

# **The Hunt Review**

## **Success and Stability**

*A Strategic Review of Guernsey's Banking Industry*

**The Rt. Hon. Lord Hunt of Wirral MBE**

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## 1. Foreword

I was delighted to have the opportunity to conduct this vital review of the banking industry in Guernsey and I trust my reflections and recommendations point a positive way forward. I should like to pay tribute to the way in which banking has sustained the prosperity of the Island and continues to provide an excellent base for its long-term prosperity. I have sought to advise on how best to build upon the successes of the past, especially where global commercial and financial systems are concerned, and also to explore opportunities the next 15-20 years may offer for underpinning continuing success. I have analysed, assessed and advised upon the risks that may lie ahead, and how best they should be managed, but my prime concern has been to explore how Guernsey can build even stronger foundations for the future.

Victor Hugo wrote *Les Misérables* on the Island and amidst its numerous pithy observations on the human condition is the remark that 'to be wicked does not ensure prosperity'. This is true, and it is equally true that virtue does not necessarily lead to material poverty. I pay tribute to all that has been achieved in maintaining and reasserting the Island's hard-won reputation for integrity, independence and standards. An internationally clean "bill of health" is much sought after and Guernsey has fully earned it. Now we must find ways to maximise the economic benefit to the Island as a whole, against a background of significant regulatory and market pressures, as the global community, the European Union and the UK seek to cope with the after-effects of the international crisis and the credit crunch, combined with increasing demands for greater transparency. Guernsey's enviable reputation has taken generations to build, but such reputations can be lost all too easily and quickly.

I am sure Guernsey will continue to set the gold standard in terms of ethical standards and professional conduct but, as those international pressures mount, my preference would be to see a much greater unity of approach with other jurisdictions facing similar pressures, in particular with Jersey and the Isle of Man. In due course I should very much like to see some form of Concordat emerge between the three territories. There are huge opportunities ahead and these exciting possibilities are more likely to be realised if all three territories act in concert. Competition has always inspired Guernsey to greater achievements, but that should not imply isolation or insularity. There is so much more that can be achieved through partnership.

**Rt Hon Lord Hunt of Wirral MBE**

## 2. Introduction

### What I was asked to do

- 2.1 On 26 March 2009 Guernsey's Commerce and Employment Department, ("the Department"), asked me to conduct a strategic review of Guernsey's banking industry, to advise the Department on how the States of Deliberation, ("the States"), could ensure the long term success and sustainability of the banking industry. The aim of the review is to consider how best to ensure the Guernsey banking industry's continued contribution to international commerce and global financial systems and consequently the prosperity and stability of the sector in the Island's economy. I was asked to examine the current structure and nature of Guernsey's banking industry and advise the Department on the strategic direction for the industry. I was also asked to advise on steps that can be taken by the States and the Department to maximise the long-term economic benefit to Guernsey and ensure it maintains its position as a world class international financial centre.

### Terms of reference

- 2.2 My terms of reference were as follows:

The review will consider the current structure and nature of banking in Guernsey, and comment upon:

- (a) The various existing business types or models including the international banks, the clearing banks, the deposit gatherers and Swiss fiduciary banks.
- (b) The economic value created by each business model and their respective long term sustainability.
- (c) The profitability, economic value and tax revenue created by each business model.

- (d) In the context of the various business models, the international and systemic risks to which Guernsey banks are exposed, and the extent to which Guernsey banks create risks to the banking and financial systems elsewhere.
- (e) Such other matters as the review may consider relevant.

In the context of an industry which faces a scarcity of highly skilled labour, to make recommendations and provide advice upon:

- (a) Whether it is in Guernsey's interests to focus on specific models or types of banking and seek to develop into a centre of excellence for that specific type of banking business.
- (b) What the benefits and risks of such a strategy might be, including reputational risk.
- (c) Whether any current aspects of the banking sector carry an order of risk (either reputational or financial) that needs to be addressed.

In the context of the conclusions reached with respect to the paragraphs above to make specific recommendations on:

- (a) Whether it is possible to adjust the nature of the Banking Sector in Guernsey to maximise its economic benefit to the Island.
- (b) What steps can be taken to reduce the risks to which Guernsey banks are exposed, reduce the risks that Guernsey banks may expose banking and financial systems elsewhere to; and
- (c) Any other recommendations that the review considers relevant.

## **Background to the Review**

2.3 Banking is central to Guernsey's success as an international finance centre. The banking sector currently employs about 2,750 people directly

in Guernsey and makes a substantial contribution to the island's economy. Employment numbers have fallen in each of the last three years suggesting that now is a good time to look closely at the sector.

2.4 In addition to providing traditional banking services to the local domestic and business community, many Guernsey banks offer core products to other parts of the finance sector, notably, fund administration, fiduciary, insurance, asset management and investment. Those services include multi-currency deposit taking, the provision of credit, global custody, foreign exchange and money transfer. In addition, many Guernsey banks provide private banking or wealth management services. The interaction and dependencies between banking and the rest of the finance sector is something in which I am interested. Banking also provides custom for a raft of ancillary services from professional to support services.

