



Guernsey Financial  
Services Commission

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**The Balanced Regulator and the Common Good**

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Many businesses around the world complain that their regulators lack balance. I can remember being in the Cabinet Office in 2004 and 2005 working on reducing the burdens of regulation and having representatives of the financial services industry complain to me that the FSA was, *inter alia*, unbalanced in its approach to regulation in so much that it was too demanding of industry. Then, of course, when I was at the FSA, we had the financial crisis and it became clear that industry had been very wrong indeed and that the regulatory pendulum had been in the wrong place – with far too much heed being paid to the notion that market forces made them in some sense self-regulating – with consequences the British economy and taxpayer have yet to escape.

What this experience taught me was that industry lobbyists will quite often tell politicians and civil servants that they are overregulated, irrespective of the underlying reality. The passion with which they express themselves is not a good barometer of whether industry is—objectively speaking – overregulated.

In the early years of this century, looked at from a British perspective, it might be thought that the idealistic socialism of my grandfather's generation, expressed in tomes such as Beveridge's *Full Employment in a Free Society*<sup>1</sup> had been replaced with a more media savvy centre-left political culture which idolised economic success, as measured through the accumulation of wealth. As Mandelson put it, he was “intensely relaxed about people getting filthy rich.<sup>2</sup>” This, when combined with the Blairite's intellectual acceptance of the Thatcherite view of the market as the creator of wealth led to an atmosphere in which, with the benefit of hindsight, the longer term benefits of sound prudential regulation of the financial sector were overlooked. It is arguable that political culture and ideology came together to create an environment in which financial services regulation was unbalanced.

Conversely, more than seven years later, if we observe the aftermath of the global reaction to the financial crisis we find, in some countries at least, that the political and mandarin classes (on both what is conventionally called the left and right) seem to regard finance and those who work in it as the root cause of all that is wrong in their economies. If nothing else, the financial sector is the convenient scapegoat for economic problems caused by issues such as low productivity, too short a working life relative to retirement, high taxes and generous welfare disincentivising work, too large a state sector and a lack of investment in education and entrepreneurship. Once again, it may be argued that political culture and ideology have come together to create a climate where regulation might be regarded as unbalanced.

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<sup>1</sup> Published 1944

<sup>2</sup> Made to a US industrialist in California in 1998

At the Commission we try to be empirical, where it is open to us to be so. We don't subscribe to the view that all financiers and financial firms are bad any more than we subscribe to the notion that they all do good. Experience has taught us that neither proposition is true but that we need to be balanced if we are to achieve good quality outcomes which favour the common good.

Balance is, in my view, the key to a lot of successful regulation. Today I'm going to talk a little about how we endeavour to achieve balance from a number of different perspectives.

- Firstly, in terms of resource organisation, at the Commission we have to make choices about how to balance resources between different areas such as supervision, policy and enforcement. The appropriate balance here may change from time to time depending on the demands which are made of us. We're currently trying to focus more resource on supervision than enforcement on the basis that prevention is better than cure and I'd expect that to remain the case though, in a small organisation such as ours, there may well be fluctuations from year to year. International or local demands may force us to take staff from supervision and enforcement work and put them on policy formulation in years to come if we are to maintain Guernsey's reputation.
- Secondly, we are seeking to use our limited resources in a balanced way though taking a structured approach to analysis of the impact and probability of something serious going wrong at any one of the firms we supervise. This is what we call risk based supervision. Under this system - which we will be rolling out to all sectors over the next 15 months - we will ensure that we spend time looking at all our largest firms whilst sampling our smaller firms. Further, we will clearly focus resources on firms we understand to be issue rich.
- In terms of our approach on the ground with firms, there will be a balance between trusting and testing. Testing everything we are told is deeply inefficient and limits the amount of ground you can cover but trusting everything we are told by a firm, as many regulators found to their cost during the financial crisis, is equally unwise. You should generally find supervisors work with you on the basis that you are telling the truth but you will also find that they will want to test some things – verbally, or through documentary scrutiny - to make sure they are doing their job properly, that they are correctly appreciating what you are telling them and that their analysis of the same facts is similar to your own.
- In terms of the subjects that will be covered during our supervisory engagements, you should, once again, see some degree of balance from us. The historic focus on checking compliance with manuals setting out controls has a place but it needs to be balanced by a fuller understanding of the firm, its business model and the character of those who run it. Going forward you should find that our supervisory teams do not seek to focus so much attention on analysing compliance with specific rules (legitimate though that is) but that they will also be interested in what makes your business tick, how you assure yourself that you have the right set of skills and characters sitting around your boardroom table and how you are seeking to manage your business risks (rather than just your compliance risks). We are investing heavily in training our teams so that they have the confidence to be able to undertake types of supervision which go beyond checking compliance – types of supervision which may

at times be less comfortable for both them and your compliance officer – types of supervision which the evidence of the financial crisis and its aftermath has convinced me are necessary if we are to obtain a balanced picture of a firm.

