



DISCUSSION PAPER

A REGULATORY FRAMEWORK FOR THE 21ST CENTURY

CONSULTATION PERIOD: 13 MAY 2013 TO 8 JULY 2013

EXECUTIVE SUMMARY

The purpose of this paper is to seek feedback from the financial services industry and the general public on proposals to reform the legal framework which governs the Guernsey Financial Services Commission. It is not proposed to examine the underlying regulatory legislation as that is the subject of a separate consultation which will be released later in the year. The key aspects of this consultation are:

- Clarifying the regulatory objectives of the Commission to ensure that proper account is taken of the economic priorities of the States of Guernsey,
- Introducing secondary matters to which the Commission should have regard including: supporting competitiveness, minimising the cost of regulation, encouraging innovation and adherence to good governance,
- Introducing a statutory obligation to engage in consultation with industry on regulatory policy,
- Improving governance of the Commission and clarifying the role of the Director-General,
- Improving decision making by introducing a financial services tribunal,
- Ensuring independence in the handling of complaints against the Commission,

HOW TO RESPOND

Responses are invited from the general public as well as the financial services industry. A list of consultation questions are contained at the end of each chapter, plus a consolidated list of questions is contained in the Appendix. General comments on the proposals or any other aspect of the regulatory framework are also invited.

The consultation period runs from Monday 13 May 2013 to Friday 5 July 2013.

Please send your comments to:

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CONTENTS

EXECUTIVE SUMMARY.....	2
HOW TO RESPOND	2
CHAPTER ONE: FINANCIAL SERVICES AND ECONOMY	6
THE CONTRIBUTION OF FINANCIAL SERVICES TO THE ECONOMY	6
THE CONTRIBUTION TO THE ECONOMY	6
TAX REVENUES AND OTHER PUBLIC INFRASTRUCTURE SUPPORTED BY THE FINANCE INDUSTRY ...	8
DIRECT CONTRIBUTION TO GOVERNMENT REVENUE.....	9
DIRECT CONTRIBUTION TO OTHER PUBLIC SECTOR INFRASTRUCTURE	9
FUTURE GROWTH PROSPECTS.....	9
HIGHER VALUE ADDED SERVICES AND PRODUCTIVITY GROWTH	9
THE CONDITIONS FOR GROWTH	10
CHAPTER TWO: CONTEXT	12
THE PROPOSALS	12
HISTORY OF THE COMMISSION AND FINANCIAL SERVICES REGULATION	12
CHAPTER THREE: ALIGNING PRIORITIES	14
SETTING REGULATORY OBJECTIVES.....	14
REGULATORY OBJECTIVES.....	14
COMPARATOR JURISDICTIONS.....	15
THE UNITED KINGDOM	15
AUSTRALIA.....	15
JERSEY	15
HONG KONG.....	16
RECOMMENDATION	16
INTRODUCING SECONDARY MATTERS	17
COMPARATOR JURISDICTIONS.....	17
THE UNITED KINGDOM	17
AUSTRALIA.....	17

JERSEY	18
HONG KONG.....	18
RECOMMENDATION	18
CHAPTER FOUR: CONSULTATION	20
OBTAINING INDUSTRY FEEDBACK	20
RECOMMENDATION	20
CHAPTER FIVE: IMPROVING GOVERNANCE.....	21
GOVERNANCE AND COMPOSITION OF THE COMMISSION.....	21
REPORTING TO THE STATES	21
HISTORICAL CONTEXT	21
THE INDEPENDENT EVALUATION REVIEW FINDINGS	22
COMPARATOR JURISDICTIONS.....	23
NUMBER OF COMMISSIONERS	24
CURRENT ARRANGEMENTS.....	24
CHALLENGES WITH ENFORCEMENT	25
TRANSITIONAL DIFFICULTIES.....	25
RECOMMENDATION	26
LENGTH AND TERMS OF COMMISSIONER APPOINTMENTS	26
RECOMMENDATION	26
TERM OF THE CHAIRMAN	26
RECOMMENDATION	27
ROLE OF THE DIRECTOR-GENERAL	27
THE APPOINTMENT AND REMOVAL UNDER THE FSC LAW	27
ROLE OF THE CHAIRMAN AND DIRECTOR-GENERAL.....	28
COMPARATOR JURISDICTIONS.....	28
RECOMMENDATION	29
REMUNERATION OF THE COMMISSIONERS	29
CHAPTER SIX: IMPROVING DECISION MAKING	32
ENFORCEMENT.....	32
RESPONSIBILITY OF DIRECTORS AND MANAGERS	32
RECOMMENDATION	32
COMMISSION DECISIONS AND APPEALS	33
THE CURRENT PROCESS	33

A FINANCIAL SERVICES TRIBUNAL	33
A POSSIBLE STRUCTURE	33
ADVANTAGES	34
DISADVANTAGES	34
THE ROYAL COURT.....	35
ADVANTAGES	35
DISADVANTAGES	35
RECOMMENDATION	36
RESOLVING COMPLAINTS AGAINST THE COMMISSION	36
COMPARATOR JURISDICTIONS.....	36
RECOMMENDATION	37

CHAPTER ONE: FINANCIAL SERVICES AND ECONOMY

THE CONTRIBUTION OF FINANCIAL SERVICES TO THE ECONOMY

1. Financial Services is the key driver of the Guernsey economy. It has been for at least the past 20 years and is likely to remain so for the foreseeable future. Guernsey has a number of key competitive advantages which have led to the development of its finance industry. Those advantages include:
 - The ability to set its own tax rates,
 - The ability to set its own legislative framework,
 - The ability to set its own regulatory regime within the confines of internationally accepted standards,
 - A skilled and well trained workforce which has built up relevant experience over the past four decades.
2. Having a pragmatic, responsive, and appropriately resourced regulator which understands the States' priorities for the finance industry is one of the tools available to the States to ensure long term economic growth. This consultation has been prepared to ensure that the regulatory framework for the financial services industry remains part of that advantage in attracting high quality financial services business that provides high value added in the economy and can maintain Guernsey's standard of living. It also intended to ensure that the regulatory framework is suitable for the next 20 years.
3. In order to set the relevant context for the recommendations contained in this report it is necessary to explain the economic contribution of financial services to the economy and to the States of Guernsey's revenues. Obviously the contribution to States Revenues is important to government finances but should not be mistaken for the Guernsey economy. The benefits to the broader Guernsey economy far outweigh the direct benefits to States Revenues. Those benefits include opportunities for Islanders to develop high levels of skills and work in relatively well remunerated and rewarding employment which can potentially offer a global career path. Ensuring that the financial services industry remains the principle driver of the economy in the medium term and beyond is the key goal of these proposals.

THE CONTRIBUTION TO THE ECONOMY

4. The financial services industry is the key driver of the Guernsey economy. It is by far and away the largest economic sector and the largest contributor in per capita economic output – its Gross Value Added ('GVA') per employee being nearly twice the Island average:

	Average	Finance	Non Finance
GDP per capita	£58,600	£105,780	£42,140
Earnings	£27,400	£46,000	N/A
Housing Licenses	1 in 10	1 in 13	1 in 9

5. This demonstrates that economic contribution of each employee in the finance industry is more than double that of employees in the non-finance sector. This significant difference in GVA is indicative of Guernsey's overall competitive advantage in the financial services

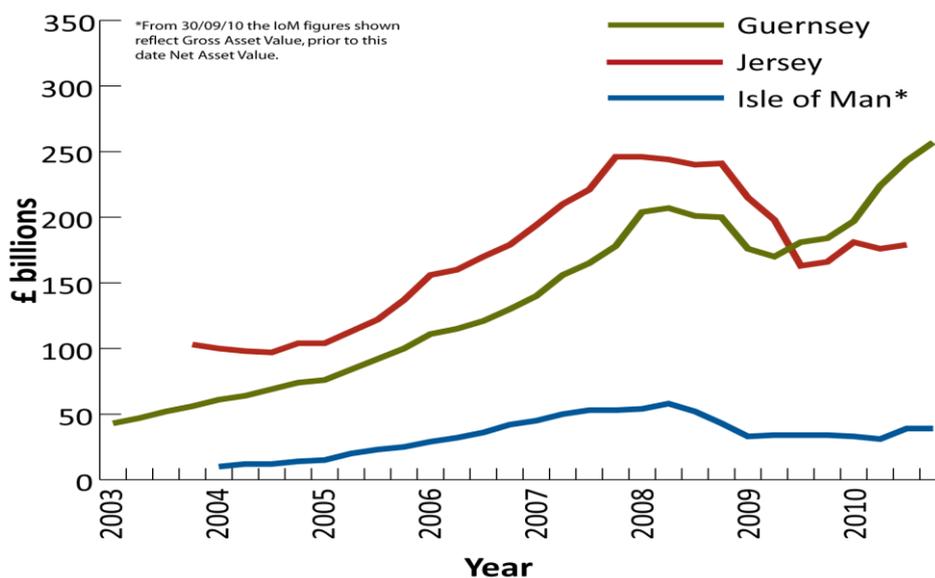
industry. The diverse range of skills and experience in the Guernsey finance industry demonstrates that the industry provides a significantly higher value added per employee.

