Guernsey Financial Services Commission

Industry Seminar – 21 November 2014

Fiduciary Supervision Policy and Innovations Division Presentation: International, Innovations and In Perspective

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Good afternoon and welcome to what we hope will be the highlight of the Commissions 2014 Industry presentations (saved the best until last).

I'm delighted to say that this was the most popular session of the day – before we start we want to see a show of hands:

Who has come here today to hear about:

- Innovations?
- Our Supervisory approach and observations?
- What you may be asked to do next year?
- Free coffee?

Slide: Presentation Overview

Eamonn and I have both joined the Fiduciary Division within the last year, and will form a double act over the next half an hour, you will see we are also joined by Nic Cleveland & Paul Evans our experienced Assistant Directors who will assist with questions later.

This afternoon we will provide an overview of:

- the newly titled Division
- Statistics
- Observations
- 2015 Key Themes

The main key message we would like you to take away is that the Fiduciary Sector within Guernsey is alive & kicking and extremely valuable to the Bailiwick.

Slide: Existing Clients by Fiduciary Turnover

This chart, like many contained within this presentation originated from the Fiduciary Annual Return.

You will note that c.24% of Guernsey's clients originate internationally from outside Europe/UK/Channel Islands – *geographical location of licensees' client base as a percentage of its latest total fiduciary turnover.*

Slide: New Clients

This slide relates to new business.

We have noted that there is a slight increase in new clients originating from overseas (up to 27%). Broadly speaking, this is driven by small increases in customers from Africa (including South Africa), Middle East and Asia. New business is becoming more international.

Originating geographical location of new clients as a % of total new clients.

Slide: Fiduciary Licensees by Type

When I moved to the Island this summer from the UK's Financial Conduct Authority (FCA), I met a fair few people who anecdotally described the Fiduciary sector as being in terminal decline – an ageing population of owners with reducing assets. Our Data paints a different picture. The total number of licensees has increased overall (from 187 to 192) in the past year – this is due to moderate growth in terms of numbers of licensees from all ownership groups apart from International Finance Groups.

Slide: Total Assets by Ownership Peer Group

In terms of assets – and by this I mean assets under regulated activity (which as you will be aware should be treated with some caution as for example some assets will have been valued at market value – others at purchase price).

Overall Fiduciary assets under regulated activity have increased 4% between 2013 and 2014. <u>These are big numbers - £bns</u>.

In terms of the story behind the statistics:

- We are aware of the considerable dominance and growth of the International Finance Group owned fiduciaries.
- We are conscious that some of the legal firms have disposed of fiduciary parts of business, which we consider accounts for the adjustment in this sectors ownership.

Slide: New International Standard for Regulating Trust Company Businesses

In conclusion to the International section of our presentation – There was a watershed moment on 17 October 2014 when the Group of International Finance Centre Supervisors (GIFCS) issued a new standard on the regulation of Trust and Corporate Service Providers.

Philip Nicol-Gent covered much of this yesterday from his perspective as Chair of the working group; but in summary, Centres of Excellence (such as Guernsey) need international standards.

Banking has BASEL, Investment has IOSCO, Insurance has IAIS, the GIFCS standard, the first of its type for Fiduciary, introduces a new minimum benchmark for Fiduciary businesses to follow.

It also crucially, provides us as regulators, with an international benchmark – drawn from existing International best practice.

There are already high standards in operation on the Island, and over the next twelve months the Commission will undertake an analysis of our regulatory regime to determine whether small adjustments (which Philip referred to as housekeeping) may be required in order to underpin the new standard.

For example, at the moment we are unable as a Commission to object to the appointment of a Fiduciary Director even if we deem them not to be Fit and Proper. In this we are out of line with International best practice.

Any proposed legislative changes will be incorporated into the Commission's work on revisions to laws – a project that is a collaborative exercise with government and industry.

You may be aware (perhaps because you follow us on Twitter – that the Revision of Laws Discussion Paper was issued on 10 November – it goes without saying that any comments or input is welcomed.

Slide: Innovations

Moving to Innovations.

Firstly, you may ask, why is Innovations now bolted onto the Fiduciary Division at the GFSC?
Whilst 'Innovative businesses' can arise from any sector on the Island, from our experience Corporate Service Providers/Fiduciaries are often involved in providing services to new innovative companies. Plus the NRFSB law tends to acts as the "Catch all" bucket when none of the other legislative framework fit.

So, as the newly titled Fiduciary and Innovations Division, what have we been doing?
It is fair to say I have been on the circuit – meeting lots of firms (currently authorised and potential business for the Islands).

We have also been:

- Engaging with Commerce & Employment
- Leading a workshop for Lawyers
- Hosting a presentation to Government
- Attending and arranging presentations from Industry

Our aim for transparent, clear and consistent communication – highlighting that we are open to Innovative businesses. As Mark outlined in the previous session – our door is open.

