Guernsey Financial Services Commission

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Risk and Operations

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Good morning, it has more emphasis now when I say it is nice to see everyone here! Even on Guernsey it feels unusual to be able to hold such events.

Whilst it has been 24 months since our last industry presentation, due to the pandemic it has definitely felt like in the latter part of that period we have been operating in dog years, with the last 12 months translating to many years of life experience. Nevertheless, whilst it has felt that way, it is interesting to reflect back on what have we actually seen in terms of risk for both Guernsey and our wider environment.

Therefore during this presentation, I am going to cover what we have seen as the Regulator during the pandemic in terms of risk and what changes we have made as a result of this. Following that, Conor will be touching on how we are using data at the Commission and some of the new technologies we are utilising to further develop our supervisory approaches.

At the initial start of the pandemic, except for some spot on and aware epidemiologists (including our brilliant Dr Brink) there was a general lack of awareness of the potential risk of a pandemic, and what it could mean for businesses and Society as a whole. Whilst risk registers in the 2000's had included bird flu or potentially Sars type events these had fallen out of favour and had been replaced with more pressing and obvious risks.

However, if we review the history of pandemics shown in this data from the Bank of England it is clear that they are much more common that we thought, and indeed that we have been lucky that this was the first major pandemic in our lifetime.

Thankfully, globally Central Banks and governments sprang into action and identified that one of the main impacts following a pandemic was an economic recession, the red lines on the graph show the significant drop in inflation in the 8 years following the start of each pandemic or epidemic.

This led to what would become one of the largest interventions in monetary policy ever, with extraordinary levels of quantitative easing globally, £450bn for the UK compared to the £200bn following the Global Financial Crisis in 2008 and the US have topped $3 trillion this time around whilst previously only just breaking $2.

Currently these actions seem to have done the trick, with a social health crisis not being compounded by a financial one. Indeed, unlike in 2008 crisis the financial services, especially banks, have helped to absorb and mitigate the risk of a financial crisis rather than contributing to it. However, there remains a question of what will happen as all the various support measures are unwound, inflation is eminently possible along with further job losses and insolvencies as furlough schemes are paused. However, there are shoots of green coming through as the dip in the level of UK GDP has not been as great as predicted after the second lockdown. Within Guernsey we saw a better than expected outcome at the end of the 2020 with the predicted shortfall in tax receipts and revenue streams falling to only £5-10mn from a forecast of £70mn originally.

Indeed, despite all the concerns in 2020, the impact of the pandemic appears to not have been as great as originally feared.

Indeed, if we look back and consider what was concerning senior management at firms pre pandemic it is remarkably similar to the position now. Deloitte carry out a UK CFO survey on a quarterly basis assessing the risks to business from a variety of factors. If we review the list of top 5 risks that were concerning CFO's pre and post pandemic we can see that, aside from the first risk factor switching from weak demand in the UK to the effects of Covid-19, there have been no other changes in remaining top 5 risks. Whilst there may be other less financial risks, such as staff welfare and mental health concerns, that are not necessarily the main focus of the CFO it does suggest that, on the whole, the main strategic risks for firms are relatively unchanged.

So what have we seen from a regulatory perspective in Guernsey. During the pandemic we took a number of steps to change and amend our supervisory approach, such as delaying the submission of returns and pausing onsite supervisory visits, but we didn't stop monitoring and contacting firms to understand their risks and how they were coping with the impact of the pandemic.

Firstly, I would like to thank all the firms we contacted for their cooperation during such a busy and uncertain time.

Secondly, what we found from this what that whilst a few firms had initial issues with operationally moving staff to work from home [and that at a certain point on the island you couldn't buy a laptop for love nor money!], was that on the whole firms coped well with the transition to working from home and that overall in 2020 we saw a gradually decrease in the main risk factors we assess as part of our supervisory visits.

In this graph the period in which Guernsey was in lockdown is highlighted in green and it clearly shows a reduction across all risk types from 2019.

It is reassuring to note that our financial crime risk remained relatively steady through 2019 and 2020 and we saw a drop in strategy and business model risks. With the latter of these it could be that firms are focusing much more on the core basics of their business and ensuring that their businesses survived the pandemic, sticking to their knitting rather than trying to learn to crochet!