- Having analysed your firm, there is then a need for balance in what we as a regulator require of you. It is perhaps easier for a regulator to fall into unduly risk adverse patterns than it would be for those in some other walks of life. We want to make sure that we are balanced in the feedback we give you after supervisory work has been completed – that we are robust in requiring the mitigation of unacceptable risks but that we are balanced in not expecting or requiring that everything which might possibly be done - were you to aspire to be the most compliant firm in the industry - is done by the day after our visit. There is a need for proportionality. In terms of ensuring that we deliver this aim, we are deploying Risk Governance Panels internally within the Commission. These panels consist of a few individuals from within and without a firm's supervision team who will come together to read and critique a supervision team's analysis and risk mitigation programme items before these are sent out to a firm. By bringing together experience and expertise from across the Commission, these fora are designed to ensure that our front line team's analysis stands up to external scrutiny and that the messages we transmit to firms requiring action have been appropriately quality assured.

Our thesis is that, in seeking balance in what we do and how we do it, we best serve the common good. We could engage on a long philosophical discussion on the meaning of the common good but I won't attempt that here. Rather I'll seek to describe what in practical terms the common good looks like if the Commission is successful in Guernsey in taking a balanced approach to regulation:-

- Firstly, we will have both financial stability and good quality controls on financial crime without the prudential and process costs of achieving this destroying good quality and legitimate business. To this end, we will continue to adapt our prudential rulebooks to match generally accepted international standards, developed to avoid a repeat of the last financial crisis in the banking area. We will also, as I announced in September, continue to take forward work to not just bring our AML handbooks up to date with the requirements of the 2012 FATF regulations but also to ensure that they are easier to understand;
- Secondly, we will have a fair degree of consumer protection. To achieve this we will work with the new Guernsey Financial Advice Standards to ensure that those in industry are conscious of the standards they must meet before providing financial advice and that they provide good quality advice. Once again, we will be balanced in our work to achieve a fair level of consumer protection. We do not believe, unlike some involved in financial services conduct work, that *caveat emptor* is – *prima facie* – invalid but we also believe that there is validity to the Granny test. This consists, for those of you who are not yet familiar with it, of asking yourself, if your financially imperfectly literate grandmother had just been sold this product, would you be angry that she had been ripped off. In the field of consumer protection there is, as in other areas, a need for balance. Well advised consumers should not have a right to compensation just because an investment has not worked out but neither should

financial advisors feel that they have anything less than a duty to offer their clients good quality advice which has the client's interests at heart.

- Thirdly, we will have good quality rules which can be easily understood. Our rules should generally be open to a common sense interpretation and should not be susceptible to over interpretation by a compliance consultant or lawyer. Too often, I've seen rules which - of themselves - were quite reasonable, gold plated by fee hungry intermediaries between the regulator and the firms implementing the rules, adding cost for no gain. We've already announced that we will be looking again at our AML rules next year and I'm also in a position to announce today that the Fiduciary Supervision and Policy Division will be leading some work to look at our guidance on RATS pensions where we believe there is scope for simplification which should lower the costs of delivering personal pensions to Guernsey residents.
- Finally, we will have good quality interactions with the firms we regulate. By this I don't mean that we will agree on all the actions which should be taken to mitigate unacceptably high risks. Sometimes we will be able to convince a firm that the course of action we are commending is the appropriate one. At other times we won't and we will still insist on steps which the firm might not, of its own volition, take. What I would like to see, however, is, in most cases, firms hearing from us why we are asking them to take measures and us understanding why, if a firm objects, it is objecting. In the same way that, around a good boardroom table, you can have good quality discussions which arrive at a definite conclusion with which the whole board may not necessarily agree, we think the Commission and firms should be capable of having civilised grown up discussions which lead to sensible and pragmatic solutions to idiosyncratic problems those firms may face.

In summary, today I've talked about the need for balance in regulation and how, by being balanced, the Commission can serve the common good. Much of regulation is about striking the right balance, in terms of what to focus on, how to focus on it and how, having focused on it, to arrive at balanced judgments about what to do. My colleagues, in our later sessions, will set out some of our plans in more detail. We won't of course get all our judgments right all of the time; we would not be human if we managed this. We are, however, committed to having good quality interactions and processes which help us get to appropriately balanced judgments as often as possible and, through doing so, serve Guernsey's common good.