- The financial services industry directly contributes approximately 40% percent of Guernsey's economic output (Gross Domestic Product or GDP). By way of comparison the retail sector is approximately 8% of GDP, tourism is approximately 3% of GDP whilst information technology contributes 3% of GDP. To provide an example of the comparative benefit to the economy of growth in the financial services industry: if it were possible to grow the financial service sector by 10% to 44% of GDP it would achieve the same result to the economy as growing the information technology or tourism sectors by 100% or the retail sector by almost 50%. It would be practically impossible to achieve that level of growth in either of those sectors in the short to medium term given the constraints on labour, land and resources. Over the long term such changes may eventuate by the natural evolution of the economy. However, at the present time the most effective way of achieving economic growth in the short to medium term is to seek to expand the financial services industry.

Industry Performance

- The economic conditions since 2008 have been difficult across the globe with most major advanced economies suffering recessions of varying severity and duration. Guernsey has not been immune to this and there has been a degree of contraction and rationalisation in the domestic financial services industry. Nevertheless in some areas the Guernsey finance industry has been strong. For example the funds industry is now larger than it was in 2008, and is the largest funds industry in the Crown Dependencies. The captive insurance sector has also seen growth in the past three years cementing Guernsey's place as the largest captive insurance domicile in Europe.

Total Assets under Management in Guernsey's Funds Industry



INTERNATIONAL INSURANCE STATISTICS IN THE 2011 - 12

International insurers - last 12 month's movement					
Type	1 June 2011	Additions	Surrenders	Net Change	31 May 2012
Companies	265	6	17	-11	254
PCCs	62	13	7	6	68
PCC Cells	332	87	24	63	395
ICCs	5	1	1	0	5
ICC Cells	13	4	0	4	17
Totals	677	111	49	62	739

TAX REVENUES AND OTHER PUBLIC INFRASTRUCTURE SUPPORTED BY THE FINANCE INDUSTRY

8. The financial services industry is also the largest contributor to government revenues through direct taxation on banking profits as well as through Employee Tax Instalments ("ETI") payments. The direct tax contribution will also expand as the Treasury and Resources Department has announced that more financial services businesses will be brought into the 10% tax band, with the result that the bulk of direct business tax revenue will be generated by the financial services sector. The financial services sector contributes approximately 35% of ETI from 25% of the workforce. In addition the finance industry generates a significant part of the revenue generated from the Company Registry (see table below). The finance industry is also the largest user of commercial property on the Island and therefore pays a significant amount of TRP revenue. The finance industry directly funds the regulatory framework administered by the Guernsey Financial Services Commission through its license fees which would otherwise have to be funded out of General Revenue of the States.
9. It is very difficult to calculate the direct contribution to government revenues with precision. In order to quantify the direct benefit to the States' financial position regulatory fees have also been included as while they don't form part of government revenues, the funding by industry relieves the government of expenditure which it would otherwise have to incur in order to meet international obligations for financial services regulation.
10. An estimate of the direct contribution to government revenue and the direct contribution of other public sector infrastructure in 2011 is as follows:

DIRECT CONTRIBUTION TO GOVERNMENT REVENUE

Revenue	Basis of Calculation	Total
Tax on Bank Profits	10% tax on banking profits	24,122,000
ETI Contribution	35% of total ETI	76,350,000
Company Registry Fees	Financial Product Company Annual Fees	5,300,000
TOTAL DIRECT REVENUE		£105,762,000

DIRECT CONTRIBUTION TO OTHER PUBLIC SECTOR INFRASTRUCTURE

Source	Basis of Calculation	Total
GFSC Fees	Annual Report	12,596,240
Guernsey Finance Funding Law	Guernsey Registry	351,000
TOTAL		£12,947,240

11. In total the finance industry directly contributes £118,709,240 to tax revenues and to support other necessary public sector infrastructure which would otherwise have to be funded by the States.
12. There are also significant secondary economic benefits that accrue from the finance industry. It has been calculated that each person employed in the financial services industry supports 1.5 employees in the broader economy. On that basis the finance industry also supports approximately 10,200 jobs in the non-finance sector. With a total of close to 17,000 jobs dependent on the finance industry the total contribution to ETI which is directly and indirectly dependent on that industry is significantly greater than that set out above.
13. Maintaining a strong and vibrant financial services industry is critical to ensuring Guernsey's continued economic prosperity. The contribution of the financial services industry to government revenues and the community is significant and is recognised by the States as essential to the future prosperity of the Island.

FUTURE GROWTH PROSPECTS

Higher Value Added Services and Productivity Growth

14. Guernsey's financial services industry has seen substantial growth over the past 20 years. It can be argued that at 40% of GDP, future growth in the sector is likely to be constrained by capacity issues. It has also been argued that Guernsey should not seek to significantly grow financial services because of concentration risk of being overly reliant on one industry and instead it needs to diversify into other industries – this is accepted but it is still vital to protect the financial services industry to maintain its position as other potential industries grow. In the absence of any change in policy, current constraints on labour, land and suitable premises

will in all likelihood constrain growth in the sector. However, there are a number of ways in which the sector can grow through shifting to higher value added business models.

15. By developing and growing higher value added business economic growth could be achieved without necessarily requiring a significant increase in the labour force. Higher value added sectors could be supported through developing the appropriate legal and regulatory framework as well as through policy development and well researched and focussed marketing. This will form part of the Island's finance sector strategy which will be released for consultation later this year.
16. In addition financial services can deliver growth through productivity gains. Productivity gains can be achieved by the application of technology and the improvement in the skills base of the workforce. Accordingly it is possible to achieve economic growth in the finance industry within the current constraints of land and labour resources.

The Conditions for Growth

17. Guernsey has relatively few policy levers at its disposal given the lack of monetary policy flexibility and current limits on fiscal policy. However, there are a range of policy options open to the States which could potentially stimulate growth in the financial services sector. There are essentially six key policy areas which are essential to ensure improved economic growth in the financial services industry and the broader economy:
18. Tax Neutrality: Maintaining a competitive tax regime is an essential element given current competitor jurisdictions. However competitive taxation is only effective when combined with other policy initiatives. It is a necessary but not sufficient condition for growth.
19. Appropriate Regulation: having the right regulatory framework is essential. For example the current AML/CFT Laws can impose a compliance cost on industry that may outweigh the risks posed by money laundering in some areas constraining innovative business opportunities from being realised. By reviewing the regulatory framework it may possible to stimulate growth in the financial services industry by reducing compliance costs and creating a more attractive business environment.
20. Innovation: Innovation is critical in maintaining a competitive advantage. By putting in place new legislation new business lines can be encouraged. For example, the development of an Aircraft Registry and the introduction of Foundations are examples of legal innovations which the States can encourage. Protected Cell Companies are the classic example of how government innovation can stimulate growth in the private sector for relatively little outlay of public funds. Innovation also occurs in the private sector through the adoption of new types of businesses and processes which can lead to economic growth. It is important that the regulatory regime does not unnecessarily limit the ability of the private sector to innovate. It is equally important that regulation is in place that is appropriate for new business.
21. New Markets: By identifying new markets and putting in place appropriate regulation, legislation and intergovernmental agreements, Guernsey can support the private sector which is looking to bring new business to Guernsey from outside its traditional European markets. An example of this is the Guernsey Finance China initiative.
22. Cost: Competing on cost is a legitimate strategy, although lower costs can probably only be achieved through lower wages which is not something that the government necessarily

desires given the need to ensure a high standard of living for the Island's residents. However other costs such as company fees, regulatory fees etc are controllable and may be worth examining in the medium to long term. Regulation needs to be effective and regulatory fees must be sufficient to ensure effective regulation.

23. Skills: Ensuring that the Island has access to higher skill sets is necessary to attract higher value added business. This can be achieved through education and training or via being flexible with housing license policy for highly skilled finance industry professionals. The skills strategy is an essential part of meeting this policy need.
24. Of these six preconditions arguably the three which would have the greatest short to medium term impact are innovation, regulation and new markets. Innovation is the responsibility of the Commerce & Employment Department, while new markets development is the work of Guernsey Finance. The purpose of this paper is to re-examine the regulatory infrastructure to ensure that it continues to be fit for purpose.

