



Guernsey Financial  
Services Commission

## Growth and Regulation?

### A Talk to the Guernsey Chamber of Commerce – 17<sup>th</sup> September 2018

I was delighted to be asked to speak here by Barrie Baxter on the basis that at a previous lunch you decided that supporting Guernsey's finance sector to help it grow was your second most important priority after transport and connectivity.

As well as being delighted, I confess that I might also have been more than a little surprised given the number of people on this island who appear to think that the abolition of the Commission, or at the very least its neutering, would be the best thing the island could do to boost growth in the sector. I fear they may be disappointed by what I'm going to say today as I try to chart the relationship between regulation and growth whilst explaining what the Commission is doing to try to facilitate the growth of the Guernsey financial services engine.

To be clear, I am far from unsympathetic to the libertarian view that if one was to take a scythe to the growth of regulation, everything would be wonderful with the animal spirits of the free market powering away and the trickledown effect that would have throughout our economy. Laws which stop you doing things are generally irritating when you want to do that thing. I certainly find the 35 mph speed limit on the broad roads around the airport irritating from time to time but then I reflect that were they to be raised to 55 mph or so, I would be much less confident letting my children ride bicycles around them so raising the speed limit (deregulation) might actually lead to a reduction in road use (by my children and other cyclists) or, worse still, an increase in harm through more damaging collisions between bicycles and motor vehicles.

When I was at college I got to know our Professor of Science and Religion [John Hedley Brooke] and even went so far as to read his books. Some not yet educated students used to ask why he existed on the basis that they saw science and religion as opposites. The truth about the relationship between science and religion is complex, so much so that he used to talk about complexity theory in relation to the relationship between science and religion. If that seems strange is it perhaps worth reflecting on whether there would have been an industrial revolution without a protestant work ethic and whether that could have come into existence without Martin Luther's reflections on the nature of man's path towards greater understanding of God. My point here is not to wreck your lunch with an extended theological exposition but rather to point out that in other walks of life, things which might seem to be opposites are actually very closely related in an often mutually supportive eco-system.

I'd argue that complexity theory also arises in the case of regulation and growth. Beyond doubt, over regulation can stifle growth. We have only to look at the licence Raj in India between 1947 and 1991 to see fairly strong evidence of over-regulation thwarting the ambitions of Indian entrepreneurs<sup>1</sup> and of that having a very significant impact on India's economic

---

<sup>1</sup> <http://indiabefore91.in/license-raj> - see comparative growth tables at the end of the article of India relative to other Asian economies

growth relative to other countries. Conversely, it is not necessarily the case that those countries with the fewest rules grow fastest. The England of the 18<sup>th</sup> Century was noteworthy for its lack of arbitrary government in a world in which the caprice of the monarch played a very large part in economic decision making in other countries. In one sense there was great liberty and freedom which helped the generation of ideas but on the other hand there was great stability because of the common law and statute, enforced by largely impartial justices. A combination of both good and effective law (regulation by another name) and economic freedom was required for commerce to flourish, not forgetting of course the immense contribution made by the Royal Navy – not exactly an anarchist institution - to creating safe, regulated corridors across the sea through which trade could increase. Life in the State of Nature (that is a human society without government) is likely to be nasty, brutish and short as Hobbes reminds us<sup>2</sup>. Hobbes was somewhat pessimistic but if we look at the actions of crowds of otherwise perhaps reasonable people in situations like the London riots of August 2011 when provided with opportunities unconstrained by law, it is difficult not to conclude that he had a point to some degree.

The issue would thus appear to be not of whether growth and regulation can co-exist but what level and type of regulation is optimal for economic growth. This is a question to which I don't think there is one philosophical answer which is right for all time – at least not for a micro state like Guernsey, very heavily influenced as we are by our need for access to other countries' markets. Rather there is a need to be pragmatic and ask the more practical question as to what type of regulation is optimal for economic prosperity (or growth if you prefer) at a certain point in time.

It is this question which I will seek to address in the remainder of my talk. In our *Regulatory Framework* guide which we published last autumn (available on our website and in hard copy on request from us for those of you who want to read more, though sadly not yet stocked by all good bookshops), we set out clearly that we regulate to achieve one of several ends:-

- a) Promoting confidence in the financial services markets in the Bailiwick;
- b) Preventing financial crime;
- c) Protecting customers where normal market conditions do not apply;
- d) Protecting financial stability; and
- e) Creating incentives (and disincentives) to promote desired market behaviours.

