Jersey Financial Services Commission

REGULATORY REFORM IN JERSEY

Speech by Lord Eatwell
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The crisis

The shocks that reverberated through financial markets in 2007/8 have not entirely dissipated; indeed a number of aftershocks are still being felt, not least because many of the problems that were revealed by the crisis have not been resolved.

Governments, central banks and regulators around the world are still struggling with the problem of how to create a financial system that is innovative and profitable, that supports and indeed enhances the performance of the economy in general, and, is at the same time, stable and secure.

Jersey has, I believe, managed the crisis years rather better than a number of other jurisdictions that specialise in financial services. A good deal of credit for that must go to my colleagues at the Jersey Financial Services Commission.

I know that everyone at the JFSC has been gratified that in recent months both the Chief Minister and the Treasury Minister have acknowledged that the Commission has served the Island very well indeed in these crisis years.

It hasn't been easy.

Not only did the Commission have to deal with licence-holders in trouble, but also it had to try to understand, and indeed manage, in the best interests of the Island, the flood of international and UK regulatory initiatives that the crisis has stimulated.

Moreover, the crisis necessitated that the Commission take a number of what I believe to be bold decisions:

- in authorisation, where a number of high profile fund and company structuring proposals were not accepted, and some difficult bank licensing calls were made;

- in supervision, where the Commission has nursed several failing trust companies to new ownership with structured workouts of both good and bad books, and the Commission has significantly augmented its work as a bank supervisor;

- and in enforcement, where the Commission tackled some serious misconduct as well as a number of controversial cases of investment mis-selling.

Many of these decisions that have not been, let us say, universally popular.

But no effective regulator will ever be popular.

By definition, regulation involves stopping people doing things that they want to do, and requiring them to do things that they don't want to do.

But an *accomplished* regulator can be respected and recognised as a force for the general good, and that is what I intend JFSC will be under my Chairmanship. Hence one of my tasks this evening is to outline what I believe, in this Island, an accomplished regulator should look like.

The acceleration of change

But before doing that I need to outline what, from my perspective, have been the consequences for financial services in Jersey of the seismic forces that the crisis has unleashed on the broader financial environment.

Today the both Industry and the Financial Services Commission face the challenge of change.

It is a truism that the world of finance is characterised by rapid innovation – sometimes that innovation is driven by the desire to enhance efficiency, sometimes it is in response to regulatory change (a process that tends to create its own tail-chasing dynamic).

But what has been generally true in the past, is even more true today.

The financial crisis has resulted in fundamental changes in the operations of financial institutions and the behaviour of financial markets. The significance of these changes for future of markets and for economic performance in general is, to be frank, as yet not fully understood.

But we cannot stand aside and just let change happen to us. If we do that we will be outflanked and condemned to competitive decline. We need to do our best, first, to understand, and then to shape the future.

Change of immediate interest to Jersey is taking place in (at least) 3 areas:

***First,* the structure of financial markets** is undergoing rapid change.

For example, there are important developments in the growth of shadow banking, i.e. the performance of banking functions by non-banks, such as asset managers and insurance companies.

A corollary of this growth in shadow banking has been the growth of bond markets, sovereign and corporate. In the past three years there has been a major switch in the composition of financial flows from developed to emerging markets, with a significant swing toward bond financing. And a similar pattern has emerged in the financing of medium-sized enterprises within developed economies, including the UK and the US.

Why might this growth of bond financing this have regulatory implications?

As we all know, bond markets are particularly sensitive to interest rate changes. On 21st May 2013, Ben Bernanke first mentioned the idea of gradually reducing or "tapering" the Federal Reserve Board's monetary expansion. Bernanke's announcement, by raising the prospect of increases in interest rates, led to a rush to cover potential losses, with convulsive movements in currency and bond markets. It is clear, today, that the Fed expects more of the same instability in the future.

What this incident taught us is that systemic risk is no longer the sole preserve of leveraged banks. Unleveraged asset managers can create systemically unstable positions too.

This is just one example. Many more are likely to follow as the changing structure of financial markets relocates risk – almost certainly in a manner that will affect Jersey financial entities in entirely new, unexpected ways.

Another example of change that has significant regulatory implications is the changing balance of economic and financial strength between West and East. In future we know that we will have to undertake the formidable task of performing due diligence in respect of prospective financial flows from unfamiliar and often opaque jurisdictions.