CHAPTER TWO: CONTEXT

THE PROPOSALS

25. The Commerce & Employment Department is proposing the revision of the Bailiwick's regulatory framework for the 21st century. The starting point for any such revision must be the *Financial Services Commission (Bailiwick of Guernsey) Law, 1987* ("the FSC Law"). Whilst it has served Guernsey well it is pre-dates current global recognised regulatory standards and the substantial changes in the Island's economy, system of government, and the nature of the finance industry itself.
26. The purpose of this discussion paper is to raise a number of potential issues for consideration by stakeholders so that the States may consider the appropriate level of reform. The Commission is working with the Commerce & Employment Department on a consolidation of the regulatory laws which should also lead to efficiencies and reduced cost to industry. These proposals are in addition to that project and will ensure that the overall tone of regulation is appropriate to ensure sustainable long term economic growth.
27. The key proposals are:
 - The clarification of the Commission's primary regulatory objectives,
 - Ensuring that the Commission will consider issues such as competitiveness, cost and economic growth in how it applies the regulatory regime,
 - To reform the governance of the Commission to remove the limit on the number of Commissioners and to require that the Director-General of the Commission is *ex officio* a member of the Commission. The appointment and remuneration of the Director-General would remain the responsibility of the Commissioners,
 - To review the enforcement and appeals process of the Commission to allow the Commission to carry out enforcement more effectively,
28. Comment is invited from stakeholders on the merits of these suggestions so that the States can make an informed judgement on the best way to reform the FSC Law.

HISTORY OF THE COMMISSION AND FINANCIAL SERVICES REGULATION

29. The FSC Law was first enacted in 1987 and followed a report from the then Advisory & Finance Committee debated by the States in May 1986. That report recommended the creation of an independent Financial Services Commission which would take over from the Advisory and Finance Committee which historically was responsible for the financial services industry.
30. The original States Report which recommended the introduction of the Commission provided that:

"The Commission would be charged with the encouragement and supervision of the financial services sector and would be available as the basic unit on to which any further associated activities could be grafted if required at a later date"
31. It is clear from that States Report that the Commission was to be responsible for the development, encouragement and supervision of the financial services sector in Guernsey.

32. The Chairman of the new Commission was the President of the Advisory and Finance Committee. The Commission would have responsibility for the regulation, promotion and development of the financial services industry in Guernsey, as well as the capacity to support other bodies which were established to support the finance industry. By creating one of the first unitary financial services regulators in the world the FSC Law was innovative and designed to suit the circumstances of Guernsey at the time.
33. The Law was modelled in part on the then operation of a States Committee. The Commissioners were those in whom statutory powers were vested, whilst the executive, much like the civil service supported the Commissioners and exercised delegated authority where appropriate. The Commission was given power to issue subordinate legislation on the basis that the Chairman, as President of Advisory and Finance, could lay such legislation before the States and answer any questions that the States may have on that delegated legislation. The Commission was financially accountable to the States through the Chairman as a member of the States.
34. The original States Report also recommended that:
- “... the expenses of the Commission would be met ultimately by licensing and other fees levied on the enterprises operating in the financial services sector, and the legislation under which the Commission’s original functions would arise should be amended so as to enable fees to be charged”
35. It is clear that the vision of the States when it established the Commission were as follows:
- The Commission would be responsible for development, promotion and supervision of the financial services sector,
 - Policy would be determined by the States and the Commission would be responsible for implementing policy,
 - The Commission must be accountable to the States,
 - The activities of the Commission should be funded through license fees levied on the financial services sector.
36. In the intervening years international standards on regulation evolved and the FSC Law was frequently amended to bring it into line with those changing standards. As a result the promotion and development of financial services were removed as regulatory functions. The States responded to those developments by establishing Guernsey Finance (as a partnership with the industry) to assume responsibility for promotion and establishing the Finance Sector Development Unit of the Commerce & Employment Department to facilitate development of the finance industry. However the license fees levied by the Commission which had hitherto supported regulation, promotion and development, were retained by the Commission and used solely for regulatory purposes.
37. Over time the FSC Law has been amended and altered to keep pace with the emerging international standards but at no stage has there been a wholesale review of the Law and it is somewhat overdue.

CHAPTER THREE: ALIGNING PRIORITIES

SETTING REGULATORY OBJECTIVES

38. One of the most important factors in getting the balance of regulation right for any economy is ensuring that the regulatory objectives strike an appropriate balance between economic growth, consumer protection, and financial stability without compromising the reputation of the jurisdiction.
39. Regulation is not an end in itself. It is a tool of public policy used to ensure that the economy can experience long term sustainable economic growth. As has been readily demonstrated by recent global events, financial crises substantially damage economic growth. Sustained or regular financial crises have the potential to permanently destroy economic capacity thus restraining economic growth in the long term. Financial services regulation exists to correct market failure, protect consumers, prevent financial crime, and ensure financial stability. All of those public policy goals exist to ensure long term economic growth. A failure to regulate appropriately undermines confidence in the financial system and ultimately underlying economic growth. Regulation that is too onerous stifles innovation and competitiveness resulting in lower growth than otherwise might have existed. Getting the regulatory balance right is the responsibility of governments which are accountable to the electorate.
40. Financial services regulation is interconnected with the performance on the economy, and it is entirely appropriate that regulators should consider the economic impact of their actions.
41. In order to achieve the appropriate public policy balance between financial stability, consumer protection and long term economic growth it is common for many jurisdictions to provide independent regulators with a number of primary objectives and secondary matters that they must consider. The primary objectives set out what the regulator is tasked to achieve. The secondary matters explain how the regulator should go about achieving those objectives.

REGULATORY OBJECTIVES

The Commission's Current Objectives

42. In Guernsey the current regulatory objectives are contained in a range of different legislation and States Reports. In addition there are secondary sources from which the objectives of the Commission may be inferred, such as the Chief Minister's letter to the Commission issued prior to the Independent Evaluation Review by Ernst & Young. Some specific objectives are contained in the FSC Law, and some of the regulatory laws also contain sector specific statutory regulatory objectives.¹ As far as the Commission is concerned its statutory objectives are:
 - To provide effective supervision of the financial services sector,
 - To make recommendations to the States on schemes for the statutory regulation of finance business,
 - To counter financial crime and the financing of terrorism,

¹ For example see the Protection of Investors (Bailiwick of Guernsey) Law, 2002.

- To maintain confidence in the Bailiwick’s financial services sector,
 - To ensure the safety, soundness and integrity of the Bailiwick’s financial services sector.
43. There is a power for the States, by resolution, to confer additional functions on the Commission, however that power has rarely been used.
44. Overall this set of statutory objectives has served the Bailiwick well over the past two decades. However there have been substantial developments in financial services regulation with many jurisdictions having put in place clear and specific statutory objectives.

COMPARATOR JURISDICTIONS

The United Kingdom

45. The UK recently introduced the Financial Services Act 2012 which, *inter alia*, created the new Financial Conduct Authority. That Law came into force in April 2013. The FCA has been given the strategic objective of ensuring that relevant markets function well. It is also given three broad operational objectives:
- Securing the appropriate degree of protection for consumers,
 - Protecting and enhancing the integrity of the UK financial system,
 - Promoting effective competition in the interests of consumers.

Australia

46. The Australian Securities and Investments Commission, the Australian equivalent to the proposed UK FCA, also has a set of core statutory objectives²:
- Maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy,
 - Promote the confident and informed participation of investors and consumers in the financial system,
 - Administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements,
 - Take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it,

Jersey

47. The core functions of the Jersey Financial Services Commission are:
- The supervision and development of financial services business provided in or from within Jersey,
 - Providing advice to the States on any matter connected with financial services,
 - Making recommendations to the States for the introduction of legislation appertaining to financial services, companies or other forms of business structure.

² See s.1 Australian Securities and Investments Commission Act 2001 (Cth). Only relevant statutory duties have been listed.

Hong Kong

48. The Hong Kong Securities and Futures Commission has the following statutory objectives:
- To maintain and promote fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry,
 - To promote understanding by the public of the operation and functioning of the securities and futures industry,
 - To provide protection for members of the public investing in or holding financial products
 - To minimise crime and misconduct in the securities and futures industry,
 - To reduce systemic risks in the securities and futures industry,
 - To assist the Financial Secretary in maintaining the financial stability of Hong Kong.

RECOMMENDATION

49. In reviewing the current statutory framework operating in the Bailiwick it is clear that the FSC Law should be reviewed to provide a set of clear statutory objectives to the Commission. Unlike many other jurisdictions, Guernsey does not have substantial domestic financial services markets. The nature of the Guernsey economy is that much of the activity in Guernsey is related to market activity elsewhere. As a result the objectives which may apply to a large economy may not be directly transferrable to Guernsey. The role of the financial services regulator in an economy such as Guernsey often may be to support other regulators in achieving their objectives.
50. Given comparator jurisdictions, international standards, and the nature of Guernsey's economy, it is proposed that in modernising the FSC Law the following primary statutory objectives should be included:
- Protecting Guernsey's reputation as an international finance centre,
 - To effectively administer the supervisory legislation which confers functions on the Commission,
 - To provide appropriate protection to retail consumers of financial services products,
 - To maintain, promote and support the efficiency, competitiveness, and transparency of financial markets located in the Bailiwick and support this elsewhere (when in the interests of the Bailiwick),
 - To combat financial crime in the financial services industry,
 - To reduce, and support the reduction of, systemic risk in the financial services sector in the Bailiwick or elsewhere (when in the interests of the Bailiwick).
51. The States should be able to amend these objectives by Ordinance to reflect changing circumstances.
52. It is also appropriate to consider what is meant by the term "reputation" in this context. The concept of "reputation" should be given a broad meaning which should include not only a reputation for good regulation but also the Bailiwick's reputation as a good place to do high quality business.
53. It is also proposed that many of the other statutory functions of the Commission are retained, such as the ability to provide consolidated economic data to the States, to exchange information with other regulators, and to make recommendations to the States on the

statutory regulation of financial services, regulatory policy or compliance with international regulatory standards.

