



The Commission's International Role

Guernsey Finance Industry Update
Wednesday 4th September 2013

I was delighted to be asked to come and talk to you by Fiona this afternoon. I've just come back from an International Conference in Cambridge where the focus was very much on how financial services regulators and other agencies can co-operate with one another and with the private sector to make the environment safer for those undertaking legitimate business.

At Cambridge yesterday a senior civil servant from Bermuda made a speech about the difficulties smaller jurisdictions face in having the capacity to comprehend and implement all the new standards and initiatives which have been developed since the financial crisis. I'd certainly share some of his concerns and at the Commission we believe it's important for there to be efficient co-operation on policy matters between public authorities in Guernsey, with appropriate industry input, if the Bailiwick is to be able to prosper in an environment where the international scrutiny of our collective actions has never been higher.

Since I started in Guernsey I've met Fiona several times and we plan to meet regularly going forwards. Together we represent two things which the States of Guernsey has made clear --over a number of years that it believes in – effective regulation and high quality financial promotion. Originally, of course, the Commission had both roles but the Edwards review in 1999 concluded that that was no longer sustainable given the conflicts of interest inherent in the two roles. I'm certainly glad that he made that recommendation and that Guernsey accepted it as I've no desire to be responsible for financial sector promotion as well as financial sector regulation – I'm happy that Fiona has the really hard – albeit the slightly more popular – job.

Having said that we can't do promotion, I don't think the Commission, as the servant of the Guernsey can or should pretend to indifference about the health of the financial sector in the Bailiwick. There is an inevitable symbiosis between the financial sector and ourselves. At its most mundane, industry pays the fees that we require to function whilst we provide the licences which give firms a right to trade.

Now some may quite reasonably ask whether the general sum of human happiness would be enhanced if we neither received fees nor provided licences or, at the very least if we charged very low fees and did nothing but provide cheap licences. Such a system might have merit if we all lived in self-sufficient country pursuing autarkic economic policies, indifferent to trade with the outside world. By contrast with such a hypothetical autarkic state Guernsey has, over a number of centuries, built a significant amount of its wealth on trade. In the last three decades that trade has been in financial services to a great degree. Whilst some might like to hark back to their privateering ancestors and suggest that a letter of marque, raw courage and a well drilled gun crew is all you need for success, the rules of engagement in the financial services sector have changed markedly over the last few years.

If our funds, insurers, banks and fiduciaries are to be allowed to engage with potential clients beyond the shores of the Bailiwick, they need to have their licences issued by an authority which is regarded as credible by the Commission's peers. This means that we need to do far more than simply issue licences. Rather we need to make sure that the scrutiny we apply to firms wanting licences is appropriately robust, and that we continue to actively and effectively supervise those we licence and that we do so to the international standards laid down by IOSCO, the IAIS, the Basel Committee and FATF. If we don't do this our licensees will rapidly become worthless and those we licence will be inhibited in their trading with counterparties outside the Bailiwick.

Many of you may, at this juncture, be asking why I've spent nearly five minutes stating what, to you, will be pretty much common sense. I've done so because Fiona asked me to comment on my first impressions of Guernsey. One of my first impressions is that a lot of people in the island have a view on financial services regulation and I have to admit to being somewhat uncomfortable with some of the views I've heard because they appear, in many ways to hark back, if not to the French Revolutionary Wars, at least to the last century when international tolerance of regulatory arbitrage and indeed tax arbitrage opportunities were hugely different from that which exists today.

I don't like to think I'm preaching a new gospel in saying this. Certainly the conversations I've had with a significant number of the men and women running some of the largest firms in the Bailiwick lead me to believe that they have a similar world view to mine and that they well understand modern international regulatory requirements and how vital it is for Guernsey to keep up to date with them if we are not to lose our reputation as a good place to do business. Because many at the Commission, the States of Guernsey, St James's Chambers and industry have worked hard in the past, Guernsey has generally had good international reviews of its regulatory standards and that has helped Guernsey

keep its reputation as an attractive investment destination. Keeping such a reputation is not an easy thing. As I mentioned at the start of my speech, many international standards have been revised in recent years and have become much tougher with levels of detail explaining how adherence to the standard is to be assessed, levels which would have been near unthinkable a decade ago.