2.5 Following the global financial turmoil that began in 2007 and reached its height in the autumn of 2008, international banking has suffered a number of significant shocks. As a result of the international crisis global banking is likely to undergo a period of change and consolidation. Although more than a year has passed since the failure of Lehman Brothers, and banking is now on a more even keel as measured by indicators such as 3-month Sterling LIBOR, emergency economic measures remain in force in the main economies and seem likely to do so for some considerable time. So significant uncertainty remains in the situation.

2.6 Even had there been no banking crisis, significant regulatory changes were underway that would have had significant implications for Guernsey. These include:

- (i) the De Larosière Report which provides a blueprint for turning the Lamfalussy third tier committees into Europe-wide regulators, further transferring power away from member state capitals to Brussels;
- (ii) the Basel II banking supervision directive which would have been reviewed in any event but the crisis will most likely result

in their being a Basel "II½" (and perhaps even Basel III) accords which will result in new banking supervision standards around the world;

- (iii) the reforms of banking supervision which will lead to the introduction of techniques such as dynamic provisioning and other measures that enable regulators to get a better handle on both banks' capital and liquidity;
- (iv) separately the Financial Services Authority ("FSA") has announced its liquidity measures aimed at giving banks a 30-90 day buffer to market lock-out (i.e. how long they can survive without recourse to inter-bank borrowing);
- (v) the EU jurisdictions such as Germany and France have long wanted to regulate hedge funds and the crisis has provided the impetus for the EU's Alternative Investment Fund Managers Directive;
- (vi) the international moves to improve tax transparency have been ratcheted up by the election of the Obama administration.

2.7 Guernsey cannot cut itself off from these developments. It has already felt the direct consequences of banks getting into difficulty, first with the Northern Rock Group and secondly with the Landsbanki Group. Whilst that chronic phase of the crisis may have passed, the effects are likely to be felt for years after the emergency economic measures are withdrawn. In particular, international attention in the immediate aftermath of the financial crisis was directed at concerns expressed by some about the role of "offshore"<sup>1</sup> jurisdictions. This attention has not diminished, and while Guernsey has a well established reputation for effective regulation and transparency, it seems likely that developments in other jurisdictions may affect international flows of money in ways which may impact on the

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<sup>1</sup> I should explain here that language is used by various parties to make political points. In my view "Offshore" is deliberately intended to convey a pejorative sense. Others prefer the term "International Financial Centre", a more neutral to positive expression. Since Guernsey appears on all the recognised "white lists" for tax transparency and regulatory performance, (the issues the detractors are concerned about), I propose to refer to Guernsey as an international financial centre in this report.

banking sector in Guernsey (whether positively or negatively). For all these reasons, now is an opportune time to review Guernsey's banking sector to consider how it should develop going forward in ways that are resilient to the after-shocks we must expect to such a major crisis.

2.8 A strategic review of this sort represents a significant innovation. Hitherto, banking in Guernsey has not resulted from, still less has it grown out of any prescriptive plan. While I do not consider that a detailed prescriptive plan would be appropriate now, it is important to recognise the factors that are likely to influence future development and to respond accordingly. The international component, the greater part of the banking sector, has grown in an era when tax transparency was not common and regulatory practice and competence was somewhat variable between jurisdictions. This landscape is changing fast. Guernsey, which already enjoys a hard won reputation as a well regulated and highly reputable place to do business, is again at the forefront of those international financial centres which are moving quickly further to improve their transparency and regulatory credentials. Inevitably, however, these international events will result in the undoing of some of the development of recent years as business patterns adjust to the new reality.

2.9 Guernsey's banks are already very well regulated by the Guernsey Financial Services Commission ("GFSC"), but there are significant differences between the situation in Guernsey and that in the larger financial centres. In particular, it is worth noting that none of Guernsey's banks is domestically owned. Rather, they are subsidiaries or branches of banks headquartered elsewhere. Moreover, Guernsey does not have a central bank which can act as "lender of last resort" to Guernsey registered banks. If anything goes wrong the resilience of banks in Guernsey is ultimately dependent upon the strength of their overseas parents; the effectiveness of the regulatory authorities responsible for those parents; and the willingness and capacity of their home jurisdictions to support them (whether through the supply of liquidity from central banks or through the supply of capital by government). This leaves something of a lacuna at present, in that Guernsey has yet to consider, at a strategic and economic level, both the value and the risks its banking sector (and the various sub-sectors and corporate structures within it) brings to the

Island. The purpose of this review is to seek to put that right, by providing a comprehensive analysis and a view of how the banking sector should look, going forward.