INTRODUCING SECONDARY MATTERS

54. In addition to primary objectives many jurisdictions also include a range of matters to which independent regulators must have regard when carrying out their regulatory functions. These secondary matters provide guidance to the regulator in how they should go about achieving their regulatory objectives. They are subordinate to those primary objectives and are always a secondary factor in any regulatory decision making. Where the two come into conflict the secondary matters must give way.
55. While this may be perceived by some as making secondary matters meaningless, they are nonetheless useful means by which governments can set the “tone” of regulation. There are different ways of achieving this outcome. Some jurisdictions include in the primary legislation matters to which the regulator must have regard when making regulatory decisions. Other jurisdictions issue a “statement of expectations” by which the government can provide guidance to the regulator on how the government expects the regulator to carry out its duties. At present no decision has been taken on what is the ideal solution for Guernsey. Legislation has the advantage that it is a lawful obligation. However it has the disadvantage that it cannot be changed quickly and must necessarily be at a relatively high level. A statement of expectations can be more detailed and also easily changed to adapt to the evolving economy. However it is not something which the regulator is statutorily obliged to consider and perhaps may be more easily ignored.

COMPARATOR JURISDICTIONS

The United Kingdom

56. The Financial Services Act 2012 contains a number of regulatory principles which the Financial Conduct Authority (and the Prudential Regulatory Authority) applies in meeting its regulatory objectives. Those principles include (relevantly):
 - The need to use resources in the most efficient and economic way,
 - The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term,
 - The responsibilities of those who manage the affairs of financial services business to ensure compliance with regulatory requirements,
 - The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which result from that burden or restriction,
 - The general principles that consumers should take responsibility for their decisions,
 - The principle that the regulator should exercise its functions as transparently as possible.

Australia

57. The Australian Government has chosen not to include a list of secondary objectives in the primary legislation. Instead the Government, through the Commonwealth Treasury has issued

a “Statement of Expectations”³ which provides the additional context for how ASIC goes about fulfilling its statutory functions. The statement is several pages in length and covers a range of issues including the relationship between ASIC and various government bodies. The key relevant matters contained in the statement of expectations are:

- ASIC should give due consideration to the direct and indirect economic costs of regulatory intervention,
- Priority should be given to initiatives which minimise procedural requirements and business costs and increase commercial certainty,
- Regulation should identify outcomes rather than prescribe how to achieve those outcomes,
- The regulatory framework should accommodate structural change and not unduly constrain market participants from pursuing opportunities for competition and innovation.

Jersey

58. The Jersey legislation requires the JFSC to have regards to the following matters:

- The reduction of risk to the public of financial loss due to dishonesty, incompetence or malpractice,
- The protection and enhancement of the reputation and integrity of Jersey in commercial and financial matters,
- To act in the best economic interests of Jersey.

Hong Kong

59. In carrying out its statutory objectives The Hong Kong Securities and Futures Commission is obliged to have regard to the following matters:

- The international character of the securities and futures industry and the desirability of maintaining the status of Hong Kong as a competitive financial centre,
- The desirability of facilitating innovation in connection with financial products,
- The principle that competition among persons carrying out financial services business should not be impeded unnecessarily,
- The importance of acting in a transparent manner,
- The need to make efficient use of its resources.

60. On its web site the HKSF also states that in carrying out its mission the HKSF “aim to ensure Hong Kong’s continued success and development as an international finance centre”.

RECOMMENDATION

61. It is proposed to introduce some secondary matters into the regulatory regime. This will provide the Commission with important context and guidance on the way in which the States

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<http://www.asic.gov.au/asic/asic.nsf/byheadline/Statement+of+expectations+and+statement+of+intent?openDocument>

expects the Commission to carry out its regulatory functions. It is also important to give the Commission guidance on the balance it should strive to achieve between appropriate supervision of financial services business and economic growth.

62. It is proposed to introduce the following secondary matters to which the Commission must have regard:

- The economic importance of financial services to the Guernsey economy,
- The need to retain Guernsey's competitiveness as an international financial centre,
- The need to ensure cost effective regulation that minimises the economic impact of regulation on the broader economy,
- The need to use its resources in the most efficient manner,
- The need to enable competition and innovation in financial services,
- That the primary responsibility for achieving regulatory outcomes rests with the owners and senior managers of financial services businesses,
- The need to adhere to generally accepted principles of good corporate governance.

Consultation Questions

Question 1: Do you agree with the proposed primary objectives for the Commission, if you disagree please explain why?

Question 2: Are there any other primary objectives which ought to be included, if so what additional objectives would you include or remove?

Question 3: Do you consider the inclusion of secondary matters to be appropriate?

Question 4: Are the proposed secondary matters appropriate, if you do not consider them appropriate please explain why?

Question 5: Are there any other secondary matters which should be included, if so please explain what those matters should include and why are they appropriate?

CHAPTER FOUR: CONSULTATION

OBTAINING INDUSTRY FEEDBACK

63. It is the responsibility of the States of Guernsey to set overall policy for the financial services industry. That States performs that function through the preparation of States Reports, the passing of legislation, and the setting of the overall strategy for the financial services industry. However the Commission also has a policy function. That policy function concerns delegated legislative functions such as setting regulations and rules of conduct for the industry. There are also broader policy issues concerning how the Commission will interpret and apply its legislative powers.
64. In fulfilling its policy function the Commission must make policy decisions in an informed and transparent manner. As is explained in this chapter it is proposed to provide a statutory framework on that policy formulation process.

A Statutory Duty to Consult

65. The Commission has always engaged in consultation with the industry and the general public. The Commission also has a track record of developing its regulatory framework with the assistance of working groups on which stakeholders are represented. This is good practice and the States is keen to ensure that such good practices continue.
66. In the UK the Financial Conduct Authority has a general duty to consult with practitioners and consumers. This statutory duty obliges the FCA to consult with stakeholders to ensure that its general policies and practices are consistent with its general duties and the matters to which the FCA must have regard.

RECOMMENDATION

67. It is proposed to introduce a statutory duty to consult and oblige the Commission to maintain effective arrangements for consulting with financial services business and the general public. This will ensure that the current good practice will continue in the future. The general duty would not apply on regulatory decision making but on the formulation of regulatory policy and secondary legislation, rule and guidance. It would not apply to the exercise of regulatory powers or decision making. There may be circumstances where it may be inappropriate to consult such as in cases where urgent action is required or where the public interest may otherwise require, or where the matter is merely one of clarification. However it is expected that the general duty would ordinarily apply to most matters.

Consultation Questions

Question 6: Do you agree with the proposal to introduce a statutory duty to consult, if not explain how consultation by the Commission might be improved?

CHAPTER FIVE: IMPROVING GOVERNANCE

GOVERNANCE AND COMPOSITION OF THE COMMISSION

Background

68. When the Commission was initially established it was one of the first unitary regulators of financial services. It was almost a decade later that an equivalent statutory regulator was created in Jersey. In setting up the Commission the approach that was taken was to model aspects of its structure on the structure of the then States committee. This was a logical evolutionary step and essentially adapted the model which was the norm given the machinery of government that existed at the time.
69. The model of a States Committee at the time was a board comprised of elected members of the States of Deliberation and non-elected members appointed by the States. Supporting the work of the political board was a civil service represented by a Chief Officer (or equivalent). This was the model adopted by the Commission, with an ex-officio Chairman who was the senior politician at the time, the President of Advisory & Finance. In addition there were up to 6 other Commissioners appointed by the States.
70. To support the Commissioners an executive was created with the most senior executive being the statutorily recognised position of Director-General. This structure was suitable at the time and is still similar to the model used by States Departments under machinery of government that has existed since 2004.
71. However in the intervening years the composition, functions and powers of the Commission have changed significantly. For example some of the key changes which have been introduced include:
 - The removal of political representation on the Commission,
 - The introduction of more significant enforcement powers,
 - The ability to issue pecuniary fines and civil penalties for breaches of the regulatory framework,
 - The power to issue public statements concerning licensed entities,
 - The introduction of regulation of trust and company service providers,
 - The power to place licensees into administration,
 - The power to appoint inspectors to financial services businesses.
72. Evolving international standards have led to a much more intrusive and robust system of regulation and the Commission must be structured in a way that ensures that it can effectively carry out its functions.