I think both regulator and industry may sometimes daydream about being able to step off this global regulatory tread mill and say, “enough is enough, this has become too difficult, I’m not going to play anymore – go away and leave me to supervise or make money in peace.” Were we collectively to do this, we would lose a large percentage of our financial services businesses within a relatively short space of time.

As the Commissioners and I see it, the Commission has a significant role in helping Guernsey prosper. We see ourselves as best helping Guernsey prosper by executing good quality regulation to international standards with integrity, proportionality and professional excellence – what internally we’ve styled “Winning for the Bailiwick”.

If that is our philosophy (or to be more precise, our interpretation of our clear duties and obligations as set out in the 1987 Financial Services Commission Law), I’ll now set out some of the practical things which we are seeking to do to play our role in helping keep Guernsey both competitive and respected.

International Work

I mentioned earlier how important it is for Guernsey that our regulation continues to be respected by the Commission’s peers across the globe. This is not a one off exercise for the Commission any more than regulation is a one off exercise for any regulated firm. Rather, retaining respectability requires constant work by the Commission.

Supervisory authorities can no longer hope to function in isolation from the modern global regulatory order. You’ll all remember that the British Empire gave up its policy of splendid isolation in 1904 when it entered into the Entente Cordiale with the French - at that point the Empire spanned nearly a quarter of the globe and British politicians, even then, considered isolation unsustainable when faced with increasing foreign threats. 109 years after the Entente the Commission takes the view (especially considering the size of Guernsey relative to the Edwardian Empire) that it is important for Guernsey to be recognised as abiding by respected international regulatory norms for good quality independent financial services regulation. At the Commission we wouldn’t deny that the siren voices urging arbitrage can sometimes sound attractive – not just to the regulated but also to the overworked regulator – but we may remember

from our Greek studies that the sirens have always merely lured poor sailors to uncomfortable deaths on rocks.

In terms of who we work with our most frequent counterparties are, on balance, the regulators in Jersey, the Isle of Man, the Bank of England and the Financial Conduct Authority. But we must also be mindful of the governments in those jurisdictions as well as the G20, the Financial Stability Board, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions, the Financial Action Task Force on Money Laundering, the Group of International Finance Centre Supervisors, the Group of International Insurance Centre Supervisors and the European Union. The EU umbrella itself includes the European Commission, the European Banking Authority, the European Securities and Market Authority, the European Insurance and Occupational Pensions Authority and the European Central Bank.

All of these other authorities and bodies have an impact in some way or the other on the Commission and, therefore, the financial sector. They would all perceive themselves to be stakeholders in what the Commission does.

For many years the Commission has been mindful of the activities of, and our relationships with, the overseas world as represented by the international bodies I have mentioned. At a minimum, a watching brief has been maintained so that we are well informed and up to date with developments and therefore reasonably placed to take any necessary action in relation to those developments. The Commission is a member of some of the international regulatory and supervisory associations, and actively involved with some of their work. This enables us to:

1. monitor international developments and initiatives and understand the reasons behind and implications of these developments and initiatives;
2. contribute to the development of international standards for the benefit of the Bailiwick;
3. learn from the experiences of overseas regulators and supervisors, and share good regulatory and supervisory practice in light of the Commission's experiences;
4. understand the implementation of international standards in other jurisdictions and contribute to the evaluation of compliance with those standards;

5. develop close relationships with our key overseas counterparties which are vital when we find ourselves dealing with a troubled firm with interests in multiple jurisdictions, trying to design an equitable outcome across borders; and
6. enhance Guernsey's credibility with overseas regulators and other bodies – challenging some unfortunate preconceptions which exist about IFC regulatory standards in some onshore jurisdictions.

With AIFMD our work with the UK FCA, the Jersey and Isle of Man Commissions, ESMA and other European Supervisors has been important in seeking to ensure a reasonable outcome for Guernsey firms.

