Guernsey Financial Services Commission

**Industry Seminar – 16 November 2016**

**Investment Supervision and Policy Division Presentation**

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You will have heard in Mark's clip him speaking about the policy regarding late fund accounts and qualified accounts, introduced recently as a response to the increasing trend of late fund accounts and qualified opinions. I will expand on his comments and what that policy means in practice:

Under this policy, when accounts are not submitted by their submission date, a letter will be sent to the Designated Manager of the fund giving notice of the Commission's intention to impose conditions on the fund's authorisation or registration. The notice given will usually be 28 days, which should allow sufficient time for example administrative errors to be cleared-up.

We will be seeking voluntary agreement to the conditions be the relevant parties, but will impose conditions, subject to the relevant appeal process, depending on circumstances.

The conditions on the fund's authorisation or registration, depending on whether the fund is open-ended or closed-ended, are likely to be no further subscriptions, capital calls, redemptions and no promotion of the fund.

Since the introduction of this policy, the Division has imposed conditions on four funds due to the accounts not being submitted within the relevant deadline. Our condition notice letters have been effective in prompting the submission of late accounts prior to the twenty eight day notice period elapsing, and consequently the number of actual condition letters issued cannot be equated to number of notice letters issued. Reminder: Penalty fees will continue to accrue until the accounts are submitted.

Mark also mentioned our treatment of funds that submit accounts with audit opinions. So which opinions concern us:

A **qualified opinion,** where the auditor concludes there are misstatements that are material to the financial statements, that the auditor is unable to obtain sufficient, appropriate audit evidence and concludes that the possible effects on the financial statements could be material.

A **disclaimer of opinion**, where the auditor is unable to obtain sufficient, appropriate audit evidence and that the possible effects are material and pervasive, or multiple uncertainties that could combine in a way which result in the auditors not expressing an opinion.

An **adverse opinion**, where the audit evidence has been obtained but the auditors do not believe that it fairly present the financial position of the fund, or is not in conformity of the relevant accounting standards or the required information was either not disclosed or was inadequately disclosed or was inaccurate.

When the Division receives the accounts with such opinions or disclaimers, we will impose conditions immediately depending on circumstances.

We are conscious that on some occasions a qualified opinion may arise from arise from a technical disclosure matter for example accounting standards enforce a particular method of presentation that does not reflect the economic reality of the fund. As Mark suggested in the clip, early discussion with the Division if the fund accounts are likely to be qualified or a disclaimer is likely, is recommended. Also the fund's auditors may also wish to consider a discussion with the Division.

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**Slide: Culture and the Global Perspective**

If you search the word culture on any reputed international securities regulators website, you are bound to get a number of hits. Since the global crisis 2007/8 regulators from around the globe have placed increasing emphasis on culture when supervising firms. Why? Well culture is seen to be the cause of decision-making, conduct and behaviour at firms. It has long been recognised that new regulations in isolation is never going to work without the appropriate culture.

Christine Lagarde of the IMF was quoted as stating that "simply adding regulations is not the answer"[i] So what have regulators around the globe been doing to change and instil the appropriate culture in firms, given that it is recognised that changing culture is difficult as it comes from past CEOs, Boards, systems and controls, can take time.

ESMA, the European Authority responsible for the safeguarding the stability of the European Union's financial system, explains its own culture of being mandated to take an active role in building a common supervisory culture among national competent authorities to promote sound, efficient and consistent supervision throughout the European Union. ESMA has not been shy in instigating a raft of regulation, new or revised, with an underlying theme being the drive to change or instil a particular culture. If we take MiFID II, for example [You didn't think I would be able to give a speech at our industry seminar without mentioning MiFID II] one of the objectives of the revisions to the original directive is to increase the level of investor protection by obliging firms to take responsibility for products throughout the lifecycle, and preventing firms own interests and commercial or funding needs from prejudicing their clients' interests.

Steve Majoor, ESMA's Chairman said:
"The financial crisis has revealed many instances where the rules on selling investment services to retail customers failed to ensure that firms acted in their clients' best interest."

So moving from the EU to Asia, the Monetary Authority of Singapore ("MAS"), have been particularly active instilling a fair culture. MAS has used it's recent FAIR (Financial Advisory Industry Review) to assess Board and Senior Management's efforts in promoting a culture of fair dealing within their organisations. A representative from MAS in a speech to the Association of Financial Advisers in Singapore in July 2015, spoke about setting the right tone not just at the top of an organisation but also the middle.

MAS has recognised that even the most intrusive supervisor can only go so far in the promotion of a culture of ethics. Industry itself must take collective responsibility, with financial institutions ultimately bearing the responsibility for getting the culture right. It is recognised that shaping culture demands a substantial effort on the part of the financial institutions. MAS has challenged it's firms to consider not only "is it legal?" but also "is it right?"

Like many regulators in the last decade, MAS has provided a safe environment through a whistleblowing programme for individuals to challenge, question and report unethical behaviour, to ensure business culture is appropriately calibrated.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, to give it its full title, brought about the most significant changes to the financials regulation in the US with a view to instil the right culture. In particular the Act gives the SEC further enforcement powers, which includes a "whistleblower bounty program" whereby the SEC rewards individuals who provide information that leads to an SEC enforcement action in which more than US$ 1 million in sanctions is ordered. The aim is to foster a culture where individuals share their concerns with the SEC and speak up at an early stage, to prevent a culture of wrongdoing becoming entrenched.

Chief of Staff at SEC[ii] in a recent speech spoke of "a culture of always doing the right thing, not tolerating bad practices or bad actors, is essential."

Since the financial crisis the FCA has been focusing on getting culture and conduct right, by paying close attention to the culture of firms and what boards and management are doing to shape the culture, of which governance is a key factor. Culture is a priority for the FCA, one of seven business plan priorities for 2016/17. So culture and governance is one of the priorities for the FCA's policy work, thematic projects and work undertaken in day-to-day authorisation and supervision.

So how do you drive cultural change? The FCA's response to the Parliamentary Commission for Banking Standards' was the introduction of their Senior Manager and Certification Regime, which aims to improve professional standards and culture within the UK Banking industry. A rules based regime has been adopted to ensure that firms and regulators are clear about who is responsible for what. The aim is for individual accountability to focus minds, drive up standards, and make firms easier to run and to supervise. The regime has also introduced a "duty of responsibility" which means Senior Managers are requested to take the steps that it is reasonable for a person in that position to take, to prevent a regulatory breach from occurring. So ultimately,

the regime is about instilling the right culture.

The FCA are looking to extend the regime to all FSMA authorised firms, and will consult in 2017.

Mark Steward, the Director of Enforcement and Market Oversight at the FCA in a speech November last year warned that "culture is in danger of becoming a buzz term, an integrated ideal of good governance, regulatory compliance and fair process. Intangible, theoretical, in danger of becoming merely regulatory, and yet another catchphrase, it cannot be bought and sold"[iii]

I would be bold as to disagree with Mr Steward's comments. You have heard from Emma and Mark that from a Guernsey perspective far from being intangible and theoretical, culture is multi-facetted and tangible, in the management of conflicts, and identifiable through the financial statements.

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[i] Economic Inclusion and Financial Integrity, 27 May 2014.

[ii] Keynote speech to Rutgers Law School for Corporate Law and Governance Camden, New Jersey 20 May 2016

[iii] Speech delivered to MetriStream Governance, Risk and Compliance Summit in London November 2015