REPORTING TO THE STATES

Historical Context

73. Up until 2004 the relationship between the Commission and the States was clear. The Advisory & Finance Committee was responsible for the financial services industry. In that role it was politically responsible for the regulatory framework, governance of the Commission, the development of the financial services industry and the promotion of Guernsey as a financial

centre. For much of the period between the creation of the Commission and 2004, the President of the Advisory and Finance Committee was also the Chairman of the Commission. As a result there was a clear line of accountability between the Commission and the Advisory and Finance Committee and ultimately the States.

74. During the review of the machinery of government the original proposal, as debated in May 2003, was for responsibility for the financial services industry be transferred to the Commerce & Employment Department which would assume responsibility for the Island's financial services industry and be politically accountable for the Commission⁴. However in a subsequent report debated in November 2003 it was recommended that responsibility be divided as follows:

- The Policy Council should be responsible for international financial matters and for establishing the policy framework for financial regulation including the Government's relationship with, and reporting lines for, the Guernsey Financial Services Commission,
- The Commerce & Employment Department should be responsible for business infrastructure issues across the financial and non-financial sectors including related legislation such as Company Law, Electronic Transactions Law etc, and for the relationship with, and funding of, organisations supporting the finance industry such as the Guernsey Promotions Agency and the Training Agency.

75. This report was adopted and the result was that the Commission now has dual reporting lines. It reports to the Policy Council on questions of governance and the overall regulatory framework, but it reports to the Commerce & Employment Department on legislative matters pertaining to regulatory legislation. In practice the Commission reports to both as almost all matters are considered by both Committees which to some extent creates unnecessary duplication. At an operational level all activity is dealt with by the Finance Sector Development Unit which advises both the Policy Council and the Commerce and Employment Department on financial services issues.

The Independent Evaluation Review Findings

76. Ernst & Young carried out an independent review of the Commission in 2011 and made a number of observations and recommendations on the relationship between the Commission and the States. Essentially Ernst & Young recommended a single point of contact. Ernst & Young made the following comments:

“At present the Commission's reporting line and responsibility is to the Policy Council – which is a committee within a government rather than a department. This makes it hard to set and sustain clear regulatory strategy and objectives. Almost all commentators agree that a clear reporting line to a government department, with agreed areas of reporting, is highly desirable. This is difficult to achieve within the current arrangements.

We recommend that a single government department should be responsible for the Commission. It is, however, difficult to determine which department this should be.

⁴ See Billet D'Etat VII of 2003

Commerce and Employment Department clearly has the strongest capability to deal with this responsibility. There is good knowledge of the industry within the department and people with appropriate skill sets to liaise with the industry and the Commission. However, C&E also has a significant conflict because it is responsible for the development of financial services. Very strong safeguards would be necessary to deal with the conflicts that would arise from this dual responsibility.

Treasury and Resources Department is freer from conflict. Furthermore most jurisdictions with a significant finance sector vest responsibility for regulation in departments of government that are equivalent to T&R. However, there is currently less capability to execute this role within T&R. It would be less than optimal to leave the direction of regulation to a department that does not have the skills and resources to properly handle it.”

77. Notwithstanding the conclusions of Ernst & Young, it has to be acknowledged that since 2010 the Commerce & Employment Department has worked closely with the Fiscal and Economic Policy Group (a Policy Council subgroup) on issues such as regulatory strategy, Commissioner recruitment, commenting on Commission fees, and scrutiny of reports and accounts provided by the Commission. This has led to clearer communications and regular dialogue between policy makers and the Commission.

Comparator Jurisdictions

78. Each jurisdiction allocates political responsibility for its financial services industry and regulator differently. In examining comparative jurisdictions it is apparent that while a significant number do indeed vest responsibility in the equivalent of a Treasury Department, others vest responsibility in department’s responsible for economic development:

Jurisdiction	Department	Other Departmental Responsibilities
Isle of Man	Treasury Department	Promotion and Development of Isle of Man as a Finance Centre
Jersey	Minister for Economic Development	Promotion and Development of Jersey’s as a Finance Centre
United Kingdom	HM Treasury	UK Economy
Australia	The Treasury	Financial Services, Economic Development, Foreign Investment and Trade Policy
Bermuda	Ministry for Finance	Business Development and Regulatory Affairs
Hong Kong	Financial Secretary	Oversees Economic Development

79. As this analysis shows it is far from unusual for an independent regulator to report to the government department that is responsible for economic development.

80. Given the conclusion reached by Ernst and Young that the Commerce & Employment Department has the greatest capacity to deal with financial services regulatory issues it is proposed to transfer responsibility for the Commission to the Commerce & Employment Department. The Commerce & Employment Department remains accountable to the Policy Council and ultimately to the States for its actions.
81. It is recognised that there are potential conflicts within Commerce & Employment's political responsibilities; however those conflicts are present in the governance arrangements of many other jurisdictions. Those conflicts will need to be managed and it will be the responsibility of the Commerce & Employment Department to manage potentially competing interests. The mandate of the Department will need to be amended to ensure that it is obliged to consider those competing interests. There should also be a high level of transparency in dealings between the Commissioners and the Board of Commerce and Employment which could be formalised in a memorandum of understanding.
82. The Policy Council would remain involved in the process as it is responsible for proposing and delivering the overall objectives of the States. It is expected that there would continue to be regular meetings between the Commissioners and the Fiscal and Economic Policy Group on strategic and economic matters, the selection and appointment of Commissioners and the regular review of Commissioner remuneration, which will ensure that the Commissioners' independence is not compromised.

NUMBER OF COMMISSIONERS

Current Arrangements

83. Currently the FSC Law provides for a maximum of 7 Commissioners. For much of its operational life the Commission has functioned with 5 or 6 Commissioners. The States has generally appointed a range of suitably experienced candidates to the Commission and has sought to appoint a balance of locally resident Commissioners and "off-island" Commissioners. The general policy is to appoint a majority of Commissioners from on-island to ensure that the Commission can have the benefit of experience from those who have practical experience of the Guernsey business environment. Off-Island Commissioners bring international experience and a degree of disinterested external oversight of the Commission ensuring that the Commission meets international best practice.
84. At present the Commissioners serve two primary functions. Firstly they are effectively the Commission's board of directors. In fulfilling the responsibility to provide strong corporate governance they are charged with overseeing the operations of the Commission, holding the executive to account and scrutinising general regulatory activity.
85. Secondly they are regulatory decision makers. The regulatory laws and the FSC Law give the Commissioners decision making power over a variety of matters. Much of the day to day operational decision making such as licensing, on-site visits etc, is delegated to the executive and staff of the Commission. However the most serious of decisions, such as imposing fines, removing a license, and taking serious enforcement action are reserved for the Commissioners who sit as a Decisions Committee made up of three Commissioners.

Challenges with Enforcement

86. This dual role creates a number of difficulties, and it is often the case that the two duties come into conflict. As decision makers the Commission must adhere to human rights and the principles of natural justice. In order to comply with these overarching obligations the Commission has produced a Guidance Note setting out the Decisions Committee process. In order to avoid any allegations of bias or prejudice and to avoid any challenge on human rights or natural justice grounds the Commission has adopted a practice of excluding those Commissioners involved in a Decisions Committee from any involvement in the investigations leading to that Decisions Committee process. This includes restricting Commissioners' access to information about ongoing investigations which may lead to enforcement action in the future. The Commission has received legal advice that this is appropriate and necessary to ensure that its regulatory decisions are not open to legal challenge.
87. This creates two practical difficulties:
- The creation of a Decisions Committee of three Commissioners means that none of the Commissioners can effectively perform their corporate governance function over the most serious cases if they are required to participate in a Decisions Committee. However they remain ultimately responsible for that process as appointed Commissioners. This places those involved in the Decisions Committee process in the invidious position of being accountable and responsible for matters where they have no information about, or involvement in, those matters.
 - Local Commissioners are often excluded from hearing enforcement matters due to conflicts of interest. It is often the case that there are personal or business relationships which prevent locally resident Commissioners from participating in Decisions Committees. This places the quite onerous burden of most Decisions Committees on the non-resident Commissioners. At the present time the Chairman of the Commission is non-resident and he is often required to participate in Decisions Committees to ensure they have quorum. This is inappropriate for the Chairman whose primary responsibility must be corporate governance.

Transitional Difficulties

88. The current legislation limits the number of Commissioners to a maximum of 7. The Commissioners are appointed for a three year term. It is also very prescriptive in the length of term that Commissioners can serve. For example if there is a casual vacancy on the Commission any person appointed to fill that casual vacancy can only be appointed for the remainder of the term of the departed Commissioner, rather than being appointed for a full term. This can result in the States having to fill a casual vacancy and then re-appoint that same person a few months later when the remainder of that term expires. This takes up valuable States debating time which could be better used for policy debates.
89. Furthermore the current restrictions prevent the States from appointing "over-lapping" Commissioners. For example in the case of 7 Commissioners, where the terms of 3-4 were expiring in quick succession it is not possible to appoint one or two of those replacements early so that there can be some transition from the retiring Commissioners to those incoming. This occurred in 2011 when the States had to appoint three new Commissioners in a very short period which provides renewal but can result in unnecessary disruption to the

regulatory decision making process. In an ideal world it would be better from a corporate governance perspective to allow for over-lapping appointments. This would ensure a degree of continuity and permit the States to better plan for future appointments to the Commission.