This is only one example. Guernsey was one of the founder members of the International Association of Insurance Supervisors (IAIS). For many years we have been a leading voice within the IAIS in relation to captive insurance. We led the drafting group for the current IAIS paper on the international supervisory standards for captive insurance and we chair the drafting group preparing the next version of those standards which is scheduled to be issued next year.

Within bodies such as the IAIS you cannot expect to be merely a silent presence if you wish to have sufficient credibility to lead important work on international standards – work which affects Guernsey. We therefore continue to put effort into maintaining an active presence in the IAIS so that we have that credibility.

We are also leading work in the Group of International Financial Centre Supervisors to renew standards for the supervision of fiduciaries. This work is linked to the drive in the G8 and others for increasing transparency of beneficial ownership of legal persons and legal arrangements. The revised standards from GIFCS should offer more comfort to the countries driving the increased transparency initiative that trust and company service providers in international finance centres are legitimate and respectable.

In fact, this theme of putting in effort to seek to ensure credibility for Brand Guernsey runs across a lot of our international activity. In essence, we aim to work hard with our international counterparts to assist them and to represent Guernsey – thereby maintaining and renewing Guernsey's reputation as a well regulated jurisdiction.

Our liaison is not only with international bodies. We spend significant time talking to colleagues in Jersey and the Isle of Man on a variety of matters.

For example, there is considerable coordination of work by the three Commissions in relation to Basel standards for banks. Our response to Basel II

was coordinated with the other islands and the same approach is being taken in relation to Basel III. We have also spent a lot of time coordinating approaches to the UK's proposals on ring fenced banks.

More recently, we have suggested it is timely to consider how best to seek further alignment between the Guernsey, Jersey and the Isle of Man AML/CFT Handbooks. Some believe that groups with operations in more than one Crown Dependency might benefit from a greater consistency of approach. Discussions between Commissions in the Isle of Man, Jersey and Guernsey are already taking place on whether there may be some scope for further alignment, especially in the context of the new 2012 FATF standards which will require revisions to our AML Handbook.

In practical terms the new Financial Crime and Authorisations Division will be undertaking several activities over the next year which we hope Guernsey firms will welcome. These include the posting of clarification and guidance on the Commission website in relation to various areas of the Handbook's requirements about which queries have been received from industry, and later, a review and revision of the AML Handbooks in an endeavour to simplify and clarify its contents, as well as of course, making it compliant with the 2012 FATF standards. As part of this latter project we will be looking to form a working party comprised of representatives from the regulated financial sector as well as continuing work with the other Crown Dependency regulators.

Turning to developing Guernsey's links with prospective new markets, while the Commission is clearly not in the business of business promotion we can properly contribute in this area in at least two important ways:-

1. Firstly, by explaining our approach to authorisation and supervision to governmental and supervisory authorities during visits like the one to China which Guernsey Finance is undertaking in November with Commission participation. Such discussions might cover whether or not our supervisory framework is equivalent to a jurisdiction, our views on particular products, risks, or on customers from a jurisdiction. All of this can contribute to creating an environment in which the authorities of other jurisdictions are comfortable with Guernsey. At the most basic level they will know they can pick up a 'phone and talk to somebody at the Commission.
2. Secondly, we can help contribute by establishing MoUs with equivalent regulators in overseas jurisdictions so that they can become comfortable with Guernsey as an operational centre for financial services firms from their domicile.

Other Support for Guernsey

In addition to the international activities I've already spoken about the Commission is undertaking a number of internal initiatives which we believe will be helpful to Guernsey firms:-

1. Firstly, there is the new innovation unit at the Commission which went live one month ago and it has already had a number of interesting conversations. One issue which we have had in the past is people coming to the Commission and asking for a novel type of business to be authorised. There are, as everyone will understand, some types of business which we understand well on sight and can evaluate fairly easily. There are other types of business which are quite novel where we need to do considerable work to understand the likely costs and benefits of the business to the Bailiwick before we can come to a balanced judgement. The innovation unit gives us some ability to do that.

