been given to allow licensees to embrace the new requirements into their business practices and 2017 was considered to be a good time to understand how these practices have evolved.
- At the Commission's Industry Presentations in 2016, Jeremy Quick, Director of the Banking & Insurance Supervision and Policy Division, commented that the provision of advice to retail clients was still an area that he was not entirely comfortable with and consequently this would be our area of focus for 2017.

3. Scope

The suitability of advice provided to retail clients is a fundamental responsibility for both investment and insurance intermediary licensees. The thematic has enabled us to understand afresh how licensees are now approaching the provision of such advice to ensure retail clients are being treated fairly.

The fair treatment of customers is a key consideration of the conduct risk² that is exhibited by a firm.

¹ Following industry engagement and consultation, the Code of Conduct for Authorised Insurance Representatives was re-issued on 1 April 2017.

² [Risk Based Supervision in Guernsey](#)

4. Approach

The thematic review consisted of 2 stages:

- An online Questionnaire was sent to 40 licensees who had previously confirmed to the Commission that they provide advice to retail clients. 4 licensees promptly advised that they no longer provide such advice and therefore would not be responding. Questionnaire responses were completed by 35 of the 36 remaining licensees.
- Onsite visits to 5 licensees to discuss their responses and examine these in practice.

The Questionnaire sought responses in a number of areas relating to sales practice; these responses are considered in section 6 of this report.

During the 2012 and 2013 thematics, pre-visit questionnaires had only been sent to the firms being visited. This time, a questionnaire was sent to all relevant licensees enabling better informed conclusions on the sector itself. This engagement also enabled us to go into greater depth on the practices being followed when onsite.

Each onsite visit lasted 2 days enabling the thematic team to discuss the information provided in the Questionnaire and undertake a meaningful number of file reviews so as to identify any systemic issues. Following a discussion with management to gain an overview of the systems and processes relating to the provision of advice, the file reviews considered how these arrangements operate in practice. Each file was assessed for the suitability of the advice that had been given using a scale of suitable, unsuitable or unclear. Files were considered to be unclear where a crucial element of the advice process was either missing or inadequate

Notwithstanding particular issues that are firm specific, which are being taken forward with that firm, this approach enabled the Commission to identify a spread of good practice, relevant to the sector as a whole, and to consider specific areas where improvements are still required.

The following pages consider how local firms are discharging their responsibilities. Areas of good practice have been highlighted by way of examples. These examples should not be taken as guidance and are in no way prescriptive as they may not be appropriate for every licensee, based on the internal organisation and the range of products offered.

Please note that all graphs contained within this report are based on the Questionnaire responses received unless otherwise stated.

5. Current Responsibilities of Licensees³

The provision of advice to retail clients by licensees conducting controlled investment business and/or long term insurance intermediary business requires adherence to the following (as applicable):

- The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002;
- The Protection of Investors (Bailiwick of Guernsey) Law, 1987;
- Principles of Conduct of Finance Business⁴.
- The Licensees (Conduct of Business) Rules 2016 (the “Licensees Rules”) (which replaced The Licensees (Conduct of Business) Rules 2014 with effect from 1 January 2017);
- The Insurance Intermediaries (Conduct of Business) Rules 2014; and the
- Code of Conduct for Financial Advisers (the “FA Code”);

³ Please note this list is not an exhaustive list for those holding licenses under the above laws and has been restricted to those relevant to the provision of advice.

⁴ Principle 1 states that “A licensee should observe high standards of integrity and fair dealing in the conduct of its business.”

6. Statistics, observations and findings

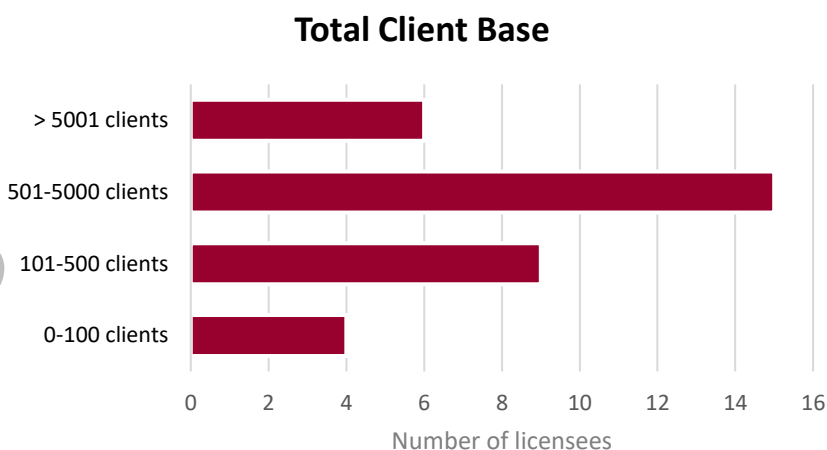
In this section:

- Data from responses to the Questionnaire, provided in the form of graphs, charts and wording, are shown in normal type;
- Guidance from observations of good practice and areas where we consider improvements are required are in bold text;
- For ease, referenced regulatory requirements are included in the footnotes; and
- Topics follow the order within the Questionnaire

6.1. Client base

Number of Clients

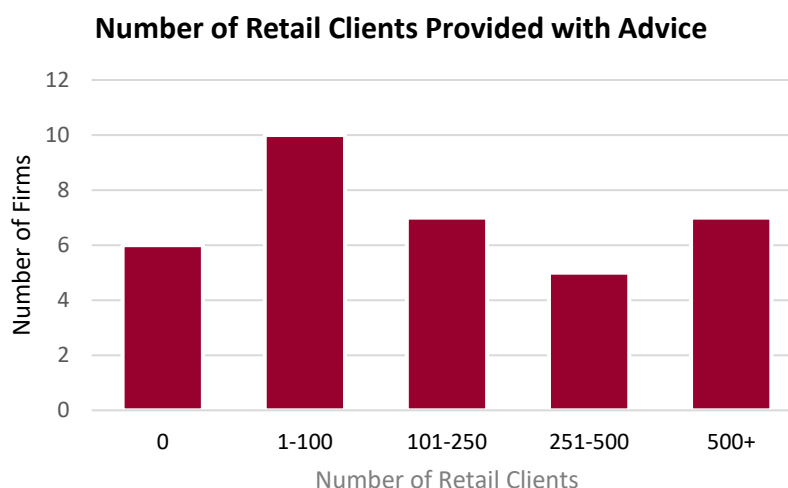
“ How many clients/customers do you currently have across all licences held by your firm? ”



The 35 respondents demonstrated a wide range of business sizes. The chart above represents 4 size categorisations for the total number of all clients across all business lines (not just retail clients). 70% of the respondents have between 101 and 5,000 clients. The 4 smallest licensees, in terms of customers served, have only 170 customers between them.

The following chart provides a snapshot of the extent of financial advice given to retail clients.

“ How many retail clients do you provide advice to, where this advice is required to be provided by a Financial Adviser? ”



The average number of retail clients per licensee who are provided with financial advice through a Financial Adviser⁵ is 384, although the range is large: 0 - 3,231. There are 3 licensees who provide financial advice to over 1,000 retail clients.

29 of the 35 respondents stated that they provide advice to retail clients, where that advice is required to be provided by a Financial Adviser. A total of 13,055 clients are provided with this advice, representing 6% of these respondents' total client base. This spread is primarily caused by:

- A number of insurance intermediaries who, although advising on long term business, predominantly specialise in general insurance; and
- Retail banks providing retail financial advice to a small proportion of their overall client base.

4 respondents reported that 100% of their total gross income arises from advice given on controlled investments and/or long term insurance.

For those firms who no longer provide advice to retail clients, where relevant, notification of the de-authorisation of Financial Advisers should be made using the form available on our website and sent by e-mail to conduct@gfsc.gg.

Other services offered

Other services offered by respondents (number of firms shown below) include:

- Investment management – 18;
- Custody services – 15;
- Mortgage or other finance broking – 13;
- Pure protection long term insurance products – 9;
- General insurance – 8;
- Banking services (deposit taking and/or lending activities) – 8;
- Trust services – 5;
- Investment consultancy; safe custody; and private office/consultancy services; and
- 1 respondent clarified that another group company provided its customers with investment management and custody services.

Client categorisation⁶

From the visits undertaken it was noted that not all licensees were explicitly informing their clients prior to the provision of services of:

- **Their categorisation;**
- **The effect of this categorisation; and**
- **Any limitations to the level of client protection that a different categorisation would entail.**

Some licensees were categorising all clients as retail by default in order to afford clients the greatest level of protection. This needs to be clear to the clients.

⁵ Firms providing advice to retail clients on controlled investments or long term insurance business are required to authorise an individual as a Financial Adviser in this regard.

⁶ Rule 7.2.1. of the Licensees Rules requires the licensee to notify a client in writing of its categorisation as a retail client, professional client, or eligible counterparty. The licensee must also inform a client, prior to the provision of services of the effect of this categorisation and any limitations to the level of client protection that a different categorisation would entail.