2.10 I should explain at the outset that much of my analysis will surround the various forms of deposit-taking undertaken in Guernsey. Trying to explain my conclusions succinctly has inevitably put pressure on the descriptions of the activities. It also gives rise to questions about what activities, and sub-sets of them my remarks are intended to cover. In consequence, I set out here a description of the activities and issues surrounding them of concern to me:

- (i) I have no objection to the taking of retail deposits per se. So some level of retail deposits must be satisfactory. However, a business model that sets out to collect large-scale retail deposits and up-stream them bears significant and recently increased risk for Guernsey. The flow of funds could dry up; new liquidity controls introduced in the jurisdiction to which the funds were up-streamed could trap them there; and, in the worst case, if the bank got into difficulty, that jurisdiction could treat the up-streaming as inter-bank transfers and cast-off the subsidiary in Guernsey without them.
- (ii) Similarly, I can have no objection to fiduciary deposits and fiduciary business in Guernsey per se. So again, some level of this business must be satisfactory. However, fiduciary deposits are inter-bank transfers of funds where the ultimate beneficiary is in another jurisdiction, and often a third-party jurisdiction. Fiduciary deposits have been as much as half the total deposits in Guernsey comparatively recently, although the proportion has declined of late. These flows could decline further as fiscal and economic conditions in those donor jurisdictions change. Furthermore, they are subject to the laws in their source jurisdictions and changes in those laws could result in a substantial drop in Guernsey's deposit base which could have knock-on effects for confidence in the banking sector generally.

Thus when I refer in this report to deposits, deposit-taking, retail deposits and fiduciary deposits, I am referring to a number of business practices which present risks originating either at the source or destination of funds crossing Guernsey's border which produce different aggregations of risk in Guernsey.

### 3. Executive Summary

- 3.1 Banking services are a vibrant part of the Guernsey economy. They employ some 9 per cent of the workforce yet they contribute 17 per cent of all tax revenues. Banks contribute about £200m to the Guernsey economy every year. This disproportionate contribution makes the success of banking and closely related activities a driver of Guernsey's prosperity. It follows that, in general terms, any recommendation that maintains or enhances this happy state of affairs might be broadly welcomed. And, of course, the converse is true.
- 3.2 Against this background, I found much to encourage me in thinking that Guernsey can expect a major contribution to its economy from banking for years to come. However, there are threats and risks to be mitigated and certainly there are many opportunities that could be exploited. I and my team believe we have identified the major threats, risks and opportunities.
- 3.3 As with most sectors of most free market economies, banking in Guernsey has simply grown as a function of the business environment presented to its institutions. Individual institutions try to make best use of the resources and opportunities available to them. This means picking the "low-hanging fruit" in many cases. In Guernsey's case this seems to have resulted in exploitation of its valid ability to keep taxes competitive and the practices of other jurisdictions in regard to tax transparency. This has drawn in high volumes of retail and fiduciary deposits by which some commentators measure the sector's prosperity. Actually, the flows of these deposits mostly provide relatively little added value to the economy of Guernsey compared with other types of banking, notwithstanding the individual employment and associated tax revenues. Moreover, the risks inherent in deposit gathering have been highlighted by the banking crisis and its consequences. For the longer term, the Government of Guernsey should make clear that its preference is to see a broader mix of banking services. Given the natural restrictions on Guernsey's resources, this would have the beneficial effects of increasing the contribution of banking to the economy still further, reducing risk, and reducing strain on resources. The findings and recommendations in my report all go to achieving these goals.

- 3.4 Whilst the risk presented by deposit gathering and up-streaming is less than comparatively recently, it remains significant. These deposits also present concentration risk and could be vulnerable depending on the attitude of regulators in both Guernsey and the various home jurisdictions. The increased attention to liquidity in London expressly refers to the risks posed by the reliance of regulated firms there on deposits from international financial centres. The Guernsey authorities need to ensure, at the very least, that any changes in the proportions of deposits held within groups are made over time<sup>2</sup>. Significant reductions in the amounts allowed to be up-streamed may undermine the business case for some institutions continuing to use Guernsey.
- 3.5 The proportion of deposits made by Guernsey residents is comparatively small. The Guernsey public have a right to reasonably expect at least the same protection as depositors in other (OECD) jurisdictions. The issue is exacerbated in smaller jurisdictions like Guernsey because they do not have a central bank capable of acting as lender of last resort and their tax base generally restricts the ability to inject liquidity or capital into a troubled bank. Guernsey has already adopted a depositor compensation scheme and it is being worked up in detail now. Such a scheme is less relevant to the majority of non-resident retail deposits. Corporate and High Net Worth ("HNW") clients will not be significant beneficiaries of such a scheme and will, anyway, make their own judgements of the creditworthiness of the banks with whom they place funds.
- 3.6 An emerging problem with several depositor compensation schemes operating or potentially operating in the Crown Dependencies, is that there is a danger that some banks will limit their contingent liability to pay for these schemes by concentrating operations in one regime. This might result in fewer jobs in Guernsey.
- 3.7 I received mixed representations about the practice of allowing managed or administered banks. I detected that there might be some self-interest in some of these representations mainly arising from considerations of

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<sup>2</sup> This is, of course subject to regulatory over-ride under extreme conditions.

competitive advantage. It so happens that the two banks to have encountered severe problems had managed operations in Guernsey, but so far as I can see, the problems cannot be said to have their origins in being a managed bank. Moreover, it seems to me that the managed bank concept fits well with the scale of operations in Guernsey.

3.8 Whilst I must necessarily focus my review on banking in Guernsey, many representations I received referred to the resource constraints inevitable in an island economy. Plainly, any economic activity operates within such constraints and I cannot ignore them entirely. The main representations I received centred on skills shortages and downstream of this, the Government's policies on population growth and housing licensing. I do not intend to comment on the Government's policies other than to note that the banks rely only slightly on the housing licensing system often as they have just a small handful of individuals reliant on licensed housing. I have not been able to test whether this reliance is intrinsic or the result of acceptance of a constraint that is actually holding banks back. This can be accurately assessed only by individual banks.