It doesn't mean that we are going to accept every innovative proposal. As you will appreciate, innovation can mean dangerous and ill thought through "get rich quick" schemes and one of our core roles is to protect the Bailiwick from harmful "innovation" which could undermine other firms in the jurisdiction as well as customers of the firm seeking a licence. That said, as something of a follower of Prof. Michael Porter's theories of competition (he happened to be a director of a strategy house I once worked for) I think that we collectively need to accept that Guernsey must evolve as an island to retain its prosperity. It may need to develop new areas of competitive advantage. The Commission wishes to be able to provide appropriate regulatory input into proposals to develop new areas.

2. Secondly, moving on from innovation, we have recently published service standards for key regulatory interactions such as authorisations. We appreciate that being timely is a key attribute for a financial services regulator. To be very clear, we will take as much time as we need when we think proposals put to us require further investigation but it is helpful to have standards with which we seek to comply so that industry can have some reasonable expectations as to when it will receive a licence, assuming we are minded to approve the application. We think, for potential introducers of business to Guernsey, it is helpful to know the speed at which they may reasonably expect the regulator to respond.
3. Thirdly, we are implementing risk based regulation – this will be one of the main tools for ensuring our operational compliance with international regulatory standards. We are investing in a formal system of risk based supervision which will be rolled out over the next two years. It will see the Commission segmenting firms according to their ability, if they go

wrong, to damage the Bailiwick. It will then engage most with the firms which would cause most damage were they to go wrong and with firms the Commission has already identified as issue rich.

Risk based supervision will also embed formal quality control processes to underwrite the consistent treatment of firms. The focus will be on resolving significant issues at firms which create unacceptable risks to the Bailiwick. In our engagements, there will be an increasing focus on governance and understanding business models (by which we mean how a firm makes its operating profit and what risks it takes to make that profit). We think that this new approach will lead to our detecting more meaningful risks more quickly, thereby enabling us to work with the firms in question to mitigate those risks before they become crises. (I should of course make clear at this point that, contrary to popular opinion, we are merely human and that we will not spot every risk which goes bad any more than a board of directors).

4. Fourthly we are developing electronic returns. Many onshore regulators now ask firms to submit regular information to them electronically. Starting with Personal Questionnaires and Personal Declarations, we plan a programme to roll out electronic reporting for all our firms so that they will be able to submit high quality information on line to our data warehouse where the information can be automatically processed. We see efficiency gains for both industry and regulator in being able to submit and review such information electronically. A NED who I was talking to recently was enthused when I told him that this should enable him to automatically reuse details about himself each time he submitted a Personal Questionnaire or Declaration. In fact, so enthusiastic was he that I did wonder if I needed to be keeping a closer eye on quite how many boards he was planning to be on.
5. Risk based supervision and electronic returns will take time but, fifthly and more immediately, we have recently rolled out a new approach to correspondence at the Commission. Our teams will be working at having more conversations - both face to face and on the telephone - whilst writing fewer letters. Those letters we write should generally be less legalistic in tone than those we may have written in the past - certainly you shouldn't generally need a lawyer to help you understand them. I also hope you will find that whilst we will remain appropriately formal, the tone of the communication will change. This doesn't mean we will be less demanding where we see poor practice but the executive at the Commission hopes it will open the door to having more practical conversations about issues we find at firms and how best to resolve them in the best way for Guernsey.

Conclusion

To conclude, thank you for listening to the Commission's thoughts on how it works to help and will continue to work to help keep Guernsey prosperous.

In summary:-

- We are engaged in a range of domestically focused initiatives which we believe should be helpful - including an AML Handbook review; establishing our innovation unit, having service standards for authorisations and changing our approach to correspondence.
- Further, we continue to work internationally with our counterparts to demonstrate, through our words and our deeds, that Guernsey is a domicile on which they can place reliance. We will continue to work to prove that Guernsey is worthy of their respect through our international activity, our assistance to other regulators, and our domestic work to introduce risk based regulation. Through these activities we aim to ensure that the licences we issue are a valuable commodity, not perhaps quite as compelling as a Letter of Marque once was, but certainly a seal of approval which is worth something beyond the shores of the Bailiwick. In that way the Commission believes it best serves Guernsey and, in a proportionate and professional manner, can help the Bailiwick to sail in shoal ridden international waters.