In practise, we can break this down into creating new rules and regulations to achieve one of more of the following objectives:-

- a) Protecting consumers and investors who find themselves exposed because of advances in technology or actual lacunas in the Bailiwick's current legislation;
- b) Seeking changes (normally strengthening) legislation to match new international or EU standards because if we don't the Bailiwick's firms are likely to lose access to international markets or global firms are going to become uncomfortable with basing any part of their operations in the Bailiwick; and
- c) Providing regulatory "products" which help maintain the Bailiwick's competitive strengths. If the shelf life of regulatory products is still markedly longer than that of

---

<sup>2</sup> Leviathan, i. xiii. 9

electronic goods, it is shorter than it once was and in a competitive international environment, the Bailiwick as a whole will be left behind if it rests upon its laurels.

For better or worse, much of our time is spent on b) above – i.e. strengthening legislation to match new international or EU standards because, at this time, that is what is required to preserve economic prosperity. Several jurisdictions, including some Caribbean islands, have failed to keep up with evolving international standards and have been financially ostracised in retaliation. Interestingly, this has often been an industry-led phenomenon with private sector banking groups simply withdrawing from the islands because they felt that the risk of operating in those jurisdictions was too great. When banks pull out, others tend to follow. Thus, initiatives such as our new AML/CTF handbook are designed to fulfil the goal of keeping the financial services sector in business, not so much economic growth per se but rather the avoidance of precipitate decline.

On other counts, however, we are able to take initiatives which we believe will help create the right regulatory environment for growth. To run through a few:-

- A) We worked with the Guernsey International Insurers Association to create dedicated Insurance Linked Securities (ILS) rules for Guernsey which were implemented at the start of 2017. Our prior insurance rules allowed for ILS structures (which generally buy catastrophe risk cover against hurricanes and flooding etc.) but some people were uncomfortable bringing their ILS business to the Bailiwick without the specific assurance provided by dedicated rules. In the year after which we put the rules on the book, the amount of ILS business equalled the total of the prior three years combined, perhaps offering reasonably robust, empirical evidence that having the right sort of regulation does indeed facilitate business coming to the island.
- B) Our investment team has developed the Private Investment Fund rules to allow for the issue of lower cost but properly regulated investment funds for fund managers who have a particularly close connection with a relatively finite group of investors. We now have [28] funds approved with the product becoming more popular following some minor tweaks to the undertakings required which we made after having become aware that some of our initial requirements were being over-interpreted by some promoters. The product fulfilled a niche in the market – offering a regulated product where a formal prospectus was not required but where the product was regulated with the safeguards that that provides to investors. Thus, we'd certainly propose that the product brings business to Guernsey which might not have been able to use one of our other fund products or alternatively it helps to retain business which might have otherwise moved domicile.
- C) Similarly, at the behest of the States, we developed a key piece of pensions regulation for the Bailiwick which we then implemented from the middle of last year. Recent feedback from the Head of the Guernsey Association of Pension Providers indicates that the “street cred” of Guernsey as a location for international pensions business has risen markedly in the year since we introduced the regulation driving up both enquiries about pensions business and the business itself.
- D) Working with industry and government, we undertook a consultation and wrote a Policy Letter for the States on Lending, Credit and Finance. In this letter we advocate abolishing the outdated non-regulated financial services business law (which we and many in industry dislike for its ambiguity as to what is covered from a number of

angles) and replacing it with a more rounded Lending, Credit and Finance law which, as well as enhancing protection for vulnerable consumers, would provide a framework within which some types of FinTech business, wanting to demonstrate its respectability, can operate. Specifically, it will provide a niche for anti-money laundering due diligence consultancies to become properly regulated thereby providing their potential clients with the assurance that they are a secure data repository which will look after sensitive personal data securely, thereby encouraging their use. Thus it is actually the case that the existence of regulation, with the boundaries and assurance it can create, may well facilitate much faster rates of FinTech growth than would otherwise be the case. Similarly, the LCF Policy Letter will provide for the regulation of lending platforms as something other than banks. As bank regulation tends to be more demanding than other types of regulation – at least in terms of capital and liquidity requirements – new regulation here should actually reduce the regulatory burden for innovative lending businesses, thus encouraging market growth. We continue to work with the States of Guernsey on this particular Policy Letter which we hope will, if it becomes law, facilitate further specialist strands of financial services law as well as freeing businesses from the burdens of the sometimes opaque NRFBSB law.