3.9 The skills question is rather more subtle. It is not really a question of the banks needing a higher qualified workforce through enhancements in education. Rather, if banking in Guernsey is to evolve as I envisage and it is to become better balanced, Guernsey will need to attract, and retain for long enough, individuals with high-value banking skills and experience. Banks require a broad range of skills for which the secondary and tertiary education systems need to cater. The model Guernsey should pursue has already begun to develop spontaneously. Several banks pointed out to us that some of their most valuable employees were those who had grown up on Guernsey, gained their degree in a mainland university, and had not returned to Guernsey until they accumulated several years' experience in banking within a major group. I am told that these individuals often return to Guernsey at the point where they expect to have children or their children are reaching school age. Encouraging such migration might suit Guernsey very well in the long term and there are arguments for encouraging this approach.

- 3.10 If I am right that retail and fiduciary deposits will play a smaller role in the future of Guernsey banking, the question arises what should take their place? As the global economy begins to adjust to the consequences of the financial crisis of 2007-8 and resumes its growth path, a number of trends reassert themselves. Not least of these is that the number of very wealthy people in the world is continuing to grow, although their geographical location is shifting eastwards. This creates excellent opportunities as the number of potential clients increases and their mobility is encouraged by higher levels of personal taxation in some jurisdictions. Some banks in Guernsey have already identified these opportunities and are providing these services. A greater focus by these and other banks may see associated benefits.
- 3.11 Wealthy families, wherever they are on the globe, will require a range of services to manage their wealth. Guernsey is well-placed to capitalise on this trend. It already has private banking services. It has the infrastructure of lawyers and accountants to support such families and it is in a good time zone to catch the ends of the Far Eastern and North American trading days. Clearly, there will be strong competition from other international financial centres, particularly the newer ones including Singapore which may think that being geographically closer to their customers is a competitive advantage. But this is only a small advantage, if any, since the wealthy often live in several places on the globe. Guernsey should not under-estimate its competitive advantage. It should market itself as one of the superior locations to set up as a bank based on its regulatory reputation, skilled workforce, convenient time zone, speed of decision-making, availability of professional support services and economic and political stability.
- 3.12 The decision of several jurisdictions, most obviously the UK, to increase marginal rates of income tax has already caused some wealthy individuals to head for Guernsey. In some cases they are leading figures in the private equity and hedge funds industries. I shall not debate whether these are customers of banks or part of banking, but the clear potential is that such individuals might be encouraged to bring part of their businesses with them if this has already not occurred to them. The Guernsey authorities might sensibly think in terms of distinguishing

between High Net Worth Individuals ("HNWIs"), who bring some of their wealth to the Island to invest, and High Net Worth Entrepreneurs ("HNWEs"), who bring some of their wealth too but also potentially could bring some of their business activities.

## 4. Current Structure of Banking in Guernsey<sup>3</sup>

### The Banks in Guernsey

- 4.1 The GFSC report that at the end of 2008 there were 48 licensed banks in Guernsey. There has been a steady decline in their number since a peak of 79 in 1999. The number has continued to fall this year, to 44 at present and may drop below 40 in 2010, in which case the number will have halved in little more than a decade. Plainly there has been long-run consolidation in banking in Guernsey which appears to be continuing into the foreseeable future. This appears to be a broadly based phenomenon and Jersey, for example, has seen a similar decline. However, on other parameters of banking activity, the sector has been growing so this consolidation appears not to be harmful to date as efficiency has improved. Nonetheless, the sector is not standing still.
- 4.2 It is important at the outset to recognise that several business models are in use in Guernsey; some are conspicuously absent and some are mostly only found in international financial centres. A differentiator is whether a bank is meeting the domestic needs of the Guernsey economy, or whether it is an international bank serving customers domiciled elsewhere. This report is overwhelmingly about international banking although I note that the Guernsey economy is served by powerful UK retail banks who were keen to impress on me when I saw them their commitment to continue to serve the Guernsey economy in the years ahead.
- 4.3 I provided a preliminary outline of the various banking business models present in Guernsey at paragraph 3.5 of my Call for Information and Submissions published in June. This provoked a broad range of views from it being an accurate representation to the opposite. Below is a slightly modified version of that table which is reproduced here to serve as a framework within which my analysis exists.

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<sup>3</sup> It will be seen that the data I have used for this chapter is assembled from a number of official and non-official sources. Anyone trying to reconcile the figures to the last decimal point might be disappointed. Due care has been taken, however, to ensure that the figures are materially of the right order and will give the reader a proper understanding of the issue being described.

