Guernsey Financial Services Commission

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Banking and Insurance Division

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Good day. Thank you for still being here today.

In the next twenty minutes or so, I will summarise recent key developments in each of the sectors covered in my division – that is banking, insurance and insurance intermediaries.

I would like to start however by addressing one aspect of the theme of this seminar. That is whether, and if so how, the regulation of banking and insurance might change in the wake of the pandemic.

It seems to me that the regulatory rules around banking and insurance have been adequate to face the pandemic. Due to sufficient capitalisation, banks have been able to lean into the wind and lend to third parties: albeit supported by G20 governments. Tough liquidity requirements have worked. There are still significant headwinds to face such as asset inflation and provisioning; but so far so good. In the UK, the FCA had some success in championing fair treatment of policyholders in the case of business interruption; without a systemic impact on the insurance sector. No insurance company has been caught operating outside its zone of comfort. Regulators have also worked co-operatively with bankers and insurers during the crisis. The temporary postponement of regulatory reporting is an example of this. Unlike in the wake of the 2008 crisis, I therefore doubt that we will see another avalanche of new capital and liquidity regulation. At least, I hope not.

During the pandemic, working from home became the norm. More and more customers started using internet or mobile banking. The use of contactless payments grew considerably. The use of cloud services increased. I suspect that, in some indefinable way, these practices have accelerated what might be broadly called the digitalisation of both the banking and insurance industries.

It seems reasonable therefore to expect regulators to step up their interest and possibly the extent of regulation in this area. The key phrase will be Operational resilience. This applies at the firm, sector and systemic level. Operational resilience was already a subject of major regulatory interest before the pandemic. By combining increased digitalisation with a global crisis, operational resilience becomes even more germane. Key aspects are cross-border outsourcing, business continuity planning and cyber-security. Although not in my remit today, regulatory focus on the resilience of payment systems will increase; given technological advances in this area.

For both the banking and insurance industry, digitalisation is about commercial survival and cost reduction. This begs the question as to what digitalisation means for customers. Does it mean poorer service for most and the marginalisation of the vulnerable? Or, slicker and better service for all? Society will look to financial regulators in the first instance to address failures in this area.

To summarise this section, I do not expect regulators to re-hash capital and liquidity rules in the wake of the pandemic. Instead, regulatory interest in operational resilience, and especially anything with an IT aspect, will markedly increase. Senior management at licenses, as well as regulators, will want to continue to deepen their expertise in this area.

Moving on, I would like to start with the banking sector; and then later discuss insurance and insurance intermediaries.

Since Covid emerged, those banks dealing with the Bailiwick public have had much asked of them both in taking appropriate health measures for staff and customers on the one hand, yet still maintaining an essential service on the other. The local banks have done a good job in striking a balance over this difficult period; remaining open at all times. Local banks have also continued to provide support for the local mortgage market.

Private Banks had an easier job in that fewer of their customers live locally. Nevertheless, in their case, the transition to working from home took place with relatively few glitches. All of which demonstrates the benefits of business continuity planning, and adaptable IT systems. Enhanced IT investment over the pandemic period may help private banks compete against digitally perceptive boutiques.

In March, the Commission issued a Consultative Paper on Basel III. There are fewer and fewer subsidiary banks in Guernsey and this is part of a global trend. The Commission is not going to imitate Canute and try to stop this shift away from subsidiaries. On the other hand, the Commission recognises that subsidiaries remain a viable option. Therefore, the Commission will continue to ensure that Guernsey banking regulations are in line with international standards; hence this paper. It is also why we continue to work with the States of Guernsey to establish a bank Resolution Committee in the near future.

Looking forward, there are several key challenges for banks. One is the continuous need to abide by financial crime regulations – a point I make in every industry seminar. As international requirements are constantly changing in this area, this is like painting the Forth Bridge. However, not to do this either at the group or local level is damaging to both the bank and the jurisdiction. Another challenge is to calibrate lending accurately. According to official estimates, both the UK and the Guernsey economy contracted significantly in 2020. Banks therefore have the difficult job of continuing to lend to prevent a further downward economic spiral, whilst at the same time maintaining sound lending criteria. Whether the banks have walked this tightrope successfully will only be seen in the coming years.

Finally, I would refer to the case this year of a bank fined by the Jersey Financial Services Commission – and yes, in case you wondered, we do talk to each other. This was in part because it had inadequate local compliance resources. This problem can apply in Guernsey too. I would therefore urge Guernsey bankers to keep speaking up for Guernsey when it comes to dividing out scare compliance resources. Your voices need to be heard at group level; otherwise Guernsey risks being left out.

Turning to insurance, last year saw a slight drop in licence numbers. We should not be too worried about this. If you are a UK firm dealing with Covid, now may not be the best time to set up a captive. However, the long-term business case is there for the future as rates harden. It is however more difficult to forecast the future for ILS, MGAs and longevity.

In terms of policy, except for green insurance, which I will mention later, the Commission has given both itself and the insurance industry a break last year. This was in the wake of a series of policy changes initiated in front of the 2019 IAIS inspection. There are still some additional policy changes required after that inspection. However, the main message of the inspection report – which you can read on our website - is about the need to do more insurance supervision. Despite this, firms periodically lobby for lower fees. For those firms that do this please can you consider how this plea a) fits in with the IAIS report and b) that lower fees for you mean higher fees for somebody else. Incidentally, the insurance sector in particular often asks the Commission to turn on a sixpence in response to the latest new idea. Again, the industry needs to remember that in starting work on one person's or one sectors' initiative, we have to stop working on something else, given that resources are very limited.