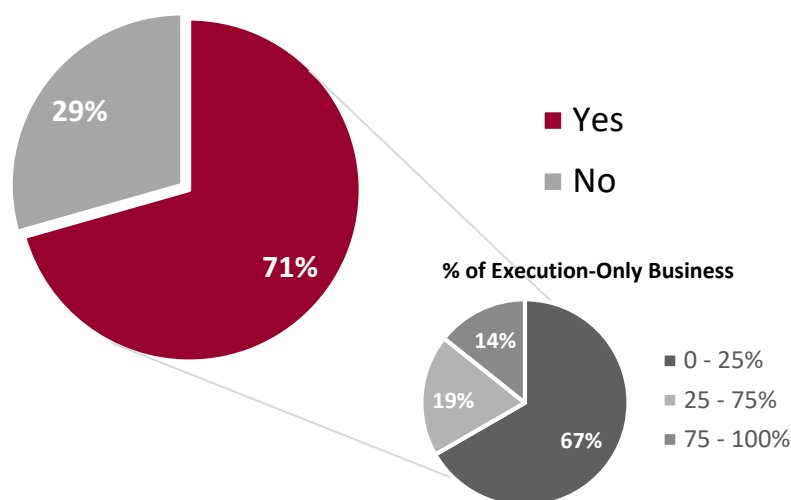
Execution-Only Transactions⁷



Have you conducted any execution only transactions for retail clients since 1 January 2015?



Execution-Only Transactions



71% of the 35 respondents confirmed that they had conducted some execution-only transactions for retail clients since 1 January 2015. The approximate percentage of execution-only business was predominantly below 25% of respondents' total business transactions over the last 6 months. 3 investment licensees reported high levels of execution-only transactions, which relate to stock-broking and/or share dealing services. These latter services are not required to be provided by a Financial Adviser.

The limitations of the licensee's responsibilities under an execution-only agreement must be clearly understood by both the licensee and the client.

Ongoing services

Only 6 of the 35 respondents stated that they do not provide ongoing services following advice being given to a retail client. Where these services are provided, these include (number of firms shown):

- Regular statements of the client's investments and their performance – 23;
- A general commentary on the market, tailored to the client's investment knowledge – 15;
- Online access to investment portfolios – 15;
- Forwarding regular product provider statements – 11;
- Other more bespoke ongoing services include:
 - Custody of investments;
 - Ad hoc valuations;
 - Discretionary management of investments; and
 - Periodic reviews and meetings with clients.

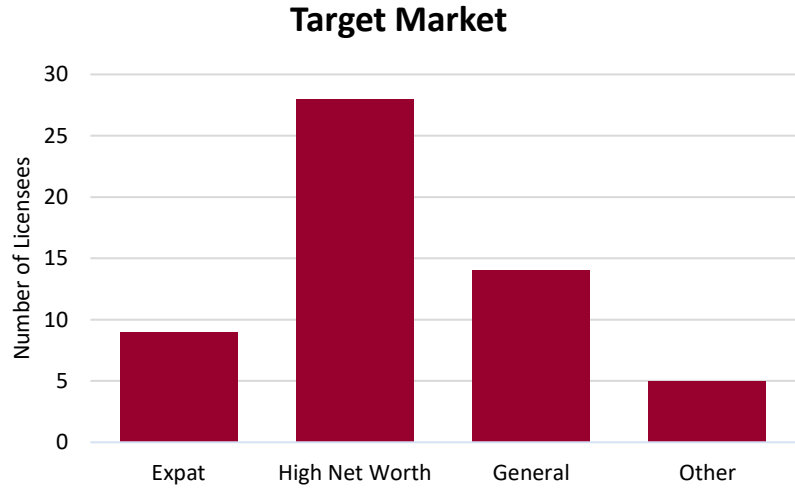
If a licensee operates under both advisory and discretionary mandates, the client should be made aware which applies to them and their respective responsibilities.

Prior to the provision of subsequent advice, all relevant factors should be updated to ensure that the advice is based on up to date information. We would expect this update to include the client's current circumstances, attitude to risk, capacity for loss and investment objectives.

⁷ Rule 5.2.1. of both the Licensees Rules and The Insurance Intermediaries (Conduct of Business) Rules 2014 sets out the requirements under the provision of either investment or intermediary services on an execution-only basis. The basis and terms on which the execution-only services are provided should be set out in adequate detail and an agreement signed by both the licensee and the client.

Target Retail Client Demographic

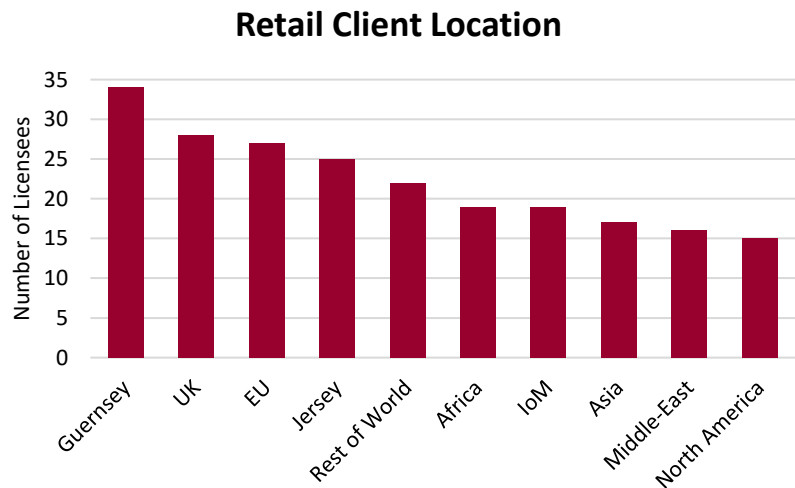
“ What is your target retail client demographic? ”



28 of the 35 respondents (80%) consider High Net Worth clients as being part of their target market.

Location of Retail Clients

“ Please indicate which territories your retail clients reside in. ”



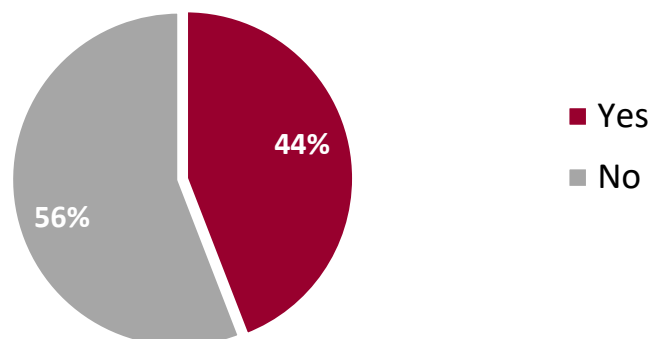
Notably, 1 respondent has no Guernsey clients and another only 5% of their client base. On average, around 60% of clients are Guernsey-based with 7 respondents having more than 95% of their clients in Guernsey.

6.2. Attitude to Risk

Automated Profiling Tools

“ Does the firm use an automated tool for assessing a retail client's attitude to risk? ”

Use of Automated Profiling Tools



The profiling tools used are a range of in-house questionnaires and external tools. 16 respondents do not use an automated tool with 13 of these using a standard questionnaire.

14 of the 35 respondents noted further steps taken in addition to automated profiling, which include:

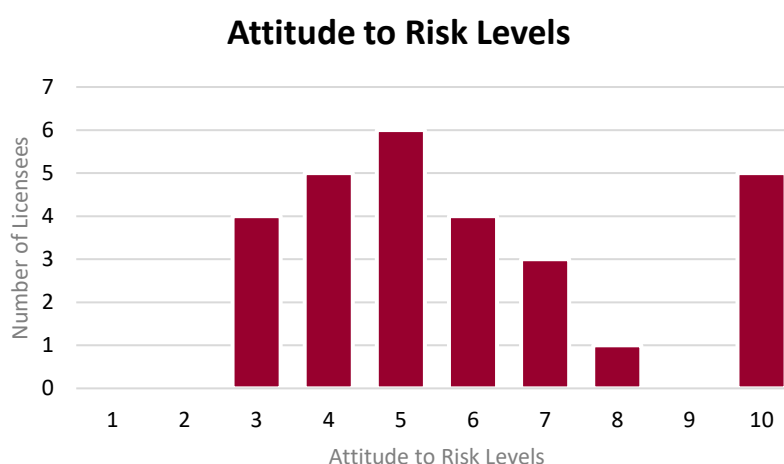
- Discussions with clients;
- Separate literature to describe risk levels; and
- Compliance suitability reviews.

3 respondents use neither an automated tool nor a standard questionnaire. Instead, they assess attitude to risk through a face-to-face meeting with the client.

We would not expect reliance to be placed solely on a profiling tool (including a standard questionnaire) in order to assess a client's attitude to risk. Use of the tool should prompt a discussion on its result and any responses which may be outliers given the client's circumstances.

Number of Attitude to Risk Levels

“ How many attitude to risk levels are identified in your scale of risk? ”



The most common attitude to risk scale included 5 levels, with the range being from 3 to 10.

The number of risk levels used by licensees is less important than the clarity provided to the client as to the explanation of the risk categorisations together with the clients' understanding and agreement that the risk assessment undertaken accords with their attitude to risk.

During the thematic onsite visits and other recent licensee engagements, we have identified confusion around expressions used as risk terms. Classifications such as “medium” “balanced” and “normal” can relate to very similar, yet differing, risk attitudes. These terms have been used interchangeably within written advice and product providers’ documentation.