RECOMMENDATION

90. It is recommended that the statutory maximum of 7 Commissioners be abolished. Instead the Law should not prescribe any number of Commissioners but should instead state that the Commission quorum should be a minimum of 3 Commissioners. This would allow the States more flexibility in appointing Commissioners.
91. As a general rule the States would appoint up to 7 Commissioners with the majority drawn from the local community. The statutory procedure for filling casual vacancies should also be removed and each Commissioner should be appointed for a minimum term by the States. The ability to appoint more than 7 Commissioners would ensure that overlapping appointments would be possible and that additional appointments could be made if necessary.

LENGTH AND TERMS OF COMMISSIONER APPOINTMENTS

92. The FSC Law provides for Commissioners to be appointed for a 3 year term; Commissioners may be reappointed for additional terms. At present the FSC Law does not provide any limit on the number of terms a Commissioner may serve. However the general practice which has been adopted by the Chairman is to limit the number of terms a Commissioner may serve to three terms, or a maximum of 9 years. Appointments beyond 9 years would be the rare exception as good corporate governance requires the regular renewal of board members to ensure appropriate scrutiny of the executive.
93. This practice has served Guernsey well and it is not proposed to introduce any specific statutory limits on the number of appointments. Instead the current practice of limiting the total length of service to 9 years should be retained. There may be circumstances where it is appropriate for an individual to serve more than 3 terms and the FSC Law should have the necessary flexibility to facilitate that outcome.

RECOMMENDATION

94. It is proposed to amend the Law as follows:
 - To specify that the appointment will be for a period of at least three years or for such further period as may be specified by the States.
 - Specifying the date of commencement for the appointment which may be a date after the relevant meeting of the States,

TERM OF THE CHAIRMAN

95. Currently the Chairman of the Commission is reappointed on an annual basis. This process is a legacy from the decision to remove the President of the Advisory and Finance Committee as Chairman of the Commission. At the time of that change the statutory obligation to prepare an annual report was also introduced as a means of ensuring a degree of parliamentary accountability.

96. In its most recent review of the Bailiwick's regulatory regime the International Monetary Fund made the following comments regarding the annual appointment process:

“...the requirement for annual renewal of the Chairman's mandate by the legislature is at variance with international standards and merits careful review, notwithstanding the four consecutive renewals accorded the current Chairman and several Commissioner's observations that failure to renew the Chairman's mandate could have the effect of having them seriously consider their own continuance in post”

97. Overall the IMF concluded that Guernsey met the relevant international standards on independence but recommended that the annual renewal process be reviewed. It has been the general practice of the States to automatically renew the appointment of the Chairman until such a time as the Chairman offers his resignation. In the circumstances the current practice does not achieve any significant policy objective, consumes valuable States resources with the preparation of the Billet D'Etat and the use of States debating time.

RECOMMENDATION

98. It is recommended that the term of the Chairman be amended to be identical with the term of his or her appointment of a Commissioner. If the Chairman of the Commission chose to step down in the middle of the term of office then there would be a power for the States to appoint one of the other Commissioners as Chairman for the remainder of his or her term.

ROLE OF THE DIRECTOR-GENERAL

The Appointment and Removal under the FSC Law

99. The FSC Law creates a statutory role of Director-General and specifies that the most senior member of the staff of the Commission shall bear the title “Director-General”. The Director-General is appointed by the Commission on such terms and conditions as specified by the Commission and holds office for a minimum term specified by the Commission. The Director-General may only be dismissed by the Commission on the following grounds:
- He is absent from three consecutive meetings of the Commission without the Commission's consent,
 - He has been declared insolvent,
 - He is incapacitated by physical or mental illness, or
 - He is otherwise unable or unfit to discharge the functions of the Director-General.
100. The last criterion is somewhat unclear as the FSC Law does not specify the functions of the Director-General, although they are generally defined in the contract of employment. Nevertheless section 11 creates substantial statutory protection for the Director-General making that position in many respects as independent as that of a Commissioner. Such statutory protection does allow the Director-General to give robust advice to the Commissioners and to the States. It also puts the Director-General in a very strong position compared to the Commissioners as the Director-General has the same statutory protection but does not have the same statutory responsibilities as he is not a Commissioner. Nevertheless the Director-General is a servant of the Commission. He or she is appointed by

the Commission in order to assist the Commissioners to carry out the functions assigned to them by the States.

101. The Director-General is charged with the management and operation of the Commission. He is equivalent to a chief executive. The first role of a chief executive must be to ensure that the organisation meets the objectives of the stakeholders and implements the Board’s strategic direction. Obviously a chief executive of any organisation must be willing and able to stand up to the Board of Directors of that organisation and justify his or her actions. Conversely the Board of Directors must hold the chief executive to account for his actions and decisions. It is through that collective responsibility and accountability that effective corporate governance can be achieved.

Role of the Chairman and Director-General

102. The statutory role of Director-General also blurs the lines of responsibility between the Chairman and the Director-General. As the Commission’s own Code of Corporate Governance which applies to regulated financial services business points out:

“the role of Chairman is central to the effective leadership and corporate governance of the [organisation]”

103. However under the current legislative arrangements the Chairman’s tenure is legally less certain and secure than that of the Director-General. At present there is also no clear delineation between the role and function of the Chairman compared to the role and function of the Director-General.
104. This lack of duty combined with the statutory protection afforded to the Director-General is not consistent with principles of good corporate governance as it reduces transparency of decision making process and creates potential barriers to proper accountability.
105. Potentially there is a lack of collective responsibility between the Director-General and the Commissioners as the Director-General is not a member of the Commission. This means that the Director-General is not collectively responsible for Commission decisions.

Comparator Jurisdictions

106. Guernsey is unusual in creating a statutory role of Director-General, where that role is not also a member of the body which is ultimately responsible for the operations of that regulator. Many jurisdictions do not provide for a specific statutory role for the most senior executive of their financial services regulator:

Jurisdiction	Statutory Role for Chief executive (or equivalent)
Jersey	The Jersey Financial Services Commission has no statutory role under the <i>Financial Services Commission (Jersey) Law, 1998</i> . The most senior executive is given the title “Director-General” and is <i>ex officio</i> appointed as an Executive Commissioner
The United Kingdom	The Financial Services Authority does not create a statutory role for its most senior employee. The most senior employee is called the Chief Executive and is effectively an Executive Director of the Authority. The board of directors of the

authority are appointed and may be removed from office by the Treasury.

The Isle of Man

The Isle of Man FSC is a statutory board. The most senior officer of the IoM FSC is the Chief Executive who is an executive Commissioner. Apart from the Chief Executive all staff of the IoM FSC are civil servants employed on the same terms and conditions as other Manx civil servants

Hong Kong Securities and Futures Commission

The HK Securities and Futures Ordinance does not create a statutory position for its Chief Executive. The Commission is simply permitted to employ persons for on such terms as it determines.

The Hong Kong Securities and Futures Commission has also set out the roles and responsibilities of the Chairman and the Chief Executive to ensure further clarify surrounding each role. That approach has considerable merit and the Department recommends that the Commission introduce a similar statement.

Recommendation

107. The Department recommends that the statutory role of Director-General, as separate and distinct from the Commissioners be refined and the most senior executive of the Commission would become *ex-officio* a Commissioner. The Commissioners will retain the freedom to appoint a chief executive (who can be described however the Commissioners see fit, although presently the title “Director-General” should be retained as it is well recognised in the international regulatory community). The recruitment, selection and remuneration of the Director-General will remain matters for the Commissioners. As a Commissioner the Director-General would be afforded the same statutory protections as a Commissioner. This will ensure collective responsibility for decision making as well as making the Director-General more accountable to the Commissioners and collectively responsible for Commission decisions. The terms and conditions of appointment of the Director-General would remain matters for the Commissioners.

REMUNERATION OF THE COMMISSIONERS

Current Arrangements

108. Under the FSC Law, the remuneration of Commissioners is set by the Policy Council. Since 1987 the remuneration arrangements have never been subject to adverse comment in any international review. At present the Policy Council reviews remuneration periodically and attempts to ensure the remuneration is sufficient to attract high quality Commissioners, whilst also recognising that for locally resident Commissioners there is also an element of public service attached to the role.
109. The Commission has requested that consideration be given to altering the present arrangements to permit the Commission to determine the appropriate remuneration for

Commission subject to consultation with the Policy Council. It is argued that this is necessary for the Commission to be seen to be appropriately independent of the government.

