



Guernsey Financial
Services Commission

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Current Themes in Supervision

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Good afternoon and thank you for staying around after lunch and the lively and interesting speeches of this morning.

I would love to match or supersede Gillian's use of technology within this presentation but firstly I am not sure that would be possible, or that I have such interesting facts to impart. However, later I will be touching on the uses and possibilities of technology within supervision so I aim to be building on the theme.

My speech today has the title of 'Current Themes in Supervision' which is a very broad topic covering a wide range of subjects but I thought I would pick on three main aspects of our supervisory approach and consider what we are currently seeing from these.

These aspects are:

- Our visits and interactions with industry
- The current risk profile of our regulated entities
- Future developments in our supervisory approach.

Slide: Methods of Supervision

So firstly looking at our visits and interactions with industry, which form part of our supervisory framework.

Within PRISM we have a number of different types of engagement with an individual firm such as Firm Risk assessments visits, engagement meetings and ad-hoc meetings which may be requested by either ourselves or a the firm.

These ad-hoc meetings can be when the firm is considering entering into a new product or activities or even when they are looking to launch a new fund. If the fund or product is dealing with a new area, asset types or structure it is very helpful for our supervisors and authorisation team to understand the regulatory aspects of the product before it is launched. I know our Authorisations team hold meetings under the Innovation banner on a regular basis with firms.

Slide: Growth in Risk

From our side an ad-hoc meeting maybe requested when we have received specific information about a firm, either through the returns they submit, general market information or through changes in the people holding prescribed positions at the firm. These trigger events could indicate an increased risk profile at the firm which we are interested in investigating and understanding.

With regards to our Firm Risk Assessment visits for many industry firms they have now received at least one, if not more of these visits, and they are becoming familiar with the process that is followed, such as the initial information requests, the on-site visits and follow up work that is undertaken. Whilst firms are becoming more used to these visits and hopefully finding them less intimidating, as noted later, we are continuing to see the same risks and risk types being highlighted.

Our engagement meetings are more regular interactions in-between our Firm Risk Assessments and are a good opportunity for our supervisory teams to investigate one particular aspect of the firm, or to receive an update on the market position of the firm and its business. It is a good opportunity for a firm to raise any questions with us, or to consider what future changes to their business they may be proposing that we, as a regulator would be interested in. However, to be clear this does not replace the requirement for firms to keep their supervisory team up to date with material changes to their business model on an on-going basis.

Firm Risk Assessments and Engagement meetings are both targeted at our larger, higher impact firms, and therefore some of our smaller firms maybe feeling left out (or potentially relieved?). Please don't worry, we haven't forgotten about you! We are continually looking at further ways we can interact more with our low impact firms, including thematics, assurance events and information requests, either across an individual sector or across all sectors.

In fact this year for the first time we have carried out two cross-sector thematics, one on Beneficial Ownership and one on cyber security.

Whilst they have yet to undertake any visits for this latter thematic it is clear from the responses to our cyber security questionnaire that this is a risk that many firms and Directors consider significant concerning for their firms. It is also appears to be an area where many firms, and their Directors, believe they don't have the relevant skills and knowledge to understand fully, with a high number of outsourced service firms providing support in this area.

As you should all be aware, our normal process following a thematic is to issue a public report detailing some of the good and bad practices we have identified during the course of the thematic and giving firms guidance on how they could look to improve their systems and controls. Obviously this would not necessarily be a good idea when talking about the strengths and weaknesses of cyber security controls at regulated entities in the Bailiwick. Therefore for this

thematic only we will instead be hosting feedback sessions for CEO's and CIO's and other relevant Board members on the issues we identified and the good practices we saw. I would encourage everyone to attend these sessions to help learn how your systems and controls could be improved in this vital area, especially as this will be your only opportunity to understand what we found. My hope is that they will be as popular as the recent sessions held by our Financial Crime team on the new AML/CFT handbook!

However, before then, I would also like to bring to your attention the information we sent to all firms which included a range of information on cyber security and a number of general guidance documents which highlight the good steps that all firms, whatever their size, can take in this area. If you haven't seen these documents they can be found on our website and provide a good starting point for firms, who were not part of our questionnaire sample, to assess how they are dealing with this key risk area.

Our second thematic is, in light of recent events, even more vital to the reputation of the Bailiwick in an international sense. The results of this thematic are due to be released within the first half of this year and I would encourage all firms, which have to file beneficial ownership information to review them. I am glad to say that the results demonstrate how seriously our firms take the need to identify the true beneficial owner in any structure however; we need, as an island, to continue to demonstrate our strong controls and practices to continue to mitigate or ideally change the uneducated views that many off-island people have of international finance centres.

The supervisory approaches I have just talked about all involve meeting individuals from our firms face to face. However, we also receive information through a number of other processes such as regular meetings with industry bodies, for example GIBA, GIFA and the GSCCA to name a few, through general market information, sometimes social media, or finally through the returns that individual firms submit to us on a quarterly, six monthly or annual basis.

All of this information aids us in building up a picture of our industry, its strengths and weaknesses but also in identifying outliers, trends or individual firms which may be taking on greater levels of risk. We use this information to then consider and decide on what actions we should take, if any, to investigate these issues further. On this basis, I would encourage all firms to ensure that the information they submit to us is accurate. At best, an outcome of submitting inaccurate information to the GFSC is multiple time consuming question being asked, or at worst a more targeted visit, taking up time and resources to try to understand what is simply an incorrect conclusion based on inaccurate information.