Slide: Innovations – GFSC Approach

This slide takes you through the key hole – behind the scenes at the GFSC. If there is an Innovative business suggestion, what happens?

1) First Question is – is there an existing natural home?
   If yes – existing contacts or supervisory channels in the Commission should be used.

- Therefore if a new on balance sheet lender turns up – we would expect you to approach banking;
- For an innovative PCC you should approach my colleagues in insurance,
- An innovative fund would probably fit under POI law and therefore you should approach my Investment colleagues,
- Or for a new trust-type structure should come to Fiduciary.

The point is that all the supervisory divisions support innovative ideas.

Slide: Our recent Experience with Innovations

So what have we seen in terms of Innovations. Whilst you can barely go a day without reading the word Innovation in the paper, in practice we have seen just a few clusters of new ideas, some of which are adaptations of old ideas.

1) We have been approached by **Payment Service Providers**

   - The middle men between the merchant acquirer & small retailer
   - This has posed some challenges:

   - Risk Appetite (businesses associated with adult entertainment, firearms retailers, online pharmacies and legal high suppliers).
   - Different business models (High volume, low value).
   - Confusion as to who the client is – we consider the trading business/small retailer to be the client.

2) Crypto or **Virtual Currencies** (Eg Bitcoin)

   Two schools of thought:

   A) As an asset
   B) As a Currency

This is continuing to prove a challenge and an area we are cautious about.

3) Crowd Funding/Peer to Peer

In reality these titles cover a broad spectrum of firms – often POI (especially for crowd funders) – but not always. The top question we will ask is: Why Guernsey? We only want quality business which adds value to Guernsey.

Slide: Non-Regulated Financial Services Businesses

A key component to Innovations is the NRFSB law – because (as previously mentioned) this often acts as the home when no other legislative framework naturally fits.

This maze slide is included because I wonder if this is what your interaction with the regulator on NRFSB's feel like this?

We have listened carefully to feedback, specifically that there is more the GFSC could do to explain what information we would like in respect of a new application.

Do we want hundreds of pages of information regarding a new proposal to avoid any risk that detail is being withheld from the regulator – NO.
Or worse – our least favourite – a non-application where we are asked to confirm that something doesn't need to be an application – NO.

We are resource constrained therefore we need to be smart with our resources. Transparency is key – therefore will put more information on our website (aide memoire) and revising our application forms.

Slide: NRFSB Revision

Turning specifically to the NRFSB Law. We are conscious that it has some serious limitations. The world **and** business opportunities have evolved since it was first introduced. The legislation arguably now registers firms that it was not designed to capture and consequently does not provide a fit for purpose supervisory regime.

The Commissions revision of law project has two parallel phases:

1) The recently issued Discussion paper – getting our rules into Internationally compliant form;
2) NRFSB Law – strengthening the Bailiwick's position in respect of Innovative businesses. Now is your moment to influence and assist the Commission's supervision of NRFSBs as we are welcoming volunteers to be involved with this work stream – please contact me or anyone in the Division to express your interest.

The first step in NRFSB revision is Information gathering. We are mainly limited to the information provided when NRFSB firms first seek registration. There is no ongoing annual questionnaire, unlike Fiduciary. Therefore, an online questionnaire will be sent out electronically to our NRFSBs shortly with responses due in the new year.

We are also mindful of the perimeter – who should be registered who isn't?
This is something we will be exploring next year, and therefore if you are sitting here today feeling flushed or red in the face worried that you may have an un registered NRFSB in your business or as a client I encourage you to proactively approach the Division afterwards to discuss your case.

I will now hand over to Eamonn to put our supervisory work into perspective.

Slide: In Perspective

Good afternoon, thank you Gillian and welcome to this final section of the Fiduciary presentation which we have entitled "In Perspective".

For those of you who don't know me, my name is Eamonn Finnerty and I was recently appointed to the Division having spent 5 years with the Banking and Insurance Division, and prior to this I spent 25 years in the financial services industry in London, New York and the Crown dependencies.

This part of the presentation will provide an introduction to the Fiduciary Supervision Policy and Innovations Division, as we have a number of new team members, we will then discuss some further information on risk based supervision using PRISM, and how this approach drives the workings of the Division, and indeed how it will structure our ongoing engagement with your businesses in 2015. We will then briefly share some key observations from recent visits and engagement tasks and finally we will provide an in-sight into the key expectations for 2015.

Slide: Resource Constrained

Further to Gillian's earlier slide indicating that there are currently 192 Fiduciary licensees – we can see from this slide that these businesses employ some 3385 staff. By contrast in the Division we currently have 11 staff which provides some context for the challenges we face with regard to resourcing & naturally fits with a risk based approach to our supervision. Further, in terms of assets, Fiduciary accounts for around half of the Islands Assets under regulated activity.