110. At present there is no evidence that such arrangements are impinging on the independence of the Commission. It has also not been the subject of any criticism by the International Monetary Fund in their review of the Islands regulatory laws in 2002 and 2011. Accordingly it is not proposed to alter the current arrangements save as follows:

- To introduce a statutory obligation on the Policy Council to consult with the Commission before determining remuneration,
- To introduce a statutory obligation on the Policy Council to ensure that the Commissioner's remuneration is reasonably commensurate with their statutory obligations,
- To introduce a statutory obligation to review the fees not less than every three years.

Consultation Questions

- Question 7: Do you agree with the proposal to transfer political responsibility for the Commission to the Commerce and Employment Department, if there is another more appropriate Department please explain why you consider that to be appropriate?
- Question 8: What other mechanisms could be put in place to manage any potential conflicts of interest between the Department's responsibility for the development of the finance industry and the management of the regulatory framework?
- Question 9: Do you agree that the statutory maximum number of Commissioners should be abolished and replaced with a minimum number of Commissioners, what do you consider to be the appropriate number of Commissioners?
- Question 10: Do you agree that the terms of office for Commissioners should permit overlapping terms for Commissioners?
- Question 11: Do you consider that the States should be able to specify the term of appointment for Commissioners in the instrument of appointment, if not please explain why?
- Question 12: Do you agree that the terms of office for the Chairman should be increased to the term of his appointment as a Commissioner?
- Question 13: Do you consider that the current practice of appointing Commissioners for a maximum of 9 years should be retained as a general policy or should it be included in the primary legislation? If you think alternative arrangements might be appropriate please explain why they should be preferred?
- Question 14: Do you agree that the statutory role of Director-General should be reviewed to make the Director-General of the Commission an *ex-officio member of the Commission*?

CHAPTER SIX: IMPROVING DECISION MAKING

ENFORCEMENT

111. The Commission has a wide range of enforcement powers which it can use to enforce the regulatory framework. Those powers range from the power to conduct routine on-site visits to powers which have very serious consequences such as cancelling a license or registration, banning a person from being involved in financial services business, making a public statement or imposing a discretionary financial penalty of up to £200,000.
112. At present there is no evidence that the Commission's current enforcement powers are inadequate, although the level of discretionary penalties which may be imposed may be inadequate given the nature of the finance industry in Guernsey. This will be a subject for discussion in the consolidation and review of the regulatory laws. However there are issues concerning whether the Commission's current internal structure is able to carry out enforcement activity effectively. A related issue is whether the regulatory approach to compliance and enforcement has achieved the right balance.

RESPONSIBILITY OF DIRECTORS AND MANAGERS

113. As set out in the various States Reports which have conferred various enforcement functions on the Commission, the States general view is that enforcement action must always be a last resort. This is the declared policy of the Commission. If the Commission has to resort to enforcement action then the regulatory framework has essentially failed as there has been non-compliance by a financial services business. The old adage that "prevention is better than cure" applies to regulation as it does in other circumstances. The approach of the Commission must be to encourage compliance with the regulatory framework rather than taking enforcement action after that framework has failed.
114. One means of achieving this outcome is through the introduction of secondary matters as set out in paragraph 62 above. Those proposed secondary matters include an obligation for the Commission to recognise that the primary obligation for compliance with the regulatory framework rests with the owners, directors, and managers of financial services businesses.
115. Regulation should focus on the desired outcomes rather than being overly prescriptive or rules based. The Commission should specify the regulatory outcomes it requires. It should be up to financial services business to determine how best to achieve those outcomes. There should also be a presumption that regulated businesses comply with their obligations.

Recommendation

116. It is recommended that the regulatory framework should move towards an outcomes based regime that gives financial services businesses the freedom to determine how best to achieve those outcomes.

COMMISSION DECISIONS AND APPEALS

The current process

117. As discussed in paragraphs 83 to 87 the role of Commissioners is essentially dual: corporate governance and regulatory decision making. Due to potential conflicts of interest this puts greater onus on the Off Island Commissioners for regulatory decision making and also results in the Commissioners collectively being less able to fulfil their corporate governance function.
118. Neither the Government nor the Commission believes that this situation can continue and that the Commissioners must be able to fulfil their corporate governance function effectively. Enforcement decisions must be taken, and be seen to be taken, by impartial and objective decision makers. To achieve this outcome requires some degree of separation between the Commissioners and the regulatory decision makers in particular cases.
119. There are two options for resolving this inherent conflict:
- The creation of a Financial Services Tribunal to allow a referral of significant decisions which are presently made by the Commissioners,
 - Expanding the rights of appeal to the Royal Court to allow appeals to be heard on their merits rather than on judicial review grounds which currently apply.

A Financial Services Tribunal

120. The creation of a financial service tribunal would permit the more difficult and contentious decisions to be referred to the tribunal who could hear the matter as an impartial arbiter.
121. The United Kingdom Financial Services and Markets Tribunal is a possible model on which a Guernsey tribunal could be based. The Financial Services and Markets Tribunal was created under the Financial Services and Markets Act 2000, although its functions have now been transferred to the Upper Tribunal which is part of the administrative justice system in the UK. The tribunal can review decisions made by the FCA and the Bank of England. The Tribunal can review decision such as:
- The giving, variation and revocation of authorisations,
 - Penalties imposed for regulatory breaches,
 - Disciplinary measures taken against authorised persons,
 - The approval and discipline of employees working for regulated financial services.
122. In practice what occurs in the United Kingdom is that the FCA conducts its investigation and formulates its decision. It then proposes that decision to the financial services business who may then elect to accept that decision or refer the matter to the tribunal for hearing. A similar regime could be developed in Guernsey for more serious decisions ordinarily reserved for the Commissioners.
123. Prior to its functions being transferred to the Upper Tribunal the FSM Tribunal was staffed by 8 legally qualified Chairman plus 19 lay members with special experience of the finance sector. Appeals lay from the tribunal to the Court of Appeal on a point of law only.

A Possible Structure

124. A Guernsey financial services tribunal would require a Chairman which would need to be legally qualified. The Chairman would be assisted by at least two experienced financial services professionals. It is probable that a pool of individuals could be nominated by the

States from whom could be drawn two or three individuals to deal with a particular case. If a financial services tribunal were to be established it would be done along the following lines:

- It could hear the most serious cases as a first instance tribunal where the Commission would be required to present its evidence before the tribunal,
- Legal representation would be permitted but would not be obligatory and at the discretion of the Tribunal. If the tribunal permitted legal representation that would not be restricted to Guernsey Advocates but would allow legal representation from non-Guernsey legal professional,
- It would operate as inquisitor rather than as an adversarial process and would not be bound by the rules of evidence and could admit any evidence it felt relevant and of assistance to it in its enquiries,
- It would be able to set its own rules and procedures to ensure an efficient and fair process for resolving disputes,
- Its hearings would be open to the public and its decisions would be published unless the Tribunal resolved that there was sufficient sensitivity to justify a session being held “in camera”.

125. The tribunal would be obliged to hear matters in a cost effective, informal and straightforward manner. It would be necessary to allow appeals to the Royal Court, but those appeals would be limited to appeals on a point of law or mixed law and fact only. It would also potentially have the effect of reducing overall enforcement cases as the Commissioners would be better able to be involved in enforcement matters earlier in the process thus potentially resolving matters more quickly than can be achieved under the current arrangements.

Advantages

126. The creation of a tribunal to hear the more serious enforcement cases has a number of advantages:

- It permits the Commission much greater flexibility in its investigation and decision making processes.
- It enables the Commissioners to have requisite oversight of the regulatory investigations and decision making process.
- It increases transparency of regulatory decisions and over time would permit a body of decisions which would provide useful guidance to the financial services industry in the long term.
- It will bring the Commissioners closer to the enforcement process resulting in simplification and potentially earlier resolution at a lower cost.

127. It is also likely that the introduction of a tribunal would minimise the number of enforcement cases as under the present regime the Commissioners are unable to properly scrutinise the actions of the executive on enforcement cases. Early involvement of the Commissioners may assist in early resolution of cases, prevent unnecessary investigations, and allow a more commercial approach to those issues given the commercial experience of the Commissioners.

Disadvantages

128. There is no doubt that the creation of an independent tribunal is the most effective way of resolving a range of issues surrounding the decision making process. However it will come at a cost which would have to be borne by licensees. The members of the tribunal would be paid

on a daily rate for the time required for each case. It will require a secretariat in order for it to function effectively. Those resources would be found by the Commission.

129. While hearings and appeals would be relatively few, in order to be credible the Tribunal must be adequately resourced.

THE ROYAL COURT

130. An alternative option to the establishment of a separate tribunal is simply to enlarge the grounds on which a person may appeal to the Royal Court. At present the grounds of appeal from a Commission decision are relatively narrow and are limited to:

- That the decision was ultra vires or there was some other error of law,
- That the decision was unreasonable,
- That the decision was made in bad faith,
- That there was a lack of proportionality,
- That there was a material error as to the facts or as to the procedure.