Interestingly, if we review operational risk as an example we see a peak at the end of 2019 and then a decrease over the course of 2020. This is contrary to a logical expectation that during a pandemic with a shift to home working, an increase in cyber security risks and less ability to supervise staff directly to make sure controls are working effectively, that operational risks would increase.

One explanation for this reduction could be that we visited less firms on-site in 2020 and were therefore less able to identify an increase in this risk area. However, we were still reviewing, monitoring and assessing data and risks at firms through a variety of other means.

Another explanation is that whilst operational risk did increase, due to the unusual circumstances everyone was operating in, and the short nature of the Guernsey lockdown, everyone was more conscious of these risks and took particular care to mitigate them. In Guernsey, our lockdown was never long enough for bad habits to slip in!

A further consideration is whether the fact that we have been locked down on island for the last year has allowed firms, and their individual staff, more time to focus on these sorts of operational issues and problems, getting around to those tasks for that have been on the list for a number of years but were always being pushed back for something more vitial! therefore reducing the overall operational risk present.

Finally, there is the fact that this only shows as a decrease in risk relative to the increase at the end of 2019. This increase was due to a number of visits carried out in the second half of 2019 identifying significant operational risk issues regarding cyber security, integration of firms following mergers and outsourcing and compliance issues. The same visits also identified heightened governance risks, which we often see go hand in hand with operational risks.

In reality, the drop in operational risk is probably a combination of all of these reasons, however taking a step back it does provide reassurance that the pandemic did not have a material impact on the main risks within the financial services sector in 2020. In fact, we only set two RMP actions directly relating to Covid-19 during the course of the year.

The other point to note here is that as we shifted and adapted our supervisory approach during the first lockdown we started looking at our data and firms from a different perspective, taking a more thematic /peer group approach for certain prudential risks types such as capital and credit risk, providing higher quality insights on firms versus looking at them in isolation.

Off the back of this therefore we have adapted our PRISM approach so that there will be less frequent face to face meetings for our larger firms with a more 'straightforward' business model. Our Firm Risk Assessment's will be more narrowly focused on the more individualistic types of risk such as governance, business model and strategy, and operational risks. Key prudential and conduct risks will be assessed by focused thematics. These changes have been supported by adaptations to our PRISM system to ensure that we can continue to capture, record, and analyse our findings for further risk analysis and insights in the future.

Whilst we have highlighted so far that there appears to have been minimal impact on risk at our firms, there is also a wider question of the impact to the level of financial services business that is carried out within the Bailiwick of Guernsey. Whilst the regulator does not see everything that occurs in financial services in Guernsey, as we are almost entirely focused on regulated activity, it was, again, reassuring to note that our overall application figures held up well during 2020. Whilst we did see some quieter periods as people were adjusting to lockdown, they were only short, and in the second most recent lockdown we didn't see a pause at all! Now whilst our figures also include things that are not necessarily new business (i.e. change of controllers) it does give a good indication that new business for Guernsey has also held up well during an unusual and challenging year! There remains a question of whether this will continue with lockdowns carrying on worldwide, if not on Guernsey, but from all indications, the start of 2021 has carried on this positive theme.

Before I leave the subject of risk, I wanted to touch on what future risks we might see. Interestingly the only financial risk that makes it onto the World Economic Forums top 10 list is the potential for a debt crisis. This not unsurprising considering my earlier comments about the level of economic and monetary policy support that has been provided over the last year.

However, a number of the other risks that make it on the list provide not only dangers but also opportunities for financial services. For example, climate action failure is one area in which financial services, and Guernsey, could play a key supporting role in mitigating the risk by facilitating the investment and developments that are needed to support the world in moving to a carbon neutral position.

Finally, before I hand over to Conor I just wanted to mention some of the changes that have been occurring within our systems. As those of you who read the fascinating document which is our Annual Report and Accounts will have noted that since 2018 we have been running a three year business plan with a number of internal projects to improve our back office systems and processes. One of these was to replace the technology behind our Online Submissions and PQ portals as the previous software had become unsupported. I am extremely happy to say this project has now been completed and hopefully regular users of the portals might have seen some of the benefits that have come from change such as a single sign on process and an improved user experience. This has been a significant project and I would like to thank everyone within the Commission who has been involved with and supported it.

However now to hear from Conor on how we are using the data you are submitting.