- E) Our most recent regulatory attempt to create an environment for economic growth has been through our development, in conjunction with industry and environmental sector actors, of the Guernsey Green Fund rules. These provide a legal framework policed by ourselves through which environmentally conscious investors can be reassured that their investments will make a positive difference in terms of helping meet the goals of the Paris Agreement on inhibiting global warming. We hope that this level of reassurance, along with the good offices of Guernsey Finance, will attract more investors to become comfortable with green investing than would have been the case with green products supported only the private sector. Whilst we are in the early days of this product, we believe that we are in a good place as the creators of the first regulated green fund product with positive publicity for our green isle being generated in media coverage from here to New Zealand.
- F) We also held a Soundbox Sprint in June – a new venture for us – where we brought together key actors and volunteers and challenged them to solve key issues where we felt inertia might be inhibiting growth. I will leave others to judge the long-term effects of the innovations created on that day but I am hopeful that by helping play our part in breaking down some of the barriers to trade which are sometimes perceived by others to exist, we can play our part in boosting value creation. Following on from this we have become a partner in the Global Financial Innovation Network where various leading regulators come together to share ideas on how to deal constructively with financial innovation, even to the extent of offering joint licensing processes to allow technological applications to be trialled simultaneously in controlled conditions in more than one market.
- G) Currently it is the case that defined benefit pensions regulation in many jurisdictions, combined with aggressive accounting standards and longer life expectancies, has effectively closed down defined benefit pension schemes of the sort enjoyed by many of our parents. Defined contribution schemes have many merits but they don't do a lot to insulate workers on average incomes from the vagaries of market volatility which can be deeply disconcerting to those not versed in financial markets – positively

discouraging socially advantageous pensions saving. We think that if people are to enjoy good pensions with life insurers able to take some of the risk out of long-term investing through the provision of variable annuities or similar structures, life houses need to be able to invest in productive assets rather than merely being forced to invest in long dated and ultra-low yield government debt which is unlikely to finance a particularly comfortable retirement. We think that, in some jurisdictions, life insurance regulation has actually become destructively heavy, thus impeding industry growth and socially beneficial retirement saving. This, perhaps, plays to my broader theme of the relationship between regulation and growth being a complex one. We are therefore considering consulting on new rules for green and infrastructure assets held by life insurance firms, cutting the capital charges on such investments so as to facilitate life houses doing good quality business in Guernsey, using it as a base from which to buy long-term equity or near equity assets which are more likely to deliver stronger returns over several decades whilst being, in terms of cash flows, approximately matched with the cash flow liabilities of paying for pensions. We don't yet know whether this will work and we will listen to the responses to our discussion paper with interest. It is an example of the complexity and overregulation in other jurisdictions perhaps offering Guernsey an opportunity, by having appropriate "right sized" regulation to deliver economic growth whilst delivering socially beneficial outcomes to international pensions savers from outside the Bailiwick. If our logic is good, other jurisdictions will copy us in due course but they are often driving supertankers which can only be helmed with extreme difficulty whereas we aspire to be a high-performance sailing dingy, able to alter course to take advantage of fairer winds for policy holders.

I hope this pattern of new regulation (or new product development if you prefer a business term) which we undertake in partnership with other actors in the Bailiwick may encourage you to reflect on the huge role which regulation has in creating a positive environment in which entrepreneurs can invest and thrive by offering services customers want.

### **Maintaining Confidence**

That is, of course, far from the limit of what a financial services regulator can contribute to growth. The vast preponderance of the Bailiwick's financial services sector is built on servicing overseas rather than domestic clients. If local firms are to be able to have overseas clients the Bailiwick as a whole has to have a good standing with a lot of overseas jurisdictions otherwise customers in those jurisdictions will simply be banned by subtle or unsubtle means from entering into contracts with the Bailiwick's firms.

To that end, in recent years we have thrice been recommended by the European Securities and Markets Authority as a regulator with equivalent standards for alternative investment funds. Whilst Brexit may have delayed the EU from delivering the full benefits we hoped for from our high standing, that high standing has meant that the Bailiwick's firms have been able to continue to have access to EU member states' national private placement regimes. We have also engaged in positive discussions with the Financial Conduct Authority to ensure Guernsey's continued access to the UK National Private Placement Regime post-Brexit.

On another continent, we have had many years of positive dialogue with the Chinese regulatory authorities. This culminated last year with the MoU I signed with the China Insurance Regulatory Commission. This meant that we had a hat-trick with the Chinese regulators

covering banking, investment business and insurance. Given the nature of government within the People's Republic such jurisdictional approval is a pre-requisite for many Chinese firms to be able to do business with firms in the Bailiwick, business which we are pleased to note is increasing markedly.

Whilst not exactly popular, the need to be compatible with the EU, led to the States granting us markedly increased fining powers. I don't expect many people in industry to like the fact that their firms are potentially exposed to those powers but they are a necessarily corollary of maintaining market access to the EU for the Bailiwick.