131. An alternative approach would be to permit a person to appeal to the Royal Court against a decision of the Commission by way of rehearing. This would effectively allow a person affected by a decision to have that decision reviewed by the Court.

Advantages

132. Using the Royal Court process has a number of potential advantages compared to the establishment of a stand-alone tribunal. Those advantages are:

- The use of pre-existing legal infrastructure and procedures,
- Experienced judiciary sitting with technical assessors (as is currently the situation with appeals) with relevant financial services experience,
- Transparent appeals process with open justice and the development of case law setting out good practice,
- The Courts can provide some economies of scale and efficiencies.

Disadvantages

133. Using the Royal Court does pose a number of possible disadvantages:

- Given the workload of the Royal Court it is unlikely that it could deal with financial services appeals as quickly as a specialist tribunal and this could add delay and uncertainty to the process. Regulatory decision needs to be prompt and certain,
- It is unlikely to offer a significant cost saving given that the legal fees involved in Court proceedings are likely to be considerable,
- The Court is bound by the rules of evidence and rules of procedure which may impact on the ability of the Commission to take into account evidence which may not be admissible under the rules of evidence but is otherwise relevant and reliable, such as intelligence from other regulators,
- The Courts are funded by the taxpayer and any increase in the Courts workload has to be met from the resources of the States.

RECOMMENDATION

134. It is proposed to introduce a financial services tribunal to hear the most contentions first instance decisions of the Commission. Feedback is also sought on whether the tribunal might also have an appellate role for other less serious decisions of the Commission. If the feedback from this consultation generally supports this process there will be additional work and consultation on the final proposals. This work is at a relatively early stage and it may be that feedback received from this consultation may further refine the proposals.

RESOLVING COMPLAINTS AGAINST THE COMMISSION

135. Where a matter does not relate to a regulatory decision making but instead is a complaint about the conduct of the Commission of another kind there is presently no formal regime to address that complaint. For example if a licensee believes that they have been dealt with in an unprofessional manner there is no means of having that complaint independently investigated. The Commission does have in place a policy and procedure for dealing with complaints. That process currently provides that:

- The complaint must be made in writing to the Director-General, or if the complaint is about the Director-General then to the Chairman,
- The Director-General will appoint a senior member of the Commission's staff that is independent from the matter under complaint to investigate and report on the complaint,
- After the investigation is complete the Director-General (or senior staff member) will write to the complainant advising of the outcome,
- If the complainant is dissatisfied then the matter will be referred to the Chairman who will undertake a further review.

136. While such a policy is welcome, the Commission is a relatively small organisation and it is difficult to see how a complaint could be impartially investigated by a staff member who may very well work closely with the person or team under investigation. It may also be the case that the fact that this is an internal investigation may very well put people off complaining in the first place. Finally the process lacks independence, transparency, impartiality and accountability.

137. The Commission does have in place a procedure to have complaints investigated by external third parties in certain cases. That mechanism is good practice and allows for impartial investigation. However it is at the discretion of the Commission, there is no statutory protection for the investigator, nor is there any obligation on the Commission to consult with that individual. Of course this has not had an impact in practice but the process could be improved through some form of statutory protections.

COMPARATOR JURISDICTIONS

The Financial Conduct Authority

138. The Financial Services and Markets Act obliges the FCA to make arrangements to the investigation of complaints against the FCA. The complaints must be investigated by an independent person responsible for investigating complaints in accordance with the complaints scheme established by the FCA. The investigators appointment must be approved

by HM Treasury and the investigator is free to act independently of the FCA and complaints are investigated without favouring the FCA.

139. The Financial Services Complaints Commissioner is presently Sir Anthony Holland. During 2010 he investigated 152 allegations and complaints against the then Financial Services Authority, the forerunner to the FCA.

The Australian Securities and Investments Commission

140. The Australian Securities and Investments Commission is a part of the Commonwealth Government Ombudsman Scheme. The Commonwealth Government Ombudsman Scheme investigates complaints against Federal Government authorities. The Ombudsman has no power to award compensation or to revisit decisions made by ASIC. However the Ombudsman is able to report to the Federal Parliament on issues that it has discovered and make recommendations on how public administration can be improved. That process ensures that administrative processes are appropriate and subject to feedback and continuous improvement.

RECOMMENDATION

141. In order to ensure transparency and accountability it is proposed to introduce into the FSC Law a statutory obligation on the Commission to implement an independent complaints regime which would allow complaints against the Commission to be investigated by an independent and impartial third party. This would have the result of providing for increased transparency and accountability as well as over time improving the administration of the regulatory framework. The scheme would be based on the following principles:
- All complaints should first be made to the Commission under the current policy,
 - If the complainant were dissatisfied he or she could refer the complaint to the independent person ,
 - That person could then investigate the complaint and provide a report to the Commission and to the Complainant with his conclusions.

142. Frivolous, vexatious or abusive complaints would be disallowed at the discretion of the independent person. The person would be appointed by the Commission subject to consultation with the Policy Council and any appointment would be for a fixed term with appropriate protections against removal. The role would be a part time role as complaints against the Commission are relatively rare. The person would be remunerated on a case by case basis and the costs would be met by the Commission

Consultation Questions

- Question 15: Do you consider that the current arrangements for determining remuneration of Commissioners should be retained, if you consider that alternative arrangements are more appropriate please explain what they might be and why they should be considered?
- Question 16: Do you agree that the regulatory approach should move to an “outcomes” based regime with a greater onus being placed on financial services business to determine how to meet those regulatory outcomes, what alternative regime could be implemented?
- Question 17: Do you agree with the proposals to introduce a financial services tribunal? If you consider them appropriate explain whether you consider the jurisdiction of the tribunal being limited to major decision is appropriate?
- Question 18: If you do not agree with the proposal in question 17, would you consider expanding the grounds of appeal to the Royal Court to be a suitable alternative? Why would you prefer the Royal Court?
- Question 19: Do you consider that an independent complaints mechanism is desirable to provide an impartial means of resolving complaints against the Commission?
- Question 20: Do you consider the proposals to establish an independent complaints mechanism to be appropriate or can you suggest an alternative model?

APPENDIX: CONSULTATION QUESTION

- Question 1: Do you agree with the proposed primary objectives for the Commission, if you disagree please explain why?
- Question 2: Are there any other primary objectives which ought to be included, if so what additional objectives would you include or remove?
- Question 3: Do you consider the inclusion of secondary matters to be appropriate?
- Question 4: Are the proposed secondary matters appropriate, if you do not consider them appropriate please explain why?
- Question 5: Are there any other secondary matters which should be included, if so please explain what those matters should include and why are they appropriate?
- Question 6: Do you agree with the proposal to introduce a statutory duty to consult, if not explain how consultation by the Commission might be improved?
- Question 7: Do you agree with the proposal to transfer political responsibility for the Commission to the Commerce and Employment Department, if there is another more appropriate Department please explain why you consider that to be appropriate?
- Question 8: What other mechanisms could be put in place to manage any potential conflicts of interest between the Department's responsibility for the development of the finance industry and the management of the regulatory framework?
- Question 9: Do you agree that the statutory maximum number of Commissioners should be abolished and replaced with a minimum number of Commissioners, what do you consider to be the appropriate number of Commissioners?
- Question 10: Do you agree that the terms of office for Commissioners should permit overlapping terms for Commissioners?
- Question 11: Do you consider that the States should be able to specify the term of appointment for Commissioners in the instrument of appointment, if not please explain why?
- Question 12: Do you agree that the terms of office for the Chairman should be increased to the term of his appointment as a Commissioner?
- Question 13: Do you consider that the current practice of appointing Commissioners for a maximum of 9 years should be retained as a general policy or should it be included in the primary legislation? If you think alternative arrangements might be appropriate please explain why they should be preferred?
- Question 14: Do you agree that the statutory role of Director-General should be reviewed to make the Director-General of the Commission an *ex-officio member of the Commission*?
- Question 15: Do you consider that the current arrangements for determining remuneration of Commissioners should be retained, if you consider that alternative arrangements

are more appropriate please explain what they might be and why they should be considered?

- Question 16: Do you agree that the regulatory approach should move to an “outcomes” based regime with a greater onus being placed on financial services business to determine how to meet those regulatory outcomes, what alternative regime could be implemented?
- Question 17: Do you agree with the proposals to introduce a financial services tribunal? If you consider them appropriate explain whether you consider the jurisdiction of the tribunal being limited to major decision is appropriate?
- Question 18: If you do not agree with the proposal in question 17, would you consider expanding the grounds of appeal to the Royal Court to be a suitable alternative? Why would you prefer the Royal Court?
- Question 19: Do you consider that an independent complaints mechanism is desirable to provide an impartial means of resolving complaints against the Commission?
- Question 20: Do you consider the proposals to establish an independent complaints mechanism to be appropriate or can you suggest an alternative model?

Please provide any general comments which you may have on the proposals.

Please send your comments to:

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