Then add in the challenge of the emergence of virtual currencies, defined by the US Department of the Treasury as: "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency". The key attribute a virtual currency does not have is the status of legal tender, nor does any central bank stand behind it. As you will all know recently we broke new ground by authorising our first Bitcoin fund here in Jersey. I can assure you that we are watching the turbulent developments in the Bitcoin world very carefully indeed.

Our ***second*** major set of consequential changes is occurring in the content and implementation of **financial regulation**: internationally, in the European Union and in the UK, all with major implications for Jersey.

Three recent developments pose challenges for the way in which the JFSC has approached its regulatory tasks.

First, the major regulators have declared that they will "protect the taxpayer" by seeking to establish effective resolution regimes for major banks, supposedly eliminating the threat of "too big to fail", and hence undermining the Commission's characterisation of a top 500 bank as having a public bail-out guarantee. Whether this attempt to insulate the taxpayer will succeed is another question. At the moment I believe the claim is not credible – but that's another story for another day.

Secondly, the inability of authorities around the world to agree on the content of reform has resulted in diverse structures within the new regulatory regimes (in banking the Volker rule in the US is different from the Liikanen proposals in the EU and both are different from the Vickers inspired legislation in the UK). This creates the potential for major market realignments via regulatory arbitrage that may pose significant challenges to regulation in Jersey – and yet may create business opportunities too.

Thirdly, the extension of quasi-extra-territorial regulation in terms of demands for regulatory equivalence, or of truly extra-territorial rulings as in the case of FATCA, inevitably changes the dynamics of financial market development, and therefore financial regulation in Jersey.

Turning now to the final item in my catalogue of major changes, **the relationships between regulators and governments are changing:** though not all these changes are in the same direction.

In many of the major economies governments, hoping to control systemic risk in the financial services sector, have ceded powers to regulators.

So regulators that have previously been endowed with what were seen as "purely technical" powers of micro-prudential regulation are now required to take the highly politicised decisions that the macro-prudential regulation of systemic risk demands. The tentative steps being taken by Financial Policy Committee of the Bank of England, for example its reluctance to assume the power to regulate loan to value ratios in the mortgage market, indicate the Committee's awareness that this could be a political minefield.

As far as Jersey is concerned developments are, if anything, moving in the opposite direction.

Whilst the Government here in Jersey remains committed to the independence of the JFSC, it is seeking a closer relationship with the regulator in the furtherance of its economic goals. This is essentially a "Jersey plc" approach, and is the rational response to the issues facing a small, highly specialised jurisdiction.

The key problem to be solved is how to manage the development of financial and regulatory policy in a coherent, mutually supportive manner. And this doesn't just involve the Government and the Commission, it involves Industry too – a matter I will return to later.

Suffice to say that discussions are underway to create a transparent framework for the mutual consideration of regulatory policy in a more effective manner than has typically been the case in the past – recognising the differing responsibilities of government and regulator, and, of course, the ultimate responsibility of the Government for the well-being of the Island.

Characteristics of an accomplished regulator

The scale, scope and pace of all these changes, and the risks and opportunities embodied in them, pose serious challenges for the JFSC, particularly in the context of the limited resources available in a small jurisdiction.

I will deal first with how the JFSC plans to meet these challenges, and then turn to concrete examples of what it will actually do.

I believe that the challenges we face will require that the Commission, if it is to be an accomplished regulator, must be **a thinking regulator, an agile regulator, and therefore an inquisitive regulator**.

A **thinking regulator** is a regulator that actively confronts the prospective challenges posed by change. The Commission has, in the past, been rather overly devoted to examining the success or otherwise of its past operations. This is, of course, necessary, since lessons are learned from the past. But too much time spent examining the past and too little devoted to future challenges and to speculative argument, does not make for a Commission that can provide the adaptive environment in which Industry can make the most of the opportunities that changing financial circumstances present.

It is this "thinking" approach that is necessary if the regulator is to be **agile**.

It is inevitable in an innovative industry such as financial services that even a successful regulator is 10 metres behind the market in a 100 metre race. The point is not to fall even further behind.

The goal should be to understand the significance of new developments, and decide on an appropriate, well-founded response within a reasonable period of time.