1 respondent utilising a questionnaire to generate an attitude to risk score ranging between 1 and 10, allocates a description from 6 categories, such as “very low”, “low”, “balanced”, “medium”, “high” and “very high” based on that score. The descriptions have wide bands applied, for example, a risk score of 2 could be allocated to “very low”, “low” or “balanced”. The Financial Adviser then selects the attitude to risk category for the client based on their knowledge of the client and these multiple categories. There is a lack of clarity for the client on the basis of this assessment.

A Financial Adviser should clearly document how they have reached a conclusion on a client’s attitude to risk.

In addition, where the level of risk identified through the risk profiling tool differs to the client’s expectation, this should be discussed with the client and documented i.e. where the client or the Financial Adviser suggests an override of the level of risk (either higher or lower than that assessed through the tool). This will provide clarity if there is a mismatch between the client’s attitude to risk and the underlying risk of the product. In addition, based on the level of risk chosen, the investment objectives of the client may not be met.

Consideration should be given as to whether a new attitude to risk assessment should be undertaken before any additional product or portfolio is recommended. In the absence of updated information, or confirmation from the client that their circumstances and objectives have not changed, it is unclear how a Financial Adviser would be able to make a suitable recommendation.

Licensees should ensure:

- **There is consistency in attitude to risk terminology;**
- **Sole reliance is not placed on either an automated risk rating tool or a standard questionnaire to assess a client’s attitude to risk;**
- **Discussions are documented, especially where the level of risk identified through the risk rating tool or standard questionnaire is overridden;**
- **Attitude to risk is considered for an initial investment, a top-up investment or an additional investment; and**
- **Clients receive clarity around their attitude to risk and how certain products (or a combination of products) have been selected to meet their risk appetite.**

Attitude to Risk was considered in section 1.3 of the 2014 Thematic Report. Although the 2017 thematic onsite visits identified progress in this area, we would encourage all licensees to review their own practice.

Risk profiling for advice in joint names⁸

The responses received to the thematic Questionnaire and files reviewed during the onsite visits, identify varying ways in which the requirement for a recommendation to be made in joint names is interpreted:

- Licensees using either a risk profiling tool or a risk profile questionnaire often also discuss the individual risk attitudes of each party as the assessment is being undertaken; and
- Predominantly, separate questionnaires are used. Some licensees complete 1 questionnaire and

⁸ 2.1(b) of Schedule 2 of the Licensees Rules and 4.1(c) of the FA Code states, make a documented assessment of the client’s attitude to investment risk. In the event of a recommendation to be made in joint names, a separate assessment should be made of each person and a documented decision made with the clients for an overall attitude to investment risk.

note where attitude to risk between the parties differ against the respective questions asked. During two of the onsite visits undertaken we were advised that these licensees regularly experienced joint clients asking for a single joint assessment to be undertaken.

The treatment of the results of the individual assessments also vary:

- Assessment results are combined to get an overall attitude to risk based on the individual assessments and this is presented to clients;
- Where differences in risk attitudes are identified, some licensees encourage the clients to discuss their individual investment objectives and to try to reach an agreement as to their overall risk tolerance that both parties are comfortable with;
- Some licensees suggest that separate portfolios could be arranged to accommodate the individual risk profiles of the clients; and
- Where there are significant variances between the attitudes to risk of the various parties, some licensees will decline to proceed as the management of such varied risk tolerances are considered unmanageable.

Care should be taken when setting attitude to risk levels to ensure that:

- **Separate assessments are made for each person;**
- **Each client is comfortable with the resultant attitude to risk level;**
- **That a lower level of risk is not automatically opted for based on the more conservative party's attitude to risk as this may result in the clients' investment objectives not being met;**
- **Documentation demonstrates due consideration of differing attitudes to risk being discussed and an approach agreed; and**
- **It is assessed both at the outset of advice being given and on an ongoing basis.**

In exceptional circumstances, should the clients not wish to complete separate assessments, the Financial Adviser should clearly explain, and document, the potential consequences of this decision.

Good practice would be to reiterate these consequences in the written advice.

6.3. Capacity for Loss

29% of the 29 respondents, who provide advice to retail clients, where that advice is required to be provided by a Financial Adviser), use an automated tool, commonly the same one as for attitude to risk, to assess a retail client's capacity for loss⁹. 50% of respondents use a standard questionnaire for capacity for loss. Alternative methods used by respondents include:

- Personal reviews;
- Using a holistic approach; and
- Through discussions with the client.

Questionnaire responses and files reviewed onsite indicate that the concept of capacity for loss appears to be widely misunderstood.¹⁰

Although a number of the risk assessment tools and questionnaires have sections with questions relating to capacity for loss, there is some confusion between the concepts of “capacity for loss” and “risk tolerance”. Some capacity for loss assessments seen in file reviews included questions asking the client what percentage loss over a period of time that the client would be concerned with.

Capacity for loss is an assessment, based on the client's personal circumstances and financial situation, to judge what actual investment loss that client could absorb without detriment to their standard of living at the date of investment or inception of the policy. The Financial Adviser should also consider that doing nothing may impact a client's standard of living due to inflation.

Consideration should be given to the client's ability to continue to enjoy their current lifestyle. This is likely to be different for the average retail client when compared with a high net worth retail client. The financial adviser should use their professional judgement, based on the information gathered from the client, rather than asking the client how they would feel about a potential loss or respond to a fluctuation in a particular market. This assessment should be discussed with the client and documented.

The 2014 Thematic Report referred to capacity for loss being insufficiently addressed by licensees. Consequently the requirement to perform a documented assessment of capacity for loss was formalised with the introduction of the new sets of conduct of business rules and the FA Code on 1 January 2015.

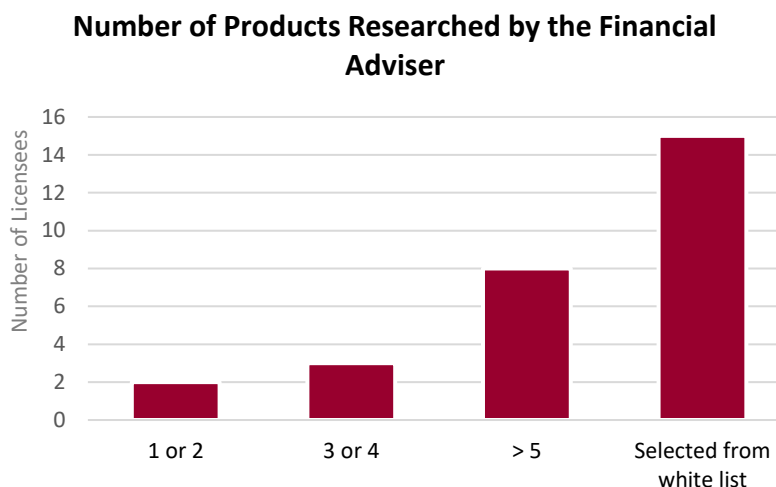
⁹ Section 2.1(c) of Schedule 2 to the Licensees (Conduct of Business) Rules 2016 and section 4.1(d) of the FA Code require the Financial Adviser to *make a documented assessment of the affordability of the funds to be invested by the client and of the client's capacity for loss*.

¹⁰ ‘Capacity for loss’ in the Conduct of Business Rules is defined as “*the financial loss a client could tolerate without a detrimental effect to their standard of living at the date of investment or inception of the policy*”.

6.4. Product Research

Number of Products Researched by the Financial Adviser

“ How many products will be researched by the Financial Adviser when providing recommendations to retail clients? ”



File reviews did not always demonstrate the market research that had been undertaken.¹¹

These reviews also identified that the file and written advice was not always clear how the Financial Adviser had been satisfied that the recommendations made complemented the client’s existing holdings and ensured that the client’s overall risk appetite was still being met. In addition, advice given was often limited to the specific investment requirement and information was gathered on that basis. In such cases clients were receiving limited advice rather than a full holistic financial review. This was addressed in section 1.1 of the 2014 Thematic Report.

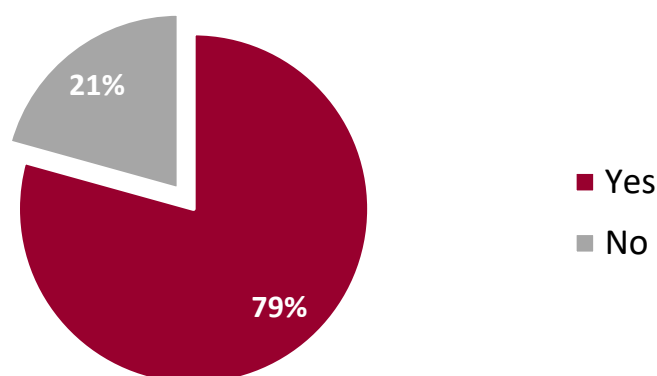
Good practice was demonstrated with 1 licensee compiling a table of providers and products considered from the market research undertaken. The table clearly showed comparison charges and allocation rates, and was accompanied by narrative explaining why each option had been discounted. Although this information could have been held on the client file to demonstrate that research had been undertaken, it was included in the written recommendation to the client.

¹¹ The Licensees Rules state that prior to making a recommendation a *Financial Adviser must maintain evidence on each client’s file of product research carried out, including but not limited to quotations, illustrations and comparisons unless the licensee maintains a Board or committee approved “white list”*.

