Domaille, Clarke and Hannis v Guernsey Financial Services Commission: exercise of regulatory powers must strike a "fair balance"

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The recent decision of the Royal Court of Guernsey (the **Royal Court**) in the matter of *Domaille and others v the Guernsey Financial Services Commission* involved an appeal to the Royal Court by three individuals (the **Appellants**) against sanctions imposed upon them by the Guernsey Financial Services Commission (the **Commission**) as directors/managers of a fiduciary services company.

In the course of its judgment, the Royal Court examined the principles applicable to the Commission in the exercise of its regulatory powers under the Financial Services Business (Enforcement Powers, Bailiwick of Guernsey) Law, 2020 (the **EP Law**).

As the EP Law, though a relatively recent piece of legislation, has broadly consolidated and codified the enforcement powers of the Commission including its prior practice, this judgment is a timely one which provides clarity as to the legal principles applicable to the exercise of the Commission's powers under the EP Law. The judgment highlights the principles which are applicable to the exercise of regulatory power by an authority for the purpose of safeguarding compliance with the law and protecting the reputation of the Bailiwick of Guernsey as a leading offshore finance centre.

Brief factual background

The Commission, acting through its senior decision maker (**SDM**), imposed discretionary financial penalties under section 39 of the EP Law upon the Appellants of £280 000, £90 000 and £30 000 respectively, and also made prohibition orders against each of them pursuant to section 33 of the EP Law, prohibiting them from acting in the role of controller, director, partner,

manager, money laundering reporting officer and money laundering compliance officer for periods of eight, four and three years respectively.

Each Appellant had been found by the SDM to have acted without probity in the course of performing their functions in their respective positions. The SDM also found that the Appellants were not "fit and proper" persons, on the basis of failure to meet the requisite minimum standards to hold the positions mentioned above, which was the basis for the prohibition orders.

Grounds of Appeal

The Appellants brought the matter to the Royal Court on appeal, essentially on the basis that there had been errors of law made in relation to the test for lack of probity, and further that the penalties imposed (both financial penalties and prohibition orders) were excessive and disproportionate (there were also other legal grounds of appeal). In particular, the Appellants contended that the assessment by the Commission of the seriousness of the failures disclosed by the relevant facts had been unreasonable, and had led in turn to unreasonable and disproportionate penalties and prohibition orders being imposed.

Findings of the Royal Court

Whilst a full examination of the technical legal issues underlying the Royal Court's judgment is beyond the scope of the present article, in summary the Royal Court found that the SDM had made an error of law in the application of the legal test for probity, as the SDM had failed to appreciate that the test for probity required an examination of the state of mind of each Appellant.

However, of greater general significance is the concern which emerges clearly from the Royal Court's judgment that the Commission generally adopted a closed-minded and unbalanced approach to dealing with the regulatory enforcement process as a whole. The Royal Court was critical of the approach of the Commission, stating at paragraph 412 that: "the Appellants first drew attention to, and sought credit for, mitigation on account of the major remediation steps which had been taken since June 2019, in their Response to the Draft Notice, contending that this should be taken into account to mitigate the proposed penalties. In its riposte to this, served in the letter accompanying the Final Notice, the Commission simply dismisses this mitigation", and the Royal Court goes on to describe the Commission's attitude in this regard as "extraordinary" and "disquieting".

At paragraph 479 the Royal Court stated further that "*I accept* that the Commission's function is to raise standards. I also accept that the Commission's approach to regulation is that of managing risk. However, the danger, it seems to me, is that approaching regulation with a dogged focus simply on risk can lead to a lack of perspective, where adherence to form and process are treated as more important than substance. Whilst the protective effect of requiring

adherence to policies, processes and controls is obvious, the Commission must surely, still, apply balance and common sense when determining whether and what sanctions to impose, in respect of defaults, if those sanctions are to remain reasonable and proportionate in the particular case."