I have two key thoughts for the insurance sector. Last year, the Commission fined an insurer in part for inadequate control over outsourcing. If an insurer chooses to outsource activities outside Guernsey, please make sure that it does so in a controlled environment. Too often, it is 'out of sight out of mind'. This is the wrong frame of mind, especially for a jurisdiction that, given its size, relies so much on overseas outsourcing. Secondly, and again this touches on the fined firm, those insurers who serve the retail public need to take especial care around compliance, control and governance. There is a material difference in a captive insurer covering parental risk, to an insurer providing insurance for the man-in-the-street. In the experience of the Commission, not all insurance managers understand this and some approach the service required for a retail insurer with the same mind set as if it were a captive.

Finally, there are the local insurance intermediaries. I refer firstly back to the beginning of the Covid outbreak in spring 2020. At that, time there was much uncertainty about travel and health insurance. The Commission developed a bank of FAQs to answer public questions. We could not have done this without the help of general insurance intermediaries. As with the banks, local intermediaries spent much time supporting the local community in a period of uncertainty.

The on-going issue troubling everybody is the difficulty of securing an appropriate level of professional indemnity insurance for insurance intermediaries. This is of course a wider issue that affects many other sectors such as fiduciaries; and it is not particular to Guernsey. It would be easy for the Commission simply to lower its regulatory requirement in response. On the other hand, this might not actually solve the problem and poses questions about consumer protection;

especially in a jurisdiction without a financial services protection fund. We have been talking to many insurance intermediaries. We intend to take this forward soon.

Unlike the banks and insurers in Guernsey, there is no trade organisation for insurance intermediaries. Whilst we are in touch with several intermediaries bilaterally, this means that is important to hold an assurance meeting with intermediaries at least once a year. Covid has meant that this has been impossible but we are keen to start up these meetings again soon.

Whilst, so to speak, on the consumer side there is the Credit and Finance Policy Letter which the States agreed earlier this year. Primarily, this means that credit provision will become a licenced activity in Guernsey. In particular, this brings non-bank lenders and brokers into the regulatory scope. The Commission engaged with lenders in 2016 and 2017 on this. We will build on this work, now that the government is moving ahead with draft legislation. This will provide additional confidence for the Guernsey public in the local financial system. However, this project is a significant one for Guernsey and its residents. In particular, this project will shine a light onto the plight of those people in Guernsey encumbered with debts that they cannot repay. There will be much activity in 2022. Indeed, the more I work on the project, the more I realise the extent of its scope for lenders, brokers and borrowers.

A notable part of the Credit and Finance is the States to bring into the regulatory scope digital lenders and facilitators. These include platforms facilitating crowd- funding and peer to peer lending, AML platforms and Virtual Asset Service Providers. The benefits of this are to ensure that the Bailiwick moves with the times in terms of customer protection and to ensure that there are no anti-financial crime gaps in our regulatory framework.

There are two areas worth mentioning that touch on all the above sectors.

The first is the continuing need for vigilance around cyber-security. Earlier this the Commission published cyber security rules. A common global observation around cyber security is that boards tend to pigeon-hole cyber-security as an IT issue and to overestimate the efficacy of their mitigation. It is therefore important that Guernsey licensees take care to assess and mitigate effectively the cyber security threat. Working from Home during Covid makes this even more urgent.

The second area is the increasing relevance of climate change; especially relevant this afternoon as it is world Earth Day. The Commission has put its nose in front of others on climate change, not least by issuing green capital rules for life insurers this year. The Commission is also active in various international bodies to ensure that the point of view of a smaller jurisdiction is taken account of. The Commission is maintaining momentum in the Bailiwick through its Spring Consultation paper. This suggests that all boards should consider how climate change affects their business and risk profile. In the case of groups, this has to be done in line with group policy, not least for banks and captives. Nevertheless, climate change will increasingly form part of the regulatory dialogue in the Bailiwick; as elsewhere.

Outside Guernsey, international regulatory attention in the banking and insurance spheres has continued to focus on climate change issues, despite Covid. We can expect a plethora of global regulatory material on such issues as disclosure, scenarios, data cleansing and collection, modelling and nature risk in front of COP26 in Glasgow in November.

Whilst speaking of international regulation, the last year has seen no travel. Nevertheless, we have been in close touch with other IFCs through video. In particular, the Group of International Insurance Centre Supervisors has been key, not least in hand-holding during a difficult period. These contacts have also helpful is calibrating our response to the crisis.

Drawing now to a conclusion and looking ahead, the future is mixed. For banks, the net interest rate margin will remain tight and some lending may turn sour as official support eases. Insurers, whether general or captive, should benefit from a continuing hardening of the market. Intermediaries should see travel insurance pick up. Nevertheless, there is, in my opinion, a long-standing and increasingly real threat to financial stability in the form of inflated global asset prices. On the other hand, crystal balls have become curiously out of fashion in recent years.

So, thank you for listening. In addition, thanks to all those cats, dogs, and in one case, hamster, who have made a personal appearance, with their human pets on my video calls over the last year. Alas, no geese.