**Table 1: Types of bank and their activities in Guernsey<sup>4</sup>**

Activity	Bank Type			
	Clearing Bank (i.e. UK clearers)	Specialist Deposit Takers	International and Private Banks	
			International Private Banking	Services for institutional and corporate clients
Providing retail banking services to Guernsey residents	X	X		
Providing commercial/corporate banking to Guernsey businesses	X			
Gathering and "up- streaming" deposits to parent representing >50per cent of balance sheet	X	X	X	x
Gathering Swiss fiduciary deposits and investing in treasury products or up-streaming to other parts of group		X	X	x
Providing services to international private clients		X	X	
Providing services to fund administration companies	X			X
Providing services to fiduciary companies	X		X	
Acting as global custodian	X		X	X
Providing portfolio management services	X		X	X

4.4 Inevitably, it is not possible to capture all the variations on the main themes of these models. For example, some banks up-stream deposits to a parent because they have the internal capacity to do so, while others with a smaller parent would need to diversify. However, I believe the categorisation in the table will serve my purpose.

4.5 The table gives the impression that banking in Guernsey is already quite well diversified. That is a misleading picture. The industry has been heavily reliant on deposit-taking. At the end of 2008 the GFSC reports that licensed banks held deposits of £157 billion, an increase of 29 per cent on 2007. Conveniently, the GFSC provides figures back to 1990.

<sup>4</sup> The size and weight of the cross indicates broadly the amount of the type of business the bank type does.

These reveal that the volume of deposits has been quite volatile year-on-year, rising by as much as 69 per cent and contracting by as much as 7.5 per cent in the period 1990-2008. However, 2009 may see the greatest contraction in the period since 1990. Part of this volatility will be explained by exchange rate fluctuations, although some seems likely to arise because deposits are mostly footloose (what used to be called "hot money") and as the returns on different asset classes fluctuate and tax regimes change, cash and near cash varies in its attractiveness. Nevertheless, over a period of 18 years, deposits rose tenfold.

- 4.6 GFSC very helpfully publish data on the sources of these deposits. They also publish data on the disposition of bank assets which at least gives a feel for the destination of up-streamed funds. The figures for 2008 are:

**Table 2: Source of bank deposits by value at end 2008**

<b>Country</b>	<b>per cent</b>
Switzerland	48
Guernsey	18
USA	9
United Kingdom	6
Jersey	5
EU (excl. UK and Ireland)	3
Caribbean	2
Ireland	1
Other	6

**Table 3: Location of bank assets at end 2008**

<b>Country</b>	<b>per cent</b>
United Kingdom	37
EU (excl. UK and Ireland)	16
Switzerland	15
USA	14
Caribbean	7
Guernsey	4
Jersey	4
Ireland	2
Other	2

- 4.7 GFSC also publishes data on the types of asset held by Guernsey banks. These are:

**Table 4: Banks' assets at end 2008**

<b>Asset type</b>	<b>£M</b>
Loans to banks and other financial institutions	111,222
Loans to companies and other legal persons	27,124
Company shares and securities	8,580
Government securities	3,179
Other assets including CDs and commercial paper	29,012
<b>Total</b>	<b>179,117</b>

- 4.8 It is perhaps worth noting that although 48 per cent of bank deposits came from Switzerland, only 4 per cent were denominated in Swiss Francs. Deposits were mainly held in the major currencies, 45 per cent in US dollars, 27 per cent in Euros and 22 per cent in Sterling.
- 4.9 More generally, these figures suggest to me that Guernsey's banking operations are on an "in and out" basis in assets that are mostly cash or close to cash. The in and out aspect is not surprising for an international entrepot. The more interesting question is whether simply moving cash around is the best approach for Guernsey in the longer run. I am clear

that it is benefiting the UK since the asymmetry of the flows between the Island and the mainland must be improving banks' liquidity there. To be clear, that means that Guernsey's banking system has evolved to become a net financier of the UK banking system. However, I am aware of the contrary view in London that this is a dependency and vulnerability so far as liquidity of banks there are concerned.

## **Economic Value to Guernsey**

4.10 I am surprised to be told that there was any doubt that banking made a significant net contribution to the economy of Guernsey, but I understand some do question its value. For this reason I have tried to set down some information about it here. I have not analysed displacement effects, that is what would happen to the resources released had banking not grown up on the Island. That would be a complex and uncertain analysis beyond my remit.

