Guernsey Financial Services Commission

Industry Seminar – 6 December 2013

Investment Supervision and Policy Division Presentation:
Markets in Financial Instruments Directive II – Importance to the Bailiwick

Emma Bailey, Deputy Director

Thank you Louise.

Good Morning everybody.

As you may have heard from the speakers yesterday or deduced from the invitation the theme of this year's seminar is "the balanced regulator and the common good". So in order to bring some balance, whilst Carl and Louise have provided eloquently an overview of the international issues impacting the investment sector of financial services in Guernsey, it has been left to me to discuss matters closer to home.

One of the more mundane domestic challenges we have faced this year, which you may have noticed is that during the course of the year the Investment Business Division or IBD, changed its name to the Investment Supervision and Policy Division or ISPD - why have a three letter acronym when you can have a four letter one.

ISPD, particularly the PD, it strikes me that it makes us sound as though we're an American TV detective show from the 1970s or 80s, ISPD with a bit of imagination we could be liken to one of my favourites being Charlie's Angels. Clearly Carl would be Charlie with myself & Louise as the brunette angels, leaving Mark Le Page to be our token blonde! Perhaps that should have been with a great deal of imagination. You can probably see why we tend to refer to ourselves as simply Investment now.

For the purpose of today I am, in the use of the term "domestic challenges" referring to matters that are experienced at a local level by us as a jurisdiction rather than being imposed on us by international standards. And those matters apply regardless of whether the investors involved are local or internationally based.

Unsurprisingly, our market in the Investment sector is predominately international, and AIFMD and MIFID have both focussed our attention on gaining a better understanding of the investor base, but it is important not to forget the domestic market. In Investment we work closely with our colleagues in the Conduct Unit on the domestic front. Those of you who have chosen to stay on after the coffee break, will hear later this morning from Rosemary Stephens assistant director of the Conduct Unit, who will be speaking to you on the topic of Consumer Protection from both an investment and insurance perspective.

The importance of striking a balance between international and domestic challenges for the investment division was shown through our divisional objectives for 2013 where of the three objectives set two had an eye to international developments and the third was domestically focussed; to undertake appropriate supervisory visits. And in contrast to last year I am pleased to report that all three objectives for 2013 have been and continue to be met. Through the latter half of the year a further domestic focussed objective has emerged for the Commission as a whole; the implementation of risk based supervision in which of course Investment is involved. The Director General covered this topic yesterday so I do not propose to go into too much depth today and copies of William's slides and speech will be available from our website in due course. However, I would say due to the volume of entities and products we supervise in Investment, we have operated on a risk based approach, albeit it less formally, for some time now. We therefore welcome the introduction of the framework William described yesterday as a formalization of that approach.

Of course it is has and always will be difficult to separate international and domestic matters. Whatever happens locally will inevitably have an impact in some shape or form on the perception of Guernsey on the international scene. This is why communication has been and will continue to be an important part of our role as supervisors. Most challenges can be overcome through communication. But as George Bernard Shaw the renowned playwright and founder of the London school of economics is attributed to having said "the single biggest problem with communication is the illusion that it has taken place".

The three domestic challenges I will focus on today, investors, auditors and statistics actually come down to communication in one form or another and may be examples of merely the illusion of communication.

Investor communication – timely & frequent, clear, directed.

I touched on this topic at last year's seminar and it is a matter that has continued to occupy our time during 2013. Communication with investors starts with the supply of a prospectus or terms and conditions document. Prospectuses are often, as we know, lengthy tomes which are rarely read cover to cover and there is a move in certain spheres of international regulation away from the reliance on disclosure and caveat emptor. However, as William said yesterday the Commission feels that there is still a place for caveat emptor but balanced with the application of the "Granny Test". The Granny Test is simple: how would I have feel if this product had been sold to my Granny? Personally speaking, I would not have any worries about my Gran, she was a tough old bird from the generation that was careful with money so much so she could make the leftovers from the Sunday roast stretch to provide meals for everyday of the rest of the week. In fact if the home economics of my Gran and her friends had been practised by certain global financiers there may have been a different story to tell about the financial crisis. But my Granddad on the other hand, was a very different kettle of fish which perhaps explains why Gran use to make him hand over his weekly wage packet and dish him out an allowance. Anyway I digress, the point is more vulnerable people, less financially astute people, need us all, supervisors and industry, to keep in mind their needs but for us to do so without limiting choice.

Other than at the outset of a relationship communication with investors often increases during periods of difficulty. On the whole the industry's response to handling investor communication has been impressive. We recognise that dealing with a fund with problems or handling clients where performance returns are not matching their expectations is at best extremely difficult. In these circumstances we expect investor communication to be timely, frequent, clear, all fairly self-explanatory I'm sure, but for it also to be directed to make sure it reaches as many of the investors as possible. Local service providers go to great lengths to ensure that investors receive the appropriate information. And often at costs to them that far exceed any fees that they may receive.