## **Enforcement**

Having mentioned fining powers, I think its proper to divert slightly from my main subject into the realm of enforcement and endeavour to slay a few myths propagated by local soothsayers who enjoy myth-making, often for fairly transparent and self-interested ends.

Our ability to enforce and our effectiveness as enforcers is closely tied to the market access which the Bailiwick's firms enjoy. Whilst some of you might sleep much more easily if the Commission sent Simon Gaudion and his team off on an all-year global golf tour, you wouldn't like the impact that this tour would have on the ability of the Bailiwick's firms to deal with international customers the year after the tour. The Commission is regarded as credible by the EU, UK and US because we do the right thing when we discover serious malpractice and law breaking, in spite of opposition from a number of quarters. When Moneyval (Council of Europe) gave us one of the highest ever ratings for AML/CTF effectiveness in 2016, they did so secure in the knowledge that we didn't look the other way when we encountered businesses taking action likely to encourage money laundering or – alternatively – inaction which had much the same effect. Rather we took action designed to correct wrongdoing and keep the Bailiwick safe for good quality business and the international markets open to the Bailiwick.

To be clear, enforcement is and will remain a last rather than a first resort for us. Aside from perimeter cases (illegally conducting financial services business without a licence thereby undercutting honest market participants), we generally look for evidence of pretty severe misconduct before we take enforcement action. We are risk based and think that most matters are much better dealt with through supervisory action to help a firm improve rather than by formal sanctions. That said, if the Bailiwick is to enjoy economic growth through its firms having access to international customers, we must remain vigilant, on behalf of those international customers, to ensure that they are treated by Bailiwick firms in accordance with our own laws. If we were not to do so, our law would swiftly come to be regarded as an ass and we would revert to somewhere closer to Hobbes's state of nature than would be comfortable for many investors. They would then depart to jurisdictions with higher standards. I'm sure you'd agreed that such dereliction of regulatory duty would be bad for economic growth.

Could too much enforcement be a bad thing – of course. Enforcement must be proportionate. As with all regulation, there is a balance where it is neither too hot nor too cold. To give some idea of scale c. 0.5% of the entities we regulate are in enforcement at any one time. That means 199 out of 200 firms aren't in enforcement. To put that in real numbers, that's around a dozen cases. Occasionally it might go as high as 15 or so and occasionally it might drop as low as ten although I'd love to see it drop lower than that. I'm well aware that the myth-makers would

like their prospective clients to believe the total is two, three or four times higher than that. It isn't and it hasn't been for the last five years. If someone says differently, please ask them when they last checked their figures with those cited in public talks by Simon Gaudion, the Chairman or me.

The trouble with enforcement on a small island is that we are often taking action against someone who went to school with a lot of other senior people on the island who know him well. It offends their amour propre that one of their school mates and childhood acquaintances should be accused of not being as pure as the driven snow. Whilst Guernsey is undoubtedly a special place, I would like to see a little more realism and a realisation that some Guernsey people working in financial services are as capable of doing bad things as those in the UK, America, France or South Africa. I have been accused of being nasty to a school friend of someone whilst at a party. His criticism was that Bloggs couldn't be guilty because he was so charming. My reply, whilst I wasn't able to give it for legal reasons at the time, would have been, "fraudsters generally are charming, it's what makes them effective." There are no easy answers on this one, I'd just ask that we don't presume that our community is incapable of nurturing bad apples simply because of our understandable pride in our island.

For every enforcement case, there are twenty instances where we are working with a firm through supervisory action to help it resolve a problem. I work hard with my team to try to ensure that we maintain proportionality throughout the enforcement processes. If we don't, we can always rely on our team of independent Senior Decision Makers (UK QCs) who sit in judgment to tell us we have it wrong and if they fail, the Royal Court is not shy of giving due consideration to appeals against our decisions on enforcement matters. We don't, I'm sure you'll be glad to hear, like to arrive at the stage where others – be they SDM's or the Royal Court – tell us that the Commission has got an enforcement case fundamentally wrong. That is why the Commission's supervisory directors review potential cases carefully before they go to enforcement and why I review enforcement's initial investigatory findings alongside colleagues to decide whether the failings identified are serious enough for the Commission to seek formal sanctions. There are checks and balances at several stages of the enforcement process. What those checks and balances do not mean is that there are lots of ways for serious lawbreakers to escape the process on technicalities, rather they mean that there are lots of opportunities for firms threatened by enforcement to persuade the Commission or the Royal Court, that they have been misunderstood.