Slide: Types of Supervisory Risks

Now to move onto the current risk profile of our firms. During the course of 2018, we carried out 37 Firm Risk Assessment visits, and over 90 supervisory interactions in total that led to 266

RMP actions being set. An RMP action is set where we see an unacceptable risk at the firm being visited.

In fact, if you look at the trend in firms displaying unacceptable risks, this has grown in each major risk type on a year on year basis since 2017 onwards. In fact, going back to 2016 we have seen a steady increase in the number of firms displaying unacceptable risks in each of our main risk categories, strategy and business model risk, governance risk, operational risk, conduct risk and financial crime risk. This suggest an increasing risk profile for all our firms.

Alternatively looking at the percentage of open RMP actions for each risk category this has been relatively stable over these main risk areas for the last three years. Financial Crime risk continues to see the majority of open RMP actions perhaps reflecting the amount of work and length of time required to mitigate the risks in this area. At the start of 2019, however governance risk had the most open actions against it.

Operational, conduct and strategy / business model risks remain key risks for our firms with a range of open actions against them.

Whilst the number of RMP actions have increased the type of actions being set for our firms remain very similar; for example ensuring they are able to demonstrate source of wealth or funds for clients, demonstrating appropriate oversight and monitoring of key outsourced providers, carrying out appropriate penetration testing of their IT systems and infrastructure and showing challenge and consideration of major strategy and business model decisions.

As we have set RMP actions these are the risks that in some respect have crystallised for us as a regulator however we are also conscious that others prudential risks, such as capital and liquidity, are growing. The decelerating growth of China linked to the ongoing trade wars between China and the US, the US and many other countries pose increasing risk to global growth. Closer to home there are significant concerns about the Italian economy and its debt levels and even Germany, which was always the stalwart of European growth, is fading. The recent OECD forecast predicts German growth of just 0.7% in 2019, a significant reversal from the 2% of 2018 and lower than even the UK's 2019 forecast of 0.8% taking Brexit into account. This suggest that going forwards our firms could face significant prudential challenges in a toughening market with a high level of uncertainty, though this seems to be more the political norm, rather than an exception in today's world. Firms need to be conscious of these developing risks types and ensure that they monitor, mitigate or remove them when they breach their risk appetite.

If taken on its own this trend of an increasing risk profile at our firms, aligned with an growing number of open RMP actions, and increasing global risks could look very concerning. However, there are counterpoints to this argument and a number of factors should be taken into account when considering trends and risk profiles.

Firstly, our ML impact firms will receive an FRA every 3-5 years and as we implemented PRISM in 2013 we are just seeing the full cycle being completed for the first time for these firms.

Therefore, over this period a number of firms were being assessed for the first time potentially leading to a higher number of actions. Secondly whilst 266 actions were created 288 actions were completed and closed in 2018, the majority of which were the responsibility of the underlying firms, showing that Boards and Directors are responding to our concerns and taking action appropriately.

Finally on a global level uncertainty seems to be becoming the new norm and from the returns we receive we haven't seen a significant drop in income across the board and we continue to see a robust number of applications leading to new authorisations for the Bailiwick, suggesting that as a whole we are coping well with this uncertainty.

Therefore, whilst these risk areas are ones that Boards should continue to focus on the individual firm responses when we highlight areas of unacceptable risk, the continual growth of businesses and the closure of RMP actions give us comfort.

Having said all that we cannot rest on our laurels, as either a firm or a regulator. As you can see from the graphs used during all of the presentations so far within the Commission we are trying to understand how the data you provide to us can be used more effectively to help predict and prevent future risk events from crystallising.

To borrow perhaps the most quoted investment phrase 'past performance does not predict future performance' would suggest that we shouldn't be looking at the past to try to prevent future risks. However, humans are the only animals that can use our memory to make predictions, and it is commonly agreed that we should look to learn from our mistakes (or at least the mistakes of others as this is much less painful than making the mistakes ourselves).

What we have learnt through this process though is that it is very difficult to do this type of learning and development as part of the day job. Therefore we have created a specific project to look at ways to improve our supervisory approach using technology such as:

- Identifying developing risk trends from the information we have and using this to ask questions or take actions at any earlier stage.
- Using network analysis to identify interconnected individuals within structures or entities as part of our authorisation process to enable us to identify actors that concern us and potentially prevent their entry into the Bailiwick.
- To use technology to help us assess and analyse all the data we receive in, including pre-visit information requests, and to do the initial analysis through machine learning or other technology allowing supervisors to probe into the more detailed questions and concerns.

- To build a machine-readable handbook to allow firms to interrogate the rules, requirements and guidance on an automated basis and build their systems and controls around it.

Now, whilst we are good at regulating we are perhaps not considered the best placed to be at the cutting edge of technology. This is why we have partnered with a university well respected with respect to technology, to use the best and brightest minds in coding and IT to help us build our systems and supervisory abilities. We are also exploring the targeted use of faculties of data scientists to help develop individual piece of technology.

The aim is that this will help us to supervise more efficiently and effectively but will also look to grow the reputation of the Bailiwick as a good regulatory jurisdiction, with proportionate supervision, and a targeted risk based approach. Overall, it should also help to protect and enhance confidence in the Bailiwick and develop our abilities to prevent significant risk events.