Product White List

“ Do you have a white list of products? ”

Use of a White List



Approximately 80% of respondents use a white list with a review frequency varying as follows:

- Quarterly in 3 cases; and in 4 further cases, if not reviewed by an earlier trigger event;
- Monthly in 3 cases; and in 3 further cases, if not reviewed by an earlier trigger event;
- Weekly in 1 case;
- Daily in 4 cases; and
- Upon a trigger event only for 3 cases.

The use of a white list provides the licensee with the ability to restrict the product types, providers or individual funds that a Financial Adviser can recommend if it is outside of the licensee’s risk appetite or that of their client base.

This restriction on products may limit the Financial Adviser’s choice when searching for a suitable product, or if trying to identify a product that meets a client’s specific wishes – such as ethical funds.

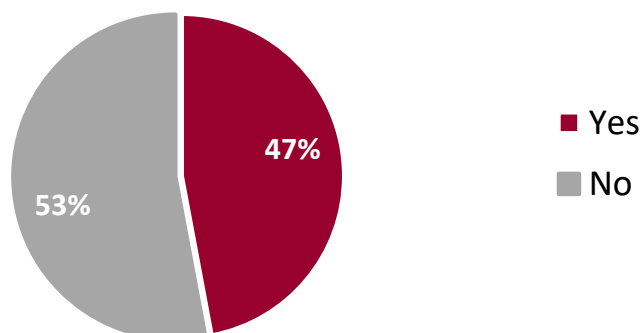
As good practice, licensees using white lists should clarify to all clients and potential clients:

- **The use of a white list for product recommendations;**
- **The limitations of the white list; and**
- **Whether any products not on the white list can be researched, accepted for transfer or regularly reviewed.**

Operating Model Portfolios

“ Do you operate model portfolios for retail clients? ”

Use of a Model Portfolio



A model portfolio is a range or grouping of various funds selected by a licensee, usually with an investment committee, and bundled into a portfolio that can be offered to its clients. Each model portfolio is usually targeted at a particular attitude to risk, or specialist investments, for clients looking to invest in a particular market. The selected funds for each portfolio may be drawn from a wide range of fund types and risk levels to provide an overall balanced and diverse portfolio.

Where model portfolios are offered, the number of model portfolios range from 1 to 10.

Of the 16 respondents using model portfolios, the balancing of products within each of the classifications was normally reassessed as follows (number of firms shown):

- annually or trigger event - 2
- quarterly - 3
- monthly or trigger event - 6
- weekly - 2
- daily - 1
- trigger event only - 1

The responsibility for rebalancing the portfolio was held by either:

- An investment committee or senior management for 14 licensees; or
- The fund managers in 2 cases.

82% of respondents using model portfolios had the authority to rebalance the model portfolio recommended to a retail client without reference to that client for their approval.

Firms should ensure that, regardless of the frequency of rebalancing, clients are aware of the following:

- **the frequency;**
- **the charge for such a service; and**
- **whether this will proceed without reference to them as the client.**

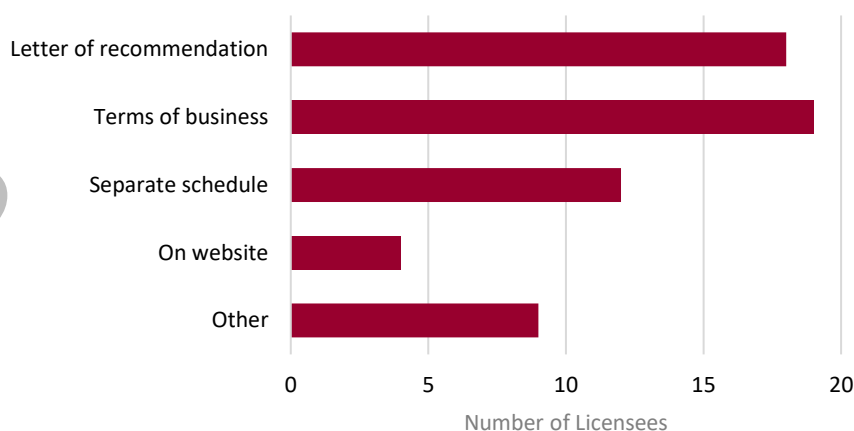
In addition, licensees that solely use model portfolios should make this clear to clients so that they know the range, scope and any limitations in the product providers and/or products upon which the Financial Adviser is able to provide advice.

6.5. Fees, Charges and Remuneration

Method of Disclosure of Fees and Charges

“ How do you disclose your fees and charges to your retail clients? ”

Fees & Charges disclosure



Licensees who responded with ‘Other’ stated that they used terms of business, a suitability report, contract notes and a fee tariff document as means of disclosing fees, charges and remuneration to their retail clients. Only 24% of respondents advised using only 1 means of disclosure, with the majority using multiple means, such as in the terms of business and as a separate schedule.

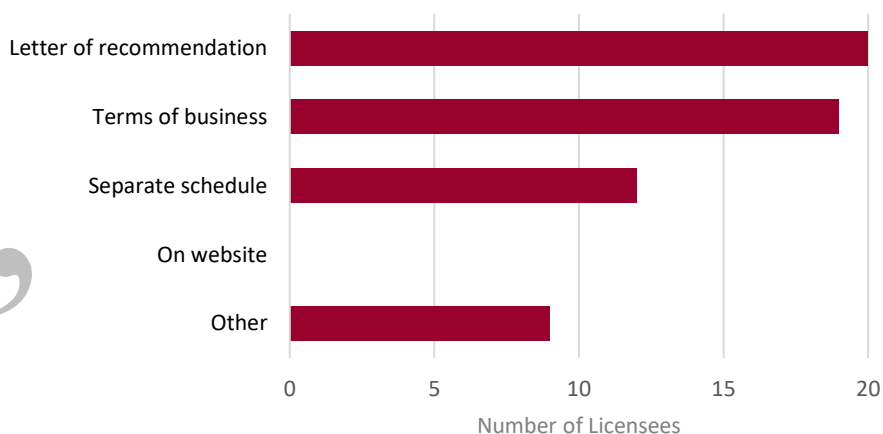
File reviews at two licensees identified two instances where the actual product charges were different to the charges explained in the written recommendation. These were not communicated to the client. Licensees should ensure that variations in charges, or any other terms and conditions are notified to the client.

Clients should be made aware of all potential fees and charges for the services to be provided prior to the provision of those services.

Method of Disclosure of Remuneration

“ How do you disclose remuneration (including commission) in connection with a transaction to your retail clients? ”

Remuneration disclosure



In addition to a licensee’s fees and charges there is a requirement to disclose all remuneration in respect of a transaction including any and all charges that will or may be incurred both at inception and the ongoing charges during the life of the product.

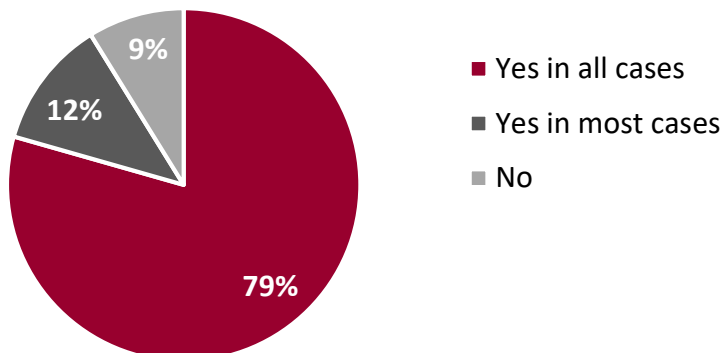
The most common method of disclosing remuneration to retail clients is through the letter of recommendation. 8 respondents use 1 method of disclosure, whilst the rest use multiple channels. ‘Other’

responses include: disclosure in the valuations received by clients; on the contract note; and in the insurer policy documentation.

Disclosure of How Fees, Charges & Remuneration are Funded¹²¹³

“ Does the firm disclose how the fees, charges (including ongoing costs) and remuneration are funded? ”

Disclosure of How Fees, Charges and Remuneration are Funded

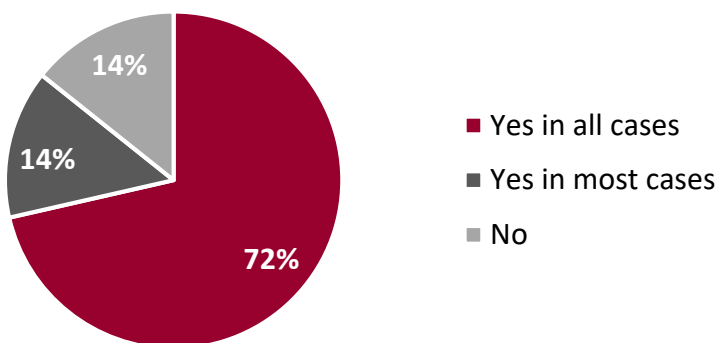


Of the 4 respondents who do not disclose how fees, charges and remuneration are funded, 3 no longer provide financial advice to retail clients and the other only has 1 legacy retail client.

Disclosing the Name of Recipients of the Fees, Charges and Remuneration

“ Does the firm disclose the name of the recipients of the fees, charges and remuneration? ”

Disclosing the name of recipients of fees



Of the 5 respondents (14%) who do not disclose the recipients, 3 no longer provide financial advice to retail clients, 1 only has 1 legacy retail client and the other advised that their advisory clients are advised through a UK group firm.