It is not the task of the regulator to be a financial entrepreneur, or to attempt to guide innovation – though the regulator may have an important part to play in thinking through policies that aid market development. It is one of the key tasks of the JFSC to provide a regulatory environment that is conducive to those innovations that serve the best economic interests of the Island – put simply, growth and jobs.

To be thinking and agile the JFSC must be an **inquisitive**, outward-looking regulator serving an outward-looking Industry - and therein lays a dilemma.

The Commission simply does not have the resource, and given the size of the jurisdiction, cannot have the resource, that enables it to pursue a significant research agenda within the Commission itself.

So what is absolutely necessary is that the senior executive team identify and engage with creative thinkers throughout the international regulatory community, leverage the work of others, and focus it through the lens of the needs of Jersey. The Board has its role to play too. The Board must be composed of individuals who bring a wide range of experience and analytical skills to the Commission, and they must be prepared to be agile, to learn.

Reforms

Thinking, agile, and inquisitive – all nice concepts, but what do they mean in practice? What are the practical changes you might expect in your relationship with the JFSC?

Some major reforms are underway already.

In September the Commission published a Policy Statement that began the process of significant revision of our Bank Licensing Policy. The Executive Summary made clear that our approach will be far more flexible than in the past, particularly if risk to retail depositors can be mitigated. Our approach is a response to the new regulatory approach to "too big to fail" that I referred to earlier, and the empirical observation that since the crisis more banks have failed in the top 500 banks, than have failed in the group from 501 to 1,000!

So the Commission's earlier approach that emphasised the need for a bank to be of systemic importance in its home jurisdiction is now a meaningless disincentive to doing business in Jersey, and is to be dropped.

Similarly, the longstanding requirement for the parental group to be in the global Top 500 has been altered for now to an expectation that it feature in the Top 1,000. Moreover, we have made clear that inability to meet this criterion should not deter an applicant from exploring options for licensing with the Commission.

And for similar reasons, the previously stated expectation that an applicant bank will have experience of operating beyond its home borders has been removed.

The Commission believes that the revised Licensing Policy reflects new realities and provides a workable and flexible framework for a wide variety of banks to operate within the robust regulatory framework to which the Island remains committed.

Further changes are likely in due course, in line with local strategies and international developments. This work is led by our Director of Banking and Insurance, Mark Sumner, who is here this evening.

With respect to Funds Business, the Commission, in conjunction with Industry and Government, is undertaking a fundamental review of the funds regime.

The overall aim is to streamline and simplify what has become overly complex. In particular we intend to speed up or in some cases even eliminate the process of authorisation.

Since this work has yet to go out to consultation I cannot fill in the details this evening. But our intention is obvious; to provide a clear, responsive and agile regulatory framework that enhances the competitive strength of the Industry. In return we will expect more rigorous compliance from the Industry, and our supervisory regime will be enhanced.

The work on the new funds regime is well advanced and will be published soon. At the Commission this work is led by our Policy and Strategy Division, but it will in time encompass a major operational component to be led by our new Director, Funds and Fiduciary, John Everett, who is also here this evening.

And we realise that the Commission's internal working practices must also be updated to meet the challenges of the new era.

Accordingly, we have established a Programme Management Office, led by our new Chief Operating Officer, Mike Jeacock, yet another of the team who is here tonight.

The task of the new Office is to develop a blueprint for change and enhanced efficiency in all the Commission's activities: from policy development to IT, from the growth of talent within the Commission to delivering value for money regulation to Jersey, from the implementation of more effective risk-based supervision to introducing new systems in the Registry.

We are taking a long, hard look at all aspects of what we do, ensure that we control costs and meet our ultimate goal which is to better serve the people of Jersey, and those who do business here.

The regulator and the industry

But we cannot achieve all this alone - we also need help from you. We need you to understand the work of the Commission, just as we need to understand you.

As far as you understanding the Commission is concerned we will be developing a range of new media initiatives – producing not just more information, but information that is well presented and with a clear rationale, all this facilitated by a new post of Head of Communications. This will mean more Discussion Papers (produced by the Policy and Strategy team led by its new Director, Charles Ilako, another who is here this evening). At the moment Charles is working on a Jersey/EU *tour d'horizon*. There will also be broader guidance material, information on best practice experience, project updates, and so on.