Last year I told you that we had spoken to a number of investors on the telephone, and following letters this tends to be our main means of communication with the investors, but during 2013 we have, at their request, held a number of meetings with investors in person. Clearly investors, in travelling to the island, have gone to some considerable trouble to come and meet with us. Often the meetings will last for two hours or more but that is only right to make sure the investors feel it was worth their while.

A few hours of contact with investors is I imagine just a taster of the level of contact most of you have with the investors or your clients but does at least show that we often have a common sense of purpose in trying to help the investors from both sides. At times our involvement can assist the investors in seeing the situation from a wider perspective or open up channels of communication which have become blocked.

Auditors – Section 27A, qualification of accounts, meetings with the Commission

The majority of you are probably unfamiliar with the finer detail of Section 27A of the Protection of Investors Law. As auditors do not form part of our licensed community there are unlikely to be many in the audience here. So why bother flagging it with you? Well S27A concerns how auditors should communicate with the Commission whilst conducting their audit reviews on the licensed entities and the regulated products.

In brief Section 27A, applies to anyone in their capacity as auditor to a licensee, an authorised or registered collective investment scheme or a client who appears to be carrying on controlled investment business. It is the duty of the auditor to communicate to the Commission matters to which the auditor has reasonable cause to believe is or is likely to be of material significance for determining either

a) Whether a person is a fit and proper person to carry on controlled investment business, or
b) Whether the Commission should exercise its powers under the Law in order to protect investors from a significant risk of loss.

Are Auditors aware of it? And what does it mean in practice? I would say that over the last few years we have had cause for discussions with all of the major players in this field under the auspices of Section 27A. These discussions have not always been instigated by the auditors however, and we have had need to approach them for information. The circumstances in which we do so varies but includes as you might expect difficulties in reaching agreement in finalising the accounts, events causing the auditor to qualify the accounts and disagreements over the correct valuation basis.

Our interaction with auditors is likely to increase but we will proceed with care. It has been said that external auditors can often appear an attractive option to a hard pressed supervisor as they are already knowledgeable about a firm and they have a helpful veneer of independence. But any assistance sought by us from the auditors will always be considered in the context of the client relationship in existence and any previous clean bill of health provided to the licensee or regulated product prior to failings being discovered.

Statistics

Part of my role in the Investment division is to help oversee the preparation of the statistics we collate from relevant investment licensees on a quarterly basis. Whilst it is never my favourite task and certainly in my view a domestic challenge, I do recognise the collation and publication of the statistics are a necessary evil. We hope you have been encouraged by the progress that Tim reported on earlier this morning with regard to online submissions as the statistics are certainly an area that would benefit both you and us from being submitted online.

When I started preparing this speech I was in an optimistic frame of mind and had presumed the statistics for quarter 3 would be complete and even been released. Unfortunately that is not the case but we anticipate that the statistics will be issued early next week. I can say that it appears the overall funds under management has fallen over the quarter which I know is not the best news but the numbers of collective investment schemes in existence in all categories has increased.

In planning this presentation I thought about how we might try to take the statistics and use them to communicate in a perhaps more meaningful way. There are a few questions or points of interest which I noted would be worthy of further consideration.

For example:

We know the success story of private equity and roughly half of the Guernsey closed ended funds in existence describe themselves as being private equity but what else is there?;

Closed ended funds still significantly outweigh open ended funds and as you know we have gone through boom periods of the launch of closed ended funds so what does that mean for the average life of closed ended funds? Will there be a point when a significant number of funds come to the end of their lives?

I do not have the answers to either of those points today but we will follow them up as this type of information may be helpful in the discussion of the future strategy of the Investment sector in Guernsey.

One final area for further consideration is the statistics we collect from the asset managers and stock brokers. These statistics complete the picture for the investment sector but we have for some time been mindful that the Form AM should be reviewed to ensure that double counting is eliminated and as with all communication that it is meaningful. Again this is something we will endeavour to make sure is done

To wrap up; communication has been the underlying theme of my part of the presentation this morning. In my view and I hope you would agree the most effective means is face to face, where all nuances of behaviour can be witnessed, tone and emphasis of voice, body language, eye contact all play a part. Face to face allows room for listening and negotiation; revisiting matters if misunderstandings occur, which is why of course physical board meetings are always the best (you must have known I would mention corporate governance somewhere). The written word (and indeed the written number) can be interpreted in many ways, be pored over and a misplaced comma (or decimal point) can change the entire meaning of a phrase or value. However, we operate in a world of high tech communication with social media ever encroaching into the business world and expectations of its use ever increasing.

But of course communication can go wrong particularly where we rely on the dark art that is predictive text; A friend recently sent me a list of predictive text flops all of which were highly entertaining but most of which are too blue to share with you today.

So whilst acknowledging that we need to embrace the new world of communication I caution against allowing it to replace face to face altogether (or at least the principles of face to face) and leave you with this thought;

"Electric Communication will never be a substitute for the face of someone who with their soul encourages another person to be brave and true"
(it could have been written yesterday)

Charles Dickens

Thank you for your attention.