File reviews identified examples, detailed below, where the Financial Advisers had not clearly explained the fees, charges and remuneration to the client. All 5 licensees visited, exhibited, to some extent, areas for improvement in relation to disclosure of fees, charges and remuneration:

- **All potential fees and charges for the investment services were not always provided prior to the provision of those services;**

¹² Rule 5.2.4.(b) of the Licensees Rules requires that *A licensee shall disclose any and all remuneration to be received in connection with a transaction prior to the execution of the transaction. If the amounts are not known, then the basis of the calculation shall be provided.*

¹³ Section 3.2.(k) of Schedule 2 to the Licensees Rules and section 5.2.(k) of the FA Code require the Financial Adviser to, *where applicable, explain that deductions are made to cover the cost of life cover, commission, expenses, surrender penalties and other charges.*

- **Lack of clarity that charges would be deducted from their investment to fund ongoing fees;**
- **Lack of clarity that an initial charge would be deducted from their investment;**
- **Details of the percentage fee from the investment made that would be paid to the licensee for the ongoing administration, compliance and monitoring and how this was funded.**

We would expect a Financial Adviser to consider the following:

- **Have all the fees, charges and remuneration been considered and made clear to the client?**
- **Have any subsequent changes to proposed fees, charges and remuneration been advised to the client?**
- **If an investment product is recommended to be replaced has a clear cost comparison taken place?**
- **If the client has incurred additional costs has the rationale been explained to the client?**
- **Has an explanation been provided to the client of the reasons why lower cost options that would meet the client's objectives have been discounted, where this is applicable?**
- **Is the client paying for services or products beyond what they need to use? E.g. using a platform, insurance wrapper or a discretionary fund manager if a single fund is being held on a platform or the investment can be accessed directly.**

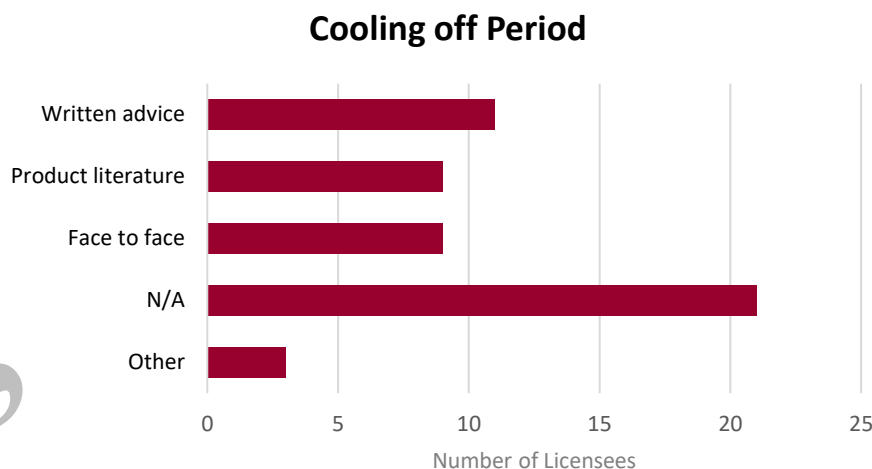
Good practice would be a simple table included in the written advice detailing the fees, charges and any other remuneration, where they are funded from and their frequency together with sufficient and clear narrative to explain what these are for.

6.6. Cooling Off Period

Explanation of the Cooling-Off Period Explained



If there is a cooling-off period applicable to a product being recommended, how and where is this explained to the retail client?



Clients should be made aware of any cooling off period¹⁴.

Respondents who selected “other” detailed that it was explained in the terms of business, whilst 2 respondents, quite understandably, noted that there was no cooling off period, owing to the nature of the investment traded.

A follow up question asked whether the explanation clarifies that during the cooling off period the retail client may receive back less than they invested and explain why, such as there may be irrecoverable fees, charges and/or remuneration incurred and/or a downturn in market value. Only 1 respondent who this was applicable to responded “No”.

Where a cooling off period exists and the client may receive back less than they invested, the Financial Adviser should explain this to the client.

In addition, sole reliance should not be placed on product provider literature to discharge disclosure obligations in relation to such areas as fees/charges/remuneration, cooling off periods, penalties of early surrender and return guarantees.

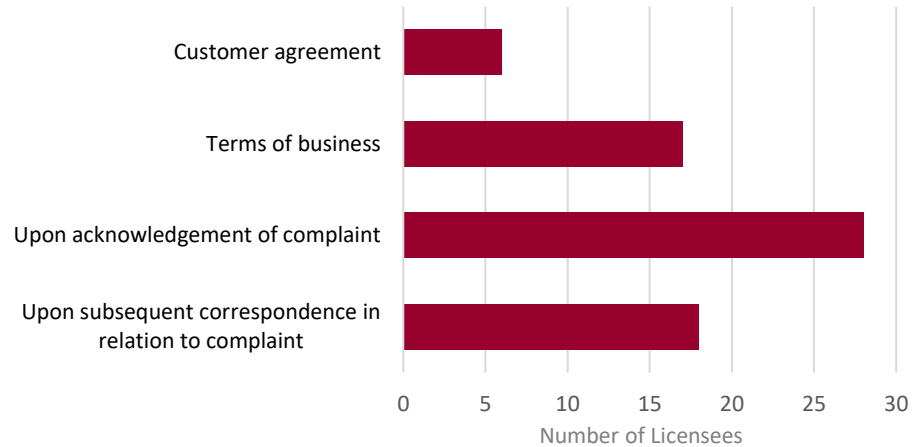
¹⁴ Section 3.2(g) of Schedule 2 to the Licensees Rules and 5.2(g) of the FA Code requires a Financial Adviser to, prior to inception or a material change, provide the client with details of any cooling off period relating to the particular product, and an explanation that there will be an opportunity for the client to cancel or withdraw from the contract, and set out the period during which the client may exercise this option. Any shortfall provisions should also be explained at this time.

6.7. Complaints

Referring to the Channel Islands Financial Ombudsman (“CIFO”)

“ At what stage is a retail client made aware that they may refer a complaint to the Channel Islands Financial Ombudsman if they are not satisfied with the response from the firm? ”

Stage at which Clients are referred to the CIFO



All except one respondent stated that they make reference to CIFO in relation to complaints resolution, although the point at which this is highlighted does vary. Good practice indicates that firms are adopting the Model Code for Complaints Handling issued by CIFO, within their own procedures.

All except one respondent also affirmed that management information on the root cause of complaints is reported to a forum which is able to take action on trends.

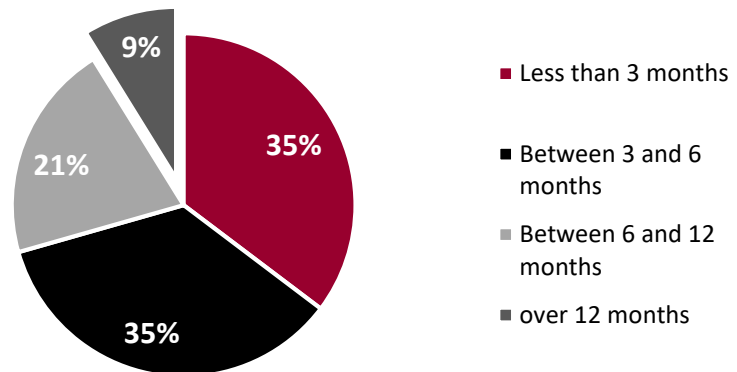
No significant matters in relation to complaints and complaint handling were identified during the onsite visits.

6.8. Handling Conflicts

Conflict of Interests Policy Last Review

“ When was the firm's conflict of interest policy last reviewed? ”

Conflicts of Interest Policy Last Review Date



With the exception of 2 respondents, a Conflicts of Interest Policy review has taken place in the last 18 months, with 20 respondents (57%) conducting this in 2017. The 2 outliers last carried out a review in 2015.

Licensees should have a conflicts of interest policy which is reviewed on a regular basis. We would encourage any outlying licensees to take the appropriate action.

Respondents advised that identified conflicts can be mitigated through:

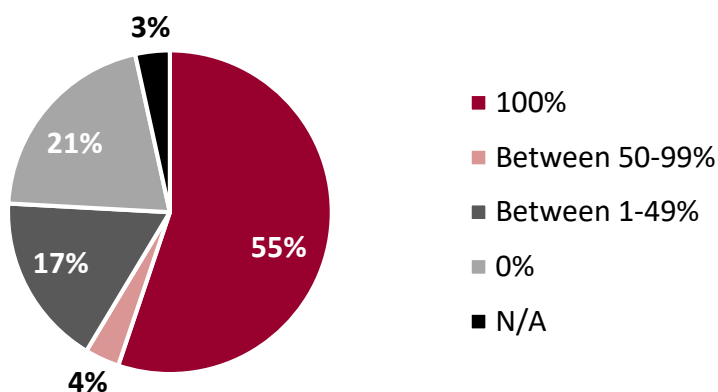
- Awareness;
- Peer reviews of advice given;
- Following internal policies and procedures; and
- Removal of sales and activity targets.