In addition there will be more training events – not only our own regular seminars, but also wider ranging events such as the seminar held here with the United States Securities and Exchange Commission just a few weeks ago.

And we are making a new commitment to e-enablement, lowering costs and improving your access to the regulator.

All this we hope will improve your understanding of us. But we, as your regulator, must work hard to continually improve our understanding of you.

To begin let's dispose of a couple of hoary old complaints about regulators.

First, how many times have you heard the complaint that "the regulator doesn't understand my business as well as I do"? Ridiculous. If the regulator, an outsider spending a relatively short time examining your firm, did understand the business as well as you do, you shouldn't be in business. You inevitably know your firm best. It's your job to provide a transparent account of your activities to the regulator to ensure that he or she can do the supervisory job well.

Second, how many times have you heard it said that you shouldn't adopt that transparent approach because it will only lead to the regulator picking on you in the future? Ridiculous and childish. Nothing warms a regulator's heart more than a business that wants to work with the regulator to achieve the goal we are all pursuing, that Jersey should be known as the very best place to build well-regulated financial business.

To better understand you, we must be a listening regulator.

So we intend to develop new and faster approaches to consultation, using methods such as the Survey Monkey, the online survey tool that we have been trialling together with JFL in the consultation on managed accounts.

There must also be a closer partnership with the Jersey Compliance Officers Association. Compliance officers have a vital role to play, not only in the development of the businesses in which they work, but also as the professional conduit of information and advice from, *and to* the Commission.

And it is important that you should know your Commissioners. They are here tonight. You should talk to them, send them e-mails, advise, complain, even congratulate – whatever you do, communicate. That's your responsibility. Without your input, the JFSC will be a poorer regulator, and that's not good for your business or good for Jersey.

This couldn't be better illustrated than by a pressing matter that should be uppermost in the minds of all of us: the forthcoming MONEYVAL evaluation.

Make no mistake - this will be a tougher examination than any we as a regulator or you as an industry have undergone in the past.

The international community, particularly in AML/CFT terms, is focusing in a hard, demanding way on whether relevant standards are indeed being met by *demonstrable* effectiveness. When the MONEYVAL team visit Jersey next January they will challenge us to do this in a number of ways that, frankly, will be pretty tough.

For example they will not want to know how many AML/CFT supervisory visits were done, but what were the concrete results, actions and documented themes emanating from those visits and they will want to see the evidence!

This is just one of a myriad of demanding tests we will face as the international community ramps up its AML/CFT oversight requirements. How effective these requirements are in meeting the defined policy goals is a reasonable topic for debate on another day. But right now there is no hiding place and everyone should be aware that some of the stellar ratings we have enjoyed in the past may no longer be available.

This does not just affect Jersey. It is a worldwide phenomenon. So what we must do is demonstrate good performance relative to those jurisdictions with which we wish to be compared (the UK, EU, US and relevant IFCs). Working together we can do that.

My goals

I have laid out an ambitious programme for regulatory reform here in Jersey. I believe our goals can be achieved. But it won't be easy.

The outstanding staff of the Commission, led so ably by John Harris, are fully stretched – and I am going to stretch them some more! And this is before additional demands are made on the Commission. For example today the JFSC has no powers to provide regulatory protection to consumers of retail financial services in Jersey. The Government has suggested that we should take on the regulation of pensions. We are certainly willing to comply with the request, but, as you will all understand, this will have resource implications.

I have been appointed Chairman of the Board of the JFSC for the next 5 years. It's entirely reasonable for you to ask the traditional interview question: "what do you hope to achieve in that time?"

I suppose I could sum up my goals as these:

- That Jersey should have sustained and enhanced its reputation as a well regulated jurisdiction in which to do business. In particular, we must continue to demonstrate conscientious observance of international standards, albeit applying a carefully calibrated sense of proportionality and risk assessment.

- That the financial services industry in Jersey should have prospered in that well regulated environment.

- That the JFSC should have served the financial services industry and the people of Jersey well by managing change in international financial markets and change in international regulation in the best economic interests of the Island.

- And that the JFSC should be an accomplished regulator – thinking, agile, inquisitive and listening. Not necessarily popular, but respected as an institution working hard to promote the general good.

If we achieve those four goals, then that will do.

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