Before I moved into the Division I was aware that the assets under management for the sector were significant, but I'm not sure I fully appreciated the actual scale, both in terms of assets managed and employment provided and thus the overall importance of the fiduciary community to the jurisdiction.

So let's meet the team.

Slide: The Team

As you can see we have broadly gone for a 4 – 4 – 2 formation however, you will note that we have precisely no substitutes. So, to introduce the team, starting with the analysts, we have recently employed Alice, Celia & Jason. Helen and Simon are our Senior Analysts with Nic Cleveland and Paul Evans as our Assistant Directors. Myself and Audrey, who can't be with us today, are the Deputy Directors and Gillian was appointed Director in July. And we are all ably assisted by the wonderful Sophie.

Now we will take a look at PRISM, and how it is applied to the Fiduciary Sector.

Slide: Probability Risk and Impact System – PRISM

In advance of today's presentation, we asked a number of licensees what they would like to hear about and PRISM and how it will impact fiduciary firms appeared at the top of the list.

As you will have heard earlier PRISM was created by the Central Bank of Ireland and has recently been adopted by the ECB – which provides quite an endorsement. This slide, which hopefully will now be familiar to some of you, and the next few slides will show how Impact and Risk are assessed for all firms; how levels of engagement are derived and what these impact ratings may mean for your firms in terms of ongoing engagement plans. We will also

consider the increasing use of Thematic Reviews across the Commission, which provide us with an efficient opportunity to focus on specific areas.
The Fiduciary Division commenced supervision under the PRISM methodology on the 1May this year – so we are still embedding these disciplines.

- Since the financial crisis, international bodies have increasingly focused on governance and systemic risks and indeed in recognising that supervisors should best use their limited resources on firms with the greatest impact to the jurisdiction.
- Locally – the Commission is evolving its risk based approach – focusing on the higher impact firms and significant risks, and the level of interaction with a firm depends on its impact rating.
- Our supervision, whilst still evolving, has become more judgment based – and is focused on gaining a better understanding of the **RISKS** a firm faces – it's not just about compliance with rules and regulations – rather we seek to gain a better understanding of the operation of the business, its directors and managers and indeed the culture of the firm.
- You may have heard in Tim Loveridge's presentation this morning that we are developing better systems & Management Information – with a drive to automate more work (e.g. checking returns & highlighting risks) – which means more time can be spent on actually understanding your firms.

Slide: Supervision under PRISM

This diagram shows the supervisory process that we have adopted. Initially an Impact Category is set which dictates the level of engagement during which we assess the probability risks (which we will cover later) – where our supervisors will form a view on the probability of a risk occurring and will be challenged at a Risk Governance Panel. This Risk Governance Panel, which will be comprised of colleagues from across the Commission will review the supervisors' conclusions, discuss the approach, ensure consistency & proportionality, and agree a way forward which **may** result in a Risk Mitigation Programme, being issued to the firm.
This really is an iterative, life cycle process.

Slide: Definitions

Definitions for Impact and Probability Risk are on the screen.

Metrics are then used in assessing the appropriate level of engagement which we will have with your firms. I'll give you a second just to read those definitions.

Slide: Impact and Engagement Levels

- This Triangle represents all the Bailiwick's Financial Services Firms. The left hand side shows the 4 impact categories and the right hand side highlights typical engagement tasks for each category. As you would expect impact ratings for individual firms can change.
- The impact rating will drive the minimum engagement plan e.g.
    - For some sectors there are no high impact firms, however where there are, we would carry out financial risk reviews every 6 months and a detailed analysis of the business model every two years.

  - For Medium high impact firms we will conduct a full risk assessment and an onsite visit on a 2 – 4 years cycle
  - For Medium low impact licensees we will conduct a full risk assessment and an onsite visit no less than every 5 years
  - We will also meet with the Board and key personnel regularly - eg for High impact firms – 6 monthly, for Medium High firms every 18 months, and for Medium Low firms every 2 to 3 years.
  - As the slide shows the greatest proportion of firms are in the Low impact category where supervision is largely on a reactive basis & more on that in a moment
  - As you would expect financial crime on-site visits will continue to occur, across all sectors, regardless of your individual impact rating
- For low impact licensees there will be fewer on-site visits – but instead we will rely on automated key risk indicators to flag areas for attention.

Slide: Probability Risk Categories

So what do we look at when analysing a firm? These are the 11 categories of risk which are considered for High and Medium High impact firms.

For the Medium Low impact firms we concentrate on the 5 risks in bold.