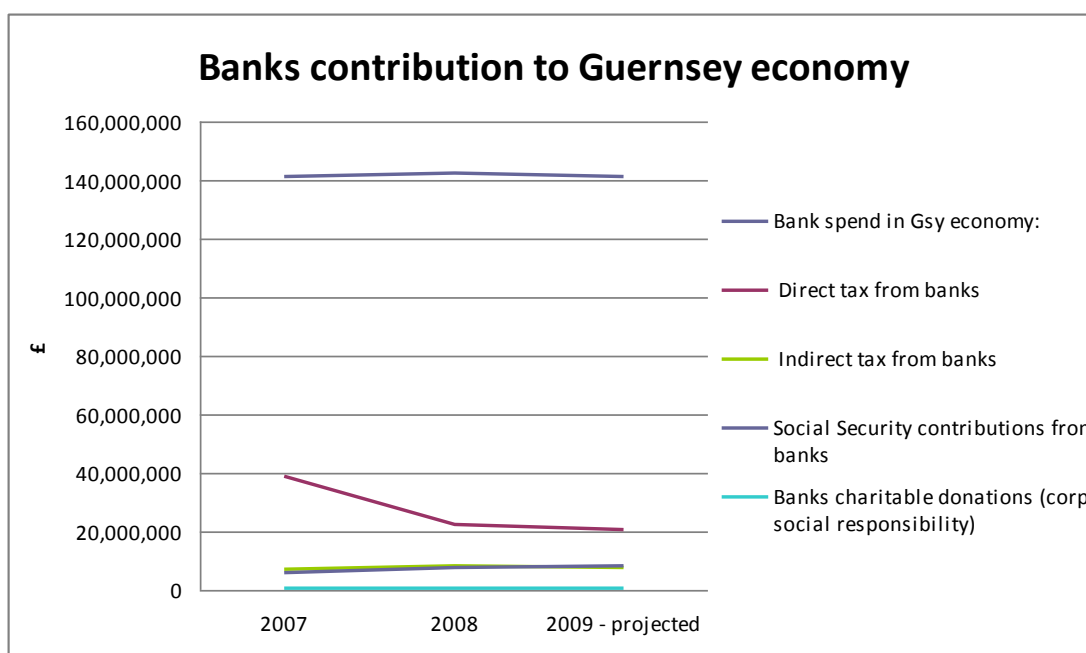
4.11 Banking benefits Guernsey in three distinct ways. Banking services are a necessary pre-condition for the well being of Guernsey's domestic commerce just as they are elsewhere, but the scale of the Guernsey economy is such that these services could be adequately provided by no more than a handful of clearing banks. Similarly, banking services and the provision of mortgages to individual consumers are clearly essential parts of the Guernsey economy but this requirement too could be (and generally is) met by a small number of clearing banks and subsidiaries of building societies. The third and by far the greatest part of the Guernsey banking sector is represented by international banking which engages the other forty or so banks on the Island (although the clearers present are heavily engaged in international banking too). As a specialisation, since the sub-sector is not essential to domestic activity (whether commercial or private) it makes sense only if its risk-adjusted benefits to the economy, whether direct or indirect, put Guernsey's scarce resources to best use. The main thrust of this report is directed at the last, namely international banking.

- 4.12 The basic data varies according to source but I am informed that banking employs about 2,750 people directly on Guernsey, although the number has been in decline over the past three years. Probably fewer than 20 per cent of those are engaged by the big four high street brands<sup>5</sup> present in Guernsey. Bearing in mind those banks conduct international banking too, I would estimate that over 80 per cent of those employees are involved in international banking business and are additional to those who would be employed in banking in Guernsey in any event. They contribute to the Island's gross domestic product and provide tax revenues. I deal with tax separately below. These banks also make a material contribution to the life of Guernsey through a wide range of activities under the corporate social responsibility banner and through charitable giving.
- 4.13 International banking also supports many other financial and professional services which would be unlikely to flourish in Guernsey in the absence of reliable, well regulated and trustworthy banking services. Most obviously, the provision of fund administration, fiduciary and other trust services by professional firms and the growth of insurance operations, particularly those using captives, depend in large measure on the international banking sector. I cannot say for certain that these businesses would not exist without international banking services, but many people I spoke to thought that was the case. I accept that I spoke to a large number of bankers who might be expected to make that representation, but even on a sceptical view, I would be surprised if the respective businesses did not grow hand in hand.
- 4.14 There are then the support services to consider. These include professional services, IT services, marketing and advertising, business continuity service providers, building maintenance and office equipment suppliers. There are also the airlines, taxi services, hotels, restaurants and a host of other service providers who benefit from the extra business the sector brings. This benefit is likely to be expressed in a number of ways but it probably includes wider choice of flights, restaurants and other services as well as the extra jobs created.

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<sup>5</sup> (Barclays, HSBC, Lloyds Banking Group and RBS/NatWest)

4.15 Quantifying this benefit grows more difficult the further away from the core activity the definition is drawn. But on the numbers given to me, it would appear that bank employees supporting international business inject about £90 million of spending power into the Guernsey economy every year through their salaries. Looked at another way, this is about £33K per direct employee. I deal with their tax revenue contribution below. In addition, banks appear to spend about £30 million a year on goods and services. Taking all forms of banking contribution to the Guernsey economy, I estimate that it is not much less than £200 million a year (or nearly £73K per direct employee). The chart below illustrates recent trends. The data is drawn from the Review's own request for information in which virtually all banks participated, for which I am very grateful.



4.16 Another way of assessing the contribution of the banks is to recognise that they provide about 9 per cent of all employment in Guernsey directly and that they also generate 17 per cent of all taxes.

4.17 I hesitate to include banks' charitable giving under a caption dealing with economic value to Guernsey as I recognise that there is no mercenary intent in their donations, rather the opposite. I do not, of course, intend any such implication. In practice, the banks are rather reluctant to

disclose the contribution they make. The chart above is based on returns to the review's data gathering exercise which reported charitable giving at £536,000 in total in 2008. I very much doubt this figure is remotely accurate. The charitable foundation of one bank alone gave almost £700,000 in 2008. In fact I was surprised to find that the banks were more forthcoming about the charitable giving of their competitors than they were about their own!