At paragraph 480, the Royal Court observed that "the fact that a person has the temerity to question the reasonableness of the Commission's criticisms then provokes the further charge that the person thereby demonstrates failure to understand his regulatory obligations. I have found examples of this kind of approach throughout this case. It rather suggests that once any matter has been referred to the ED, it is almost a matter of honour that charges should be laid and severe penalties successfully exacted."

The Royal Court encapsulated the necessary balance to be struck at paragraph 481 stating that while the Royal Court did "not diminish the breadth and importance of the Commission's function…managing risk to the financial system and maintaining market confidence; ensuring fair, efficient and transparent markets, protecting financial services' customers and countering financial crime and the financing of terrorism…**there must be a balance in the manner in which the Commission exercises its powers which pays due regard to the individual's case**. I said, several times during the hearing, the Commission should surely wish its reputation to be that of being "firm but fair". I could even revise this to being "strong but fair", but on either basis, to be reasonable and proportionate, the sanctions which it imposes ought to show such a balance, " (emphasis added).

Summary of the Royal Court's criticisms of the Commission's approach

The Royal Court summed up its criticisms of the process and approach of the Commission at paragraph 482 of the judgment, identifying the following as problematic:

- "The background of an initial zeal by the ED for identifying faults, becoming the basis for the Draft Enforcement Notice and the fixing of the proposed sanctions"
- "A subsequent focus of the ED and the Commission becoming the perceived importance of repelling challenge, winning all arguments and finding justification for the Commission's initial decision"
- "…[The] flawed and unfair introduction of charges of want of probity at the Final Notice stage, based on no relevant further evidence"
- "Reliance for direct or indirect penal consequences, on a further charge (O Co) based entirely on compulsorily self-reported materials"

- "Refusal to give any appropriate recognition for very major, and apparently effective, measures taken to restore the administration of ATL's business to a proper track"
- "Failure to keep in mind the distinction between ATL the company, and the Appellants as individual persons, and consequent failure to consider and engage with the question of which defaults were properly and fairly sanctioned against ATL, and which against the Appellants personally"
- "Failure generally to pay fair regard to how far the matters of charge were historic, and specifically failure to observe the principle of non-retrospectivity of legal powers of sanction, even as a matter of fundamental fairness"
- "Failure to observe the Commission's own principle of consistency, by paying actual regard to the sanctions imposed by the Commission in similar cases..."

The Royal Court concluded at paragraph 483 that "any of the above, whether alone or in combination, provides an actual reason why the sanctions ultimately imposed on the Appellants could have become unreasonable or disproportionate."

On the basis of these findings, the Royal Court set aside the prohibition orders against the Appellants, allowed their appeal against public statements being made, and substantially reduced the financial penalties imposed on each of them. The Commission was ordered to bear the costs of the appeals.

Practical points to take away from the judgment

We would suggest that this judgment is a timely reminder and recapitulation of the basic principles of fairness (both procedural and substantive) which are to be observed by a regulator in the exercise of its functions of oversight and enforcement.

A number of key principles may be taken away from the judgment, as follows:

- It is necessary for a regulator to deal fairly and in a balanced manner with enforcement. It must remain receptive to the evidence provided to it by those being examined and must engage with this evidence in a fair and reasonable manner
- The above includes taking into account actions taken to remediate the failings in question, and the penalties imposed must be fair and proportionate to the failings identified
- The addition of a serious charge (such as lack of probity) at a late stage of the enforcement process, and without any further evidence to support this introduction, may be problematic
- Retrospective imposition of penalties is not acceptable

- Penalties imposed must be consistent with those imposed in other cases, and the issue of prior penalties compared to those being imposed must be carefully considered by the regulator

Conclusion

The principles as set out above are salutary and are quite distinct from the particular facts of this case (which is being taken on appeal by the Commission). We would suggest that, beyond the particular facts of this case, the judgment provides important lessons as to how the enforcement process should be conducted so as to comply with the applicable legal requirements.

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