A couple of examples of what we would consider are:

- For Strategy/business model risk – we may consider over aggressive growth plans.
- Governance risk – we will look at board and committee quality, management quality, and culture.
- With regard to Financial crime risk – please note that this risk is assessed by the Financial Crime Supervision and Policy Division whereas the other risk categories are considered within the Fiduciary Division
- Probability risks that are assessed as high or medium high could prompt further interaction with a firm to mitigate.

Slide: Reactive Supervision

In addition to our engagement plans and risk mitigation programmes, we will also respond to trigger events, which we refer to as reactive supervision. This will apply to all firms but is particularly important in our supervision of low impact firms. Trigger events could arise from a number of different sources:

Example, from the firm – regulatory returns might show a change in a Key Risk Indicator, e.g. a financial resource requirement level. A customer complaint may highlight another concern with a firm. Other external sources might include information from an auditor, the media, law enforcement, or indeed another supervisor.

There will also continue to be interaction between the financial crime division and the supervisory and policy divisions, as each may come across concerns in the other's area.

By recording and monitoring trigger events we are also able to identify trends.

In addition, a trigger event may lead to further investigation which could involve a thematic review.

Slide: Potential Thematic Reviews

Thematic reviews will be conducted more frequently by the Commission and will apply to all firms, but are particularly pertinent to the supervision of low impact firms.

Thematic reviews are undertaken to improve our understanding of risks in a certain area, they also facilitate identification and understanding of emerging risks.

We could undertake a thematic review as a result of seeing a trend in trigger events or in response to a specific concern.

Examples of thematic reviews that we may consider in the coming year are as shown.

And, whilst we are on this slide, may I take the opportunity to thank everyone who responded to the RATS consultation, we are currently reviewing responses and will provide further updates in time

Slide: Observations

So having used PRISM for approximately 6 months it is probably not surprising to note that whilst the supervisory process has changed, the issues that we see can remain the same.
Evidence of good practice, which is clearly seen on visits to high performing firms, can be covered in the headings above.

- Really ‘know your client’
  - Know your client and understand them, their risk appetite, plans and goals & explicitly record this information on the client management system. We acknowledge that good KYC is a requirement under the Handbook but it should also provide real confidence to your business developers in suggesting appropriate product structures to your clients.

- CDD at the heart of the business
  - CDD = explicitly record knowledge/discussions/decisions processes/analysis or risks. All of which avoids key person risk.
- Embedded compliance culture

  A note here that we can see differences in culture between internationally owned and owner manager firms.
- Risks understood, measured, managed and mitigated
  - Explicitly recorded Risk appetite, which is then shared & communicated within the firm – from the board room, to the business developers and to the administrators. We have seen some first class examples of firms with a well documented, clear, concise risk appetite statement which is clearly understood & shared throughout the business.
  - We have also seen applications where proposals to enter new business areas are lacking and clearly without full understanding of the risks such a venture might pose. Perhaps a coffee here with the Commission’s economist would be worthwhile.

- Active consideration and management of litigation risk, reputational risk & financial crime risk is explicitly documented on client files & throughout board minutes.
- Collective understanding and knowledge in business.
- Best practice firms ensure that specialist areas of the business are understood by all and indeed time is clearly invested in training and developing team members.
- Best practice also includes a proactive strategy to avoid and reduce key person risk and for succession planning purposes.

Slide: 2015 Expectations

So turning to Expectations for 2015.

Risk based supervision is at the heart of what we do and is supported by the PRISM methodology. We expect, as Gillian said, the world of innovations to continue at the current pace.

Online submissions, starting with PQs will increasingly become the usual delivery method for various returns and submissions.

Policy development will continue as we progress the Revision of Laws Project, including the NRFSB Law.

As you would expect AML/CFT visits will continue as a significant engagement task across all sectors.

Thematic reviews will become a more commonly used tool across the Commission. Once an engagement task is conducted a review will take place, but this does not mean that you will always get a Risk Mitigation Programme – only where one is, after thorough consideration and challenge, deemed appropriate and necessary.

The Commissions approach is a collaborative process where we encourage constructive dialogue, and the recent Open Day sessions to socialise the Discussion paper on the Revision of Laws Paper is a good example here. May I say Thank you to those of you from the Fiduciary community who attended. Firms who have been through the PRISM process have been complementary about its structure and outcomes.

In terms of policy development you will be aware from our session today, and from our Investment colleagues earlier in the day, that there are a number of live workstreams:

- The TCSP standard,
- The Revision of Laws - In parallel with the NRFSB revision
- The RATS consultation
- And MiFID II
- We are sharing and discussing these with you at this early stage, in the spirit of open and collaborative partnership; and we really do encourage your participation to help shape and form future policy which affects us all.

To reiterate the message Gillian started our presentation with:

- The fiduciary sector in Guernsey is alive and kicking, and extremely valuable.

Thank you for listening and we would now like to invite your questions to the Panel