4.18 I believe that the banks' charitable giving is above £2 million a year. The low figure returned to me does, of course, exclude the giving of the charitable foundations the banks have set up because it is accounted for separately. I will just dwell briefly on what the banks do. Several of them have set up charitable foundations or trusts with the express purpose of funding good works. Some set aside a small proportion of their profits, typically 1-2 per cent. There are many specific examples of giving but I will just mention by way of example a £300K contribution towards a MRI/CT scanner.

4.19 The banks also sponsor activities which whilst not charitable, nevertheless certainly contribute to the well-being of Guernsey social and cultural life. Examples are sponsoring the Island Games and a recent cinema event. No doubt the banks' logos and branding are evident on these occasions but that kind of support adds to the general level of well-being.

## **Tax contribution**

4.20 From the previous chart it can be seen that Guernsey banks contribute tax in three main ways, direct tax on their profits, indirect taxes such as income tax paid by employees and social security payments. The direct tax on their profits covers the banking services they provide (largely deposit taking at present) and services derived from deposits, such as credit related earnings. Earnings on capital are also taxed at 10 per cent (which interestingly includes the earnings they make on the regulatory capital they are required to hold). Many banks also provide services which are not derived from banking, such as global custody, and they are

not taxed. On the core banking business the tax contributions in 2008 were:

**Table 5: Taxes paid by banks to Guernsey in 2008**

<b>Tax</b>	<b>£'000</b>
Direct tax	22,532
Indirect tax	15,000
Social security contributions	13,522
<b>Total</b>	<b>51,054</b>

4.21 Towards the end of the review period news broke that the Financial Secretary to HM Treasury had told Guernsey, Jersey and the Isle of Man that the zero-10 tax regimes in operation in those jurisdictions would be unlikely to be considered by other Member States compliant with the EU Code of Conduct on taxation even though that had been the UK's stance. In the current economic and financial conditions following the banking crisis this careful form of words may be reasonably interpreted to mean that a generally applicable tax should be applied to corporate profits.

4.22 Banks already pay 10 per cent and I do not think this development should be seen as destabilising to the banking sector. Plainly, they will be concerned about implications of any tax changes for their corporate customers and for the economy of Guernsey generally. However, as soon as the initial surprise wears off I believe this will turn out to be an issue that can be coped with smoothly. The priority should be to move quickly to provide business certainty even if the transition should be phased over a period of time.

## **Risk**

4.23 In this section I consider:

- the risks faced by banks; and
- the risks posed by banks.

Inevitably, there is a good deal of overlap between these two categories of risk, in that any risk to any banking activity in Guernsey constitutes a risk to the Guernsey economy proportionate to the benefit that activity provides. But banking may expose Guernsey to risk in other ways. For example, a banking failure could lead to direct losses for Guernsey consumers. Such an event, or any other sort of banking "scandal" could lead to a loss of confidence in Guernsey as an international financial centre with potential repercussions for other financial services sectors.

4.24 In the Call for Evidence and Submissions I provided a summary of risks facing banks in Guernsey and asked them to confirm that the right risks had been identified and to bring forward any other risks they believed to be present. I also asked respondents to prioritise their top five risks from my list. The results of the prioritisation are set out below:

**Table 6: Banks' assessment of risk**

<b><u>OVERALL RANK OF RISKS IDENTIFIED BY BANKS</u></b>					
	<b><u>Total score<sup>6</sup></u></b>	<b><u>Rank</u></b>	<b><u>Number of banks classed it as a risk</u></b>	<b><u>Rank by numbers classed as a risk</u></b>	
Market	37	1	10	1	
Credit	36	2	9	2	
Regulatory and compliance	25	3	7	4	
Reputational	23	4	7	4	
Jurisdictional	21	5	9	2	
Guernsey Depositor Compensation Scheme ("GDCCS")	16	6	5	6	
Liquidity	13	7	4	9	
Operational	11	8	5	6	
People	7	9	5	6	
Litigation	7	9	3	10	
Counter-party	2	11	1	11	

- 4.25 Given the events of 2007 and 2008 it is hardly surprising that market and credit risk should come top. Interestingly, however, four of the risks I proposed did not register at all. These were concentration, sovereign, conduct of business and financial reporting risks. Of these I am willing to accept that respondents possibly did not unbundle credit risk to address concentration and sovereign risks separately, yet they were concerned about them. Likewise, conduct of business risk may have been bundled with regulatory and compliance. It would be interesting to know why financial reporting risk fell below the radar since there is some evidence to show that financial reporting standards will be tightened as part of the response to the banking crisis and this seems likely to require banks to become still more transparent.
- 4.26 That conduct of business risk did not register may simply be a semantic point that it was thought about under regulatory and compliance, but banks in the UK are facing significant and growing conduct of business risk and Guernsey cannot expect to be isolated from it entirely even if it does serve a more sophisticated customer base to that of the UK. Guernsey ought to consider adopting a statutory banking conduct of business regime as has recently come into force in the UK.
- 4.27 The silence on concentration and sovereign risk is harder to explain since this goes to the heart of the concerns many had about those home states of Guernsey banks that do not have credible lender of last resort facilities or broad tax bases with which to absorb the financial consequences of bank failures. This may indicate that the risks to Guernsey banking should be thought about in a rather different way in the future. For example, banks might consider sovereign risk to their balance sheets at the individual level but the authorities may need to think about it as a risk concentration issue particularly since experience shows, and the GDCS formally creates, a pooling of that risk to some degree.
- 4.28 In contrast, respondents to the Call for Information and Submissions analysed a number of the risks in a way rather helpful to my work. There

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<sup>6</sup> Each bank was asked to rank the risks presented to them by selecting the five they considered the greatest and awarding them marks on 5-1 scale. The scores here are the sum of the points awarded so that the highest score is the greatest perceived risk.

was a general view that there would be less focus on tax planning in future as the leading jurisdictions drive it out through successively tougher transparency requirements. There was some feeling that deposits would tend to fall as the banks moved to concentrate on providing services to HNWIs and away from the mass affluent. I cannot make a direct connection between the two on the basis of the responses I received but the way in which the arguments were constructed leads me to believe that the industry expects a move away from tax-driven services, with a consequent reduction in the number and value of deposits. The risk here is the transitional risk that, as one source of revenue declines, the other does not rise to replace it. If that risk materialises it would have two distinctly different effects. The first would be a reduction in economic benefit of the sector to Guernsey through an overall reduction in activity, employment and tax revenue. The second would be a reduction in deposits causing reputational damage going wider than deposit taking and, indeed, the whole banking sector.

- 4.29 This theme was developed in two broad directions. There was the belief that the UK and the USA as sources of funds would decline and would, over time, be replaced by other territories, most obviously in the Middle and Far East. The transitional risk here is that competing financial centres such as Singapore might prove more attractive than Guernsey. Inter-connected with this potential migration is one to a different service offering as service quality and range and flexibility of offering replaced tax efficiency as the determinant of where to bank. HNWIs were also thought to be changing their behaviour. Their increasing willingness to engage in online trading of traditional banking products will result in private banks having to concentrate on niche investment and lending products to attract new clients.
- 4.30 In turn these transitional risks give rise to a people risk, in that mature and experienced private bankers would be increasingly demanded and they would mostly have to be brought in from outside Guernsey, a process made difficult by the restrictions in place on bringing in new staff.
- 4.31 There is a further dimension of the risk presented by the deposit gathering and up-streaming model that emerged from my discussions but

which is evident from the events of 2007-8 and the decision to establish the GDCS. If these deposits decline as I have been told they will, and indeed I tend to think they will, the risk they present to the GDCS and the distortions created will inevitably decline too. But if not, then Guernsey will have to face the reality that a large-scale activity that does not add proportionate value will continue to place a potentially heavy burden on the GDCS. Moreover, there is the risk, however remote, that new liquidity controls in the jurisdictions to which these funds are up-streamed might have the effect of making them stickier should a Guernsey subsidiary want them back. This is a simple example of risk concentration in one class of business.

4.32 The risk presented by retail deposit gathering is, to some extent, modified by the type of bank authorised to operate in Guernsey. The basic choice lies between a subsidiary and a branch. A subsidiary is a separate legal entity within a banking group with its own balance sheet. A branch is just that; it is not a separate legal entity and its assets and liabilities rest directly on the balance sheet of the bank, normally in its home jurisdiction<sup>7</sup>. Traditionally, prudential regulators have tended to prefer subsidiaries in their jurisdictions since they afford the possibility of greater control over the assets and liabilities. The hitherto unforeseen risk inherent in the subsidiary model of supervision is that, if there is a liquidity crisis, the quality of the home jurisdiction's arrangements come into sharp focus. This issue is particularly acute where, as in Guernsey, there is no central bank which could act as lender of last resort. In the event of such a crisis, the parent bank, and the relevant authorities in the jurisdiction in which the parent bank is located, may be more likely to "walk away" from a subsidiary company than they would be in respect of liabilities held directly on the bank's own balance sheet.

4.33 The somewhat counter-intuitive outcome of this analysis, evidenced in some measure by recent developments is that branches may, in some cases, be better than subsidiaries for Guernsey. This is because the home jurisdictions' liquidity or capital interventions and their ability to

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<sup>7</sup> In some jurisdictions it is the practice to allow branches of subsidiaries so, for example, a branch in one international financial centre could have its parent in another international financial centre, whose parent, in turn, is elsewhere again. The GFSC does not allow this practice.

require mergers or other forms of reconstruction at home will normally apply equally to a branch but not a subsidiary. As we have seen with the Heritable and Landsbanki cases the deposits in a subsidiary or sister bank, once up-streamed, can be treated as inter-bank deposits. The subsidiary can then be cut loose without them. There is no hard and fast rule that can be applied, the GFSC would have to look through to the home jurisdiction and form a view on the prospects in each individual case. But in the meanwhile numerous subsidiaries and branches are authorised in Guernsey and they are what they are.

- 4.34 No quantification of the risks described in this chapter is feasible. Indeed, they are to some extent conjecture, although it is conjecture put forward by experts. My observation is that, to the extent that a major deposit base has built up under conditions that may not apply in the future, some possibly large reduction in their scale could occur now these conditions are changing. If so, all the issues worrying the banks in Guernsey would then come into play. In chapter 5 I explore further what Guernsey might do about these risks.

## 