My point in the context of this discussion is that I appreciate that some might, on the basis of one set of facts, regard enforcement as a drag on growth. Were it to be done arbitrarily and pervasively so that someone in the industry had to worry that even the slightest comma out of place on a document would result in enforcement action, they would be right. This is, however, as I hope our public statements demonstrate, very far from the truth of the matter. We are disciplined and discerning about our enforcement and we seek to be effective. Because of this, international inspectors and other jurisdictions give us credit and allow our firms to continue to access their markets. Enforcement was a particular focus for one of the ESMA reviews relating to AIFMD market access arrangements to which I referred to earlier. Had we simply had an enforcement team with wooden guns, shiny uniforms and an armoured car with no engine, we would have failed that inspection and the Bailiwick's firms would have suffered. The same may equally well be said in respect of Moneyval and other inspections to which we

are frequently subject as we work to maintain the Bailiwick's license to operate – without which growth will become strongly negative.

### **Looking to the Future – Growing trading opportunities**

As the UK leaves the EU and resumes control of its own trade negotiations (if I may be so bold as to make those presumptions), it is likely that the Department for International Trade will focus on free trade agreements which are rich in terms of the access they offer to the UK services industry including, of course, financial services.

The Institute of Economic Affairs, in its report “Improving Global Financial Services Regulation” published in May this year, proposed that the UK should form alliances with other major financial centres, and make comprehensive bilateral agreements. It also proposed that the Channel Islands should be part of such agreements. In a similar vein, the Commission has proposed in a recent meeting of the International Organisation of Securities Commission's European Regional Committee, that there should be further work towards establishing a global regime for the mutual recognition of investment funds.

If we assume that such services rich free trade agreements are made, and given the progress Australia and New Zealand have already made in making such agreements, there is no good reason to suppose that they will not be made, there is a considerable prize for Guernsey's main exporting sector, if it can gain access to such free trade agreements. These agreements would break down barriers to financial services, which are often afflicted by regulatory barriers to trade rather than tariffs. This would also, we believe, ease the global flow of investment so the investors can receive good returns through using user friendly regulated Guernsey structures to invest in value creating projects around the world, to an even greater extent than is already possible.

Clearly, whether Guernsey can participate in future UK free trade agreements will depend on the sort of future economic partnership in which the States of Guernsey and HM Government wish to engage but there are many encouraging historical precedents for Guernsey being able to accede to UK treaty arrangements. Nevertheless, for the UK to be willing to allow Guernsey to become part of a free trade agreement which contains a strong financial services component which it has negotiated with another country, it is going to have to be comfortable that Guernsey's financial services regulation meets the same common international standards as it and the country with which it has negotiated the free trade agreement. It would be a logical nonsense for the UK to admit any jurisdiction which it felt had standards which would put at risk its citizens and the citizens of the country with which it had concluded the free trade agreement. This, with a view to the medium term future, is another reason why, in a Guernsey specific context, our regulation can be seen to be a necessary pre-requisite to safeguard a reasonably probable and economically significant future growth opportunity.

### **Concluding Remarks**

Regulation can undoubtedly damage growth if it is arbitrary and does not fit well with the needs of market participants but done well, it can create an environment where people are secure enough to execute trades and make investments which they would otherwise have been unwilling to make, thus driving growth. The industrial revolution - overlooked by the security of the Common Law and the Royal Navy - is evidence enough of that.

In a Guernsey specific context, given the export-focused nature of the vast bulk of the financial services industry and its accompanying professional services infrastructure, it is imperative that our regulation is perceived to be credible by those overseas who determine whether we have continued or enhanced access to their markets for our financial services products. Since the Global Financial Crisis, international standards have become both more rigorous and there has been far more scrutiny of whether they are actually being applied effectively rather than merely written into laws to be filed on a shelf somewhere. Whilst some of the, perhaps slightly unhelpful, global regulations relating to, for example, capital requirements for market making may be softened as their unintended consequences become clear in our highly interconnected world, it is naïve to think that the bulk of international standards will not remain in place and be subject to rigorous and regular reviews with adverse consequences for small jurisdictions which fail to prove compliance. This is actually a good thing for Guernsey for without the benchmark of international standards against which to measure ourselves, our entreaties to other jurisdictions to offer us access to their markets would be far more likely to fall upon deaf ears. Thus, whilst I fear I will disappoint you by giving you the answer you expected, I must conclude that in a Guernsey specific context, good standards of financial services regulation are not just a nice to have but an imperative for our future prosperity and growth.

W E D Mason  
Director General  
17<sup>th</sup> September 2018