6.9. Peer Review

Percentage of Written Advice Peer Reviewed for Fully Qualified Financial Advisers

“ Approximately what percentage of written advice is peer reviewed for a fully qualified and competent Financial Adviser? ”

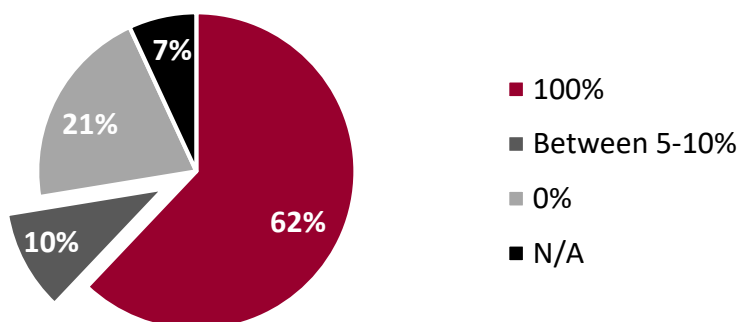
Percentage of files peer reviewed for fully competent Financial Advisers



Percentage of Written Advice Peer Reviewed for Newly Authorised Financial Advisers

“ Approximately what percentage of written advice is peer reviewed for a newly authorised Financial Adviser? ”

Percentage of files peer reviewed for newly authorised Financial Advisers



16 respondents (62%) (of the 29 licensees who provide advice to retail clients, where that advice is required to be provided by a Financial Adviser) undertake peer reviews of 100% of the advice given by both fully qualified Financial Advisers and newly authorised Financial Advisers.

6 firms (21%) do not appear to carry out the peer review of advice given to retail clients either by a fully qualified and competent Financial Adviser or a newly authorised Financial Adviser. Whilst it is not fully clear whether other forms of review are performed, such as through compliance monitoring (which by itself is insufficient), this cold data is a cause for concern.

In addition, file reviews identified that, where advice had been peer reviewed, it was not always evident that the observations made had been taken into account by the Financial Adviser.

With peer review forming part of a Financial Adviser’s supervision, it is an important factor in the advice process, in particular where the Financial Adviser is newly authorised. Peer review provides

the challenge from someone of similar knowledge and experience that would be lacking in a retail client. It also assists in spotting drafting errors.¹⁵

Where a firm has good policies designed to ensure suitable advice for its clients and effective compliance review leads to good outcomes for these clients, the depth and frequency of peer review may be reduced.

We would encourage licensees to consider their peer review and compliance policies, to determine if these are effective in ensuring that all recommendations are suitable.

¹⁵ The Commission's 'Guidance Note on Training and Competency Schemes' states that a *Peer review should form a part of the FA's supervision. Peer review should be carried out by an individual holding an acceptable level 4 qualification and suitable experience. The reviewer does not necessarily have to be appointed as an FA, but must be deemed competent by the licensee to perform this role.*

6.10. Client Documentation and Understanding

Comments on Client Documentation and Understanding primarily arise from onsite file reviews.

Client information

One licensee assisted the onsite team by placing a client profile at the front of each client file. This was supported by the information in the file itself.

An up to date client profile, summarising the client and their circumstances on each client file would provide a good overview of the client, particularly if the Financial Adviser is absent if that client has a query or is seeking further advice.

Objective setting

An area of weakness were examples of the failure to clearly refer, in the written recommendation, to the client's objectives and how the recommendation being made should help to achieve those objectives. Recommendation letters also contained examples of client decisions having already been made prior to the letter having been written and when there was no apparent urgency for this to have taken place.

This was a matter highlighted by the Commission in its 2014 Thematic Report (sections 1.2 and 2).

Recommendation letters should provide sufficient information for a client to make an informed decision and should be clearly distinguishable from execution-only engagements.

Terms of Business Agreements

Some files lacked clarity on when the terms of business agreement was issued to the client.

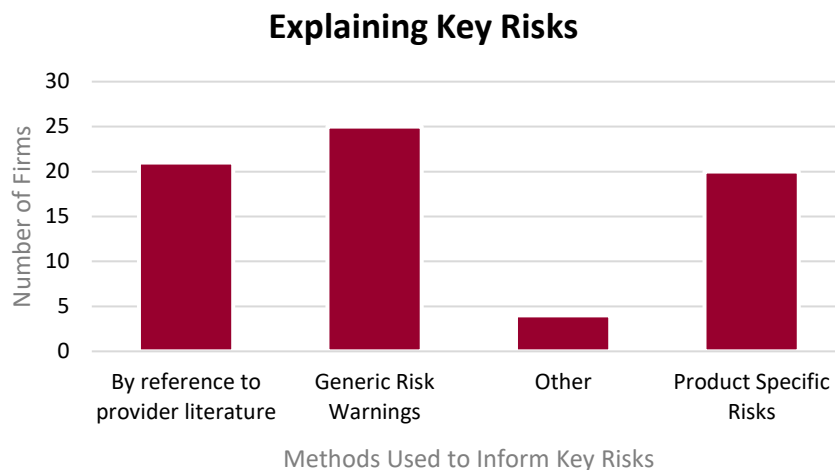
Good practice demonstrated was the issue of the terms of business agreement at the initial meeting with the client. The written recommendation was presented in a subsequent meeting.

The licensee and their client should understand the basis of their relationship and the terms on which any recommendation is made, particularly where there are limitations on the products or services provided. A signed terms of business agreement should be in place prior to providing services to a client, including before any recommendation is made.¹⁶

¹⁶ The rule in 5.2 and section 1.6. of Schedule 2 of the Licensees Rules outline requirements that a Financial Adviser must fulfil in relation to agreements between the licensee and the client and what must be provided to a client before advice is given.

Explaining Key Risks¹⁷

“When recommending a product to a retail client how are key risks explained within the recommendation?”



“Other” includes discussions held with the clients.

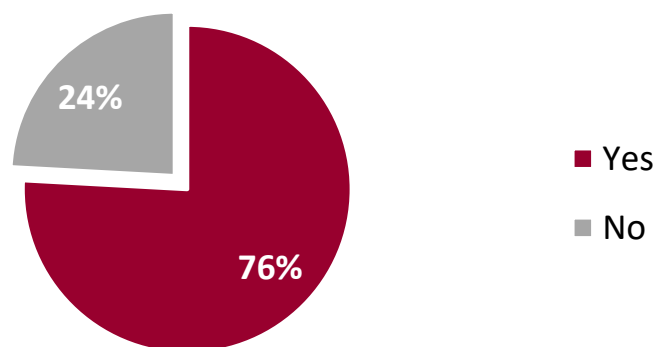
Some file reviews identified a high level of dependence on investment provider literature for specific product risks. In certain cases this documentation was quite substantive. 1 licensee included a list of generic product risks in their written advice, with no specific reference to the risks of the product being recommended.

Licensees should ensure that written advice is tailored to each client and is not generic in nature. Where appropriate, reference to key risks mentioned in the recommendation letter, should be referred to relevant sections of supporting provider literature. This matter was highlighted by the Commission in section 2 of its 2014 Thematic Report.

Details of Benefits Being Lost

“If a recommendation to replace a product is being made, does the recommendation include details of any benefits being lost?”

Confirmation of Any Benefits Being Lost



7 (24%) of the 29 respondents, who confirmed that they provide advice to retail clients where that advice must be provided by a financial adviser, stated that they did not provide details of benefits being lost.

Without further discussion with these licensees we are unable to assess if there is a more systemic weakness in this area. However file reviews indicate this to be an area which may require attention, especially for insurance intermediary business.

One file reviewed was for a client who wished to consolidate their pension arrangements. There was no documentation of the features, performance and benefits of the ceding schemes or comparative risk

¹⁷ Under the FA Code, it is a requirement for a Financial Adviser to include an explanation of the key risks associated with the product in the written advice.

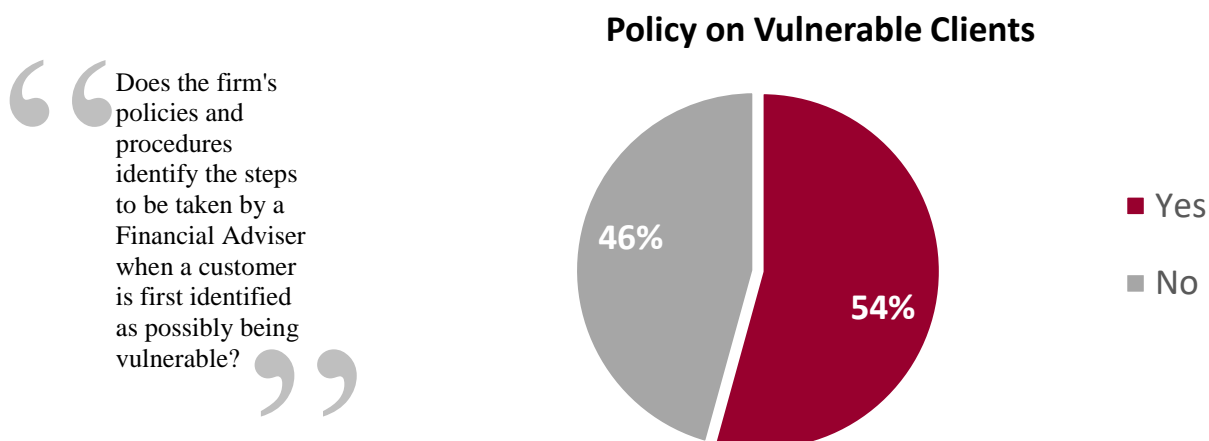
disposition to ensure that the recommended product offered better prospects of satisfying the client's objectives. There was also minimal explanation in the written advice of the benefits being lost or costs of surrender/transfer to a RATS from the client's existing product and defined contribution pension.

Licensees should ensure that a recommendation to convert, allow to lapse, cancel or surrender any product is in the best interest of their client¹⁸. The client should receive sufficient information to make an informed decision.¹⁹

Where the client has not been provided with sufficient information, the client may make an uninformed decision which is not in their best interests.

Pension transfers were highlighted by the Commission in section 3 of its 2014 Thematic Report.

Policy on Vulnerable Clients



Licensees were also asked to provide their definition of who might be considered a 'vulnerable client'. Responses varied quite significantly with 1 respondent basing vulnerability solely on age and others identifying a wide range of possible scenarios. 2 respondents advised that they were in the process of drafting vulnerable clients' policies.

Below are comments provided by 4 respondents:

- “Vulnerability can come in a range of guises, and can be temporary, sporadic or permanent in nature. It is a fluid state that needs a flexible, tailored response. Many people in vulnerable situations would not diagnose themselves as ‘vulnerable’. Vulnerability can be defined as, but not limited to, age, mental state, health, education and family circumstances. This is captured in an internal policy which addresses these factors when profiling and interacting with our clients.”
- “Persons who might be advanced in age so as to experience cognitive, dexterity or sensory impairments; persons experiencing severe or long-term illness, mental health difficulties or physical disabilities; persons experiencing such changes in personal circumstances as might

¹⁸ Section 3.1.(a) of Schedule 2 of the Licensees Rules and section 5.1.(a) of the FA Code requires that a Financial Adviser shall not advise a client to convert, allow to lapse, cancel or surrender any product unless he can demonstrate the action to be in the best interests of the client. If such action is advised then the reasoning should be fully documented in the written advice provided to the client.

¹⁹ Section 3.2.(i) of Schedule 2 of the Licensees Rules and 5.2.(i) of the FA Code requires that prior to the inception (or any other material change to a controlled investment or including cancellation) of a controlled investment, and in order to assist the client in making an informed decision, a financial adviser shall provide the client with written advice, which must include as a minimum full and frank disclosure of any matter which may affect the client's decisions.

render their decision-making uncharacteristic (loss of employment, bereavement, divorce, etc.); persons in debt. These definitions are not limited or intended to be exhaustive.”

- “Someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care.”
- “It is critical to our fair treatment of Customers that we are proactively alert to indicators of vulnerability when we are providing Products to them. We have a vulnerable persons’ policy and key aspects of this are incorporated into the Investment Advisers procedures.”

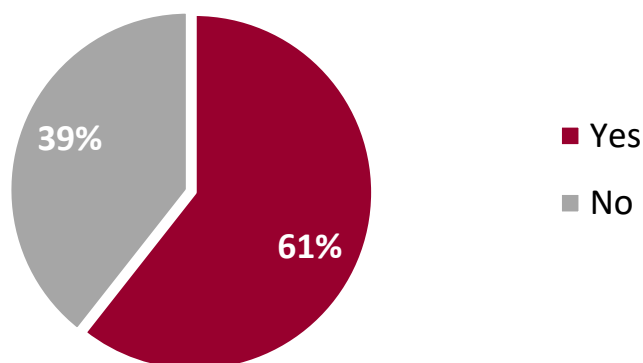
We also note that vulnerability is included as a consideration in the Code of Conduct for Authorised Insurance Representatives, effective from 1 April 2017.

We would encourage all firms to consider introducing a vulnerable clients’ policy to assist them in treating their customers fairly²⁰.

Policy on recording telephone calls

“ Does the firm electronically record telephone calls as standard procedure? ”

Policy on recording telephone calls



We would expect clients to be made aware of any calls being recorded.

Licensees were also asked on their use of other methods of communication.

We are pleased to note that no respondents permit the use of personal e-mail accounts for client communications.

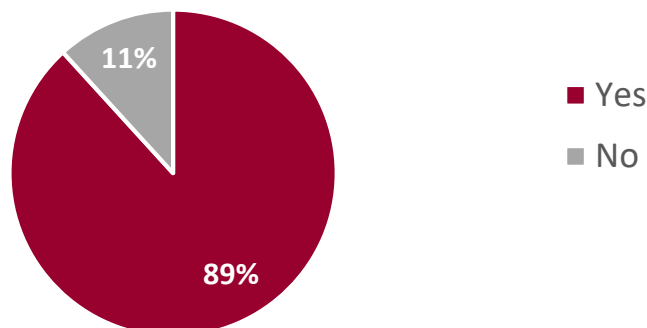
²⁰ Principle 1 of the Principles – A licensee should observe high standards of integrity and fair dealing in the conduct of its business.

6.11. Compliance and Internal Audit

Compliance Review of Client Files

“ Does the firm's compliance officer/team review retail client files to ensure adequate records relating to client advice have been kept? ”

Percentage of Firms that have Compliance review of client files



We were surprised that there were 4 respondents where compliance reviews do not take place. This appears to relate to licensees that do not provide advice given by a Financial Adviser or have a legacy retail client.

Licensees were asked on the frequency of file reviews. Responses were as follows (number of firms shown):

- annually - 5
- quarterly - 3
- monthly - 9
- weekly - 1
- 'Other' including risk weighting and trigger/thematic based approaches.

53% of respondents review client files at random, 12% by risk of client and 9% by size of client.

2 onsite visits identified compliance concerns.

We would encourage all firms to assess if their policies and procedures in relation to compliance are adequate. In particular, the Board, having effective responsibility for compliance with the law and regulatory requirements²¹, should consider whether the information that it receives is sufficient to highlight any areas that should be of concern²².

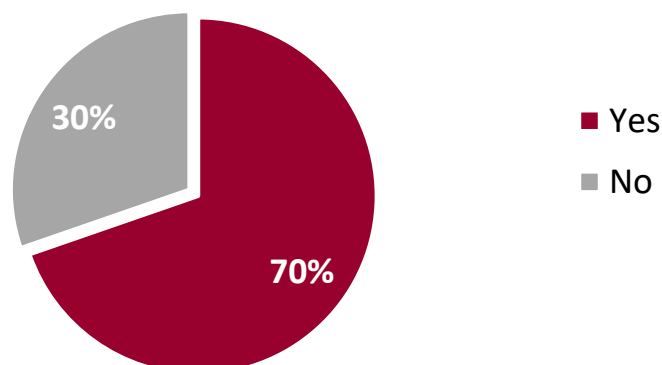
²¹ Rules 3.1.1 of both the Licensees (Conduct of Business) Rules, 2016 and the Insurance Intermediaries (Conduct of Business) Rules 2014 state that *The Board has effective responsibility for compliance with the Law, the Rules and any rules, codes or guidance made under the Law. In particular the Board must take responsibility for the policy on review of compliance and discuss a review of compliance at appropriate intervals.*

²² Rules 3.2.2.(h) of both the Licensees (Conduct of Business) Rules, 2016 and the Insurance Intermediaries (Conduct of Business) Rules 2014 require that *The Board must ensure that the Compliance Officer appointed be fully aware of both his obligations and those of the licensee under the Law and the Rules.*

Churning and/or Switching

“ Does the firm gather any management information that would identify churning and/or switching? ”

Management Information on Churning and/or Switching



We were surprised that not all respondents gather this management information. This appears to relate to licensees that do not provide advice given by a Financial Adviser.

Licensees were asked for examples of their management information which would identify churning and/or switching. Responses included:

- Peer reviews of all new business;
- Outsourcing reviews;
- Compliance monitoring programmes;
- Director sign-offs for new business/ switches;
- Where a product switch is considered the benefits to be gained/lost and the cost to the client is explained to the client. In addition, adjustments to fees, charges and remuneration is frequently made so that the client is not disadvantaged; and
- Surrender logs are reviewed monthly and peer reviews are undertaken where any surrender is involved.

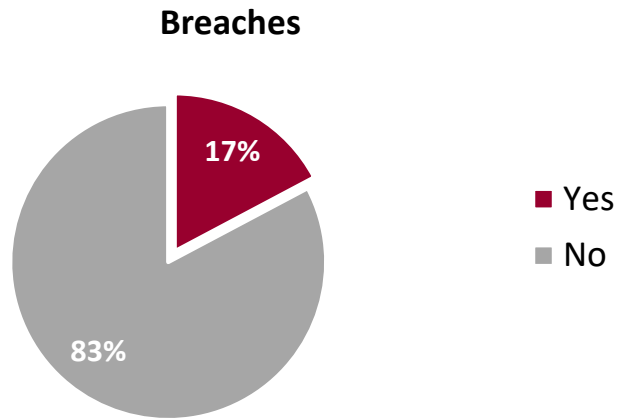
There was no noticeable trend in the responses from those who do not gather such management information.

Where churning and/or switching is possible, good practice would be to undertake regular checks as part of a compliance monitoring programme that mitigates this risk.

We would encourage all firms to assess if their policies and procedures in relation to churning and/or switching are adequate. In particular, the Board should consider where there may be potential for abuse and ensure that adequate controls exist.

Breaches

“ Has the firm recorded any breaches in relation to its policies, procedures or regulatory requirements surrounding the provision of financial advice to retail clients since January 2015? ”



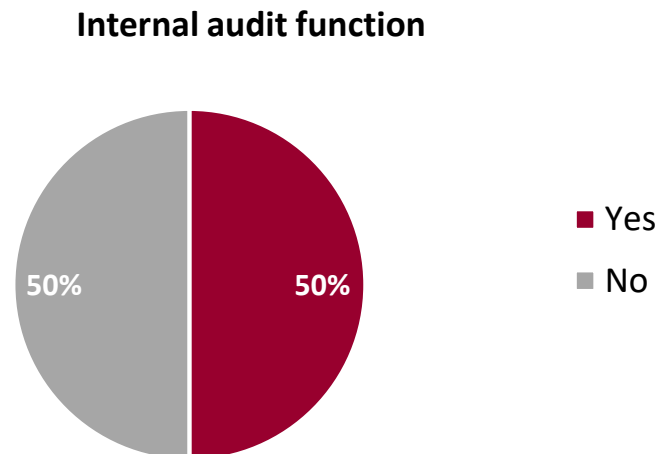
Licensees were asked to identify any breaches in relation to sales practices. A common response related to the late notification of the authorisation/de-authorisation of a Financial Adviser/Authorised Insurance Representative.

Licensees are reminded of the notification requirement for the authorisation (and de-authorisation) of a Financial Adviser or Authorised Insurance Representative using the notification form available on our website and submission by e-mail to conduct@gfsc.gg.

We would also remind licensees of the notification requirement in relation to any breach by a Financial Adviser of Schedule 2 to the Licensees (Conduct of Business) Rules, 2016 or the Code of Conduct for Financial Advisers, as appropriate to the licence²³.

Internal Audit Function

“ Does the firm have an internal audit function (including Group Internal Audit)? ”



Of the respondents with an internal audit function, 7 have undertaken audits in relation to advice being given to retail clients. 3 audits were conducted as recently as 2017, with 2 in 2016 and 2 in 2014.

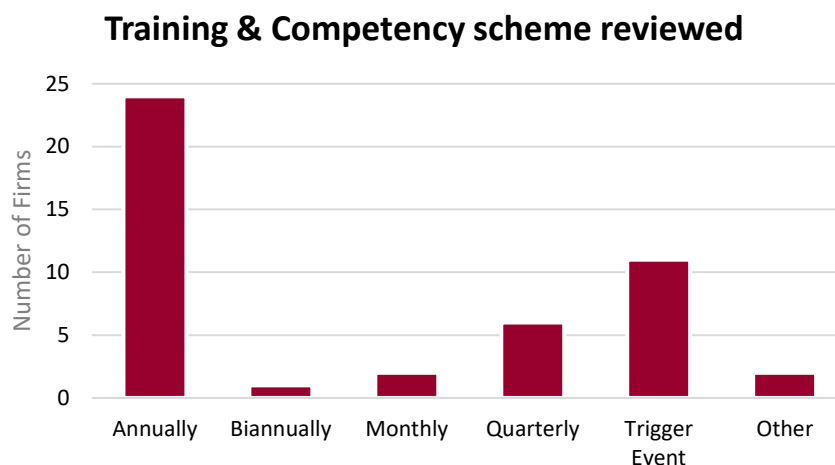
We would encourage firms to conduct either a compliance monitoring review or an internal audit review against the contents of this thematic report. The review should not only include areas for improvement that we have identified but also a comparison with the sector to identify where the firm may be an outlier to good practice.

²³ Rule 12.4.1(e) of the Licensees (Conduct of Business) Rules, 2016 and section 11.4.1(e) of the Code of Conduct for Financial Advisers.

6.12. Staffing

Frequency of Training & Competency scheme reviews

“ How frequently is the firm's documented Training & Competency scheme reviewed? ”



Most respondents last reviewed their Training & Competency schemes within the last 12 months. 1 respondent had a last review date in 2015.

Licensees were also asked if their Training & Competency schemes were role specific. 24% of respondents stated that their training and competency schemes are not role specific. Whilst no further detail has been sought from these licensees, it is unclear how these firms are able to make an ongoing assessment of the competency of their Financial Advisers.

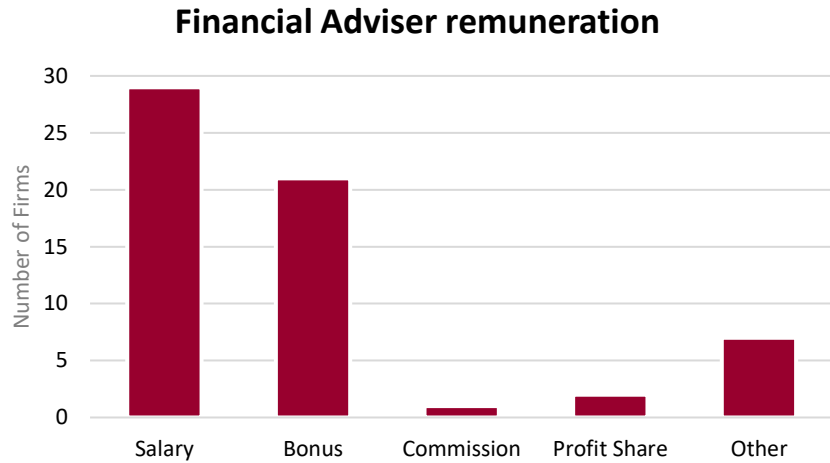
Licensees are required to have a Training & Competency Scheme for all employees appropriate to the nature and scale of their business. In relation to Financial Advisers and relevant Authorised Insurance Representatives, licensees should refer to the Guidance Note on Training and Competency Schemes issued by the Commission.²⁴

Licensees should ensure that a newly employed qualified Financial Adviser (or Authorised Insurance Representative for pure protection long term insurance business) is competent prior to formal authorisation by the board. We are pleased to note that we are receiving fewer notifications of employee authorisations where the start date and authorisation date is the same. Such authorisations raise concern that the firm has failed to assess the new employee against its own policies and procedures and their knowledge of the firm's product offerings. We would encourage all firms to review their procedures in this regard.

²⁴ Rule 3.6 of the Licensees (Conduct of Business) Rules, 2016 and rule 3.5 of the Insurance Intermediaries (Conduct of Business) Rules 2014.

Financial Adviser Remuneration

““ How are Financial Advisers remunerated? ””



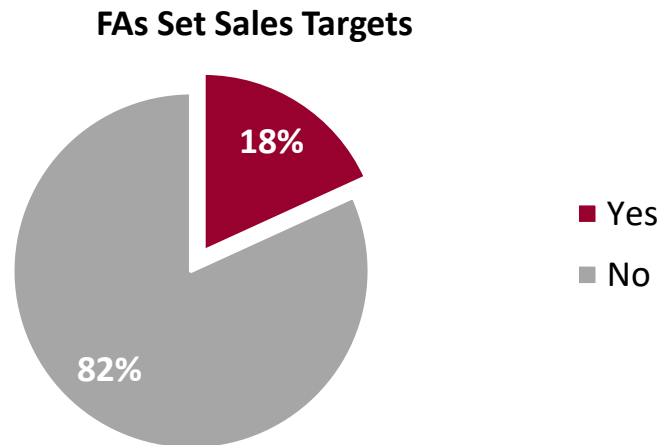
“Other” includes benefit in kind - gift shares and bespoke arrangements with self-employed Financial Advisers.

It is pleasing to note that licensees have largely moved away from using commission based rewards for Financial Advisers.

For the 1 respondent that pays commission, it should be noted that this is only 1 element of the remuneration package it provides for its Financial Advisers and the respondent also has scope to penalise poor practice.

Sales Targets

““ Are Financial Advisers set sales targets? ””

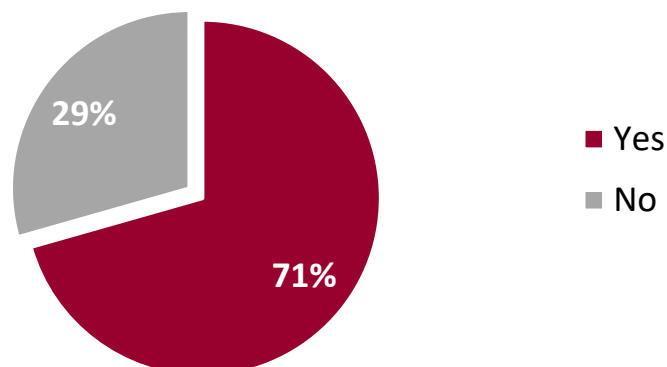


Significantly, only 6 respondents set their Financial Advisers sales targets. These are primarily set at a business level and include service targets and growth targets for income and assets under management. Whilst sales form an element of some targets, they are not the only indicator of a Financial Advisers performance.

Penalising Poor Behaviour

“ Does the Firm's remuneration policy and/or employment contracts have scope to penalise poor practice? ”

Penalising Poor Practice



From the examples provided by respondents, most penalties relate to the reduction or loss of discretionary bonuses and future pay increases. In many cases, key performance indicators/disciplinary triggers are used to identify when the Financial Adviser's performance falls below a licensee's set standards.

Key Person Dependency

27 of the 35 respondents indicated they have no key person dependency. Weakness was identified by 6 respondents in relation to controlled investment advice and 4 respondents regarding long term insurance business.

As one would expect, key person dependency was more prominent in the smaller licensees. Further, all licensees who suffer from a key person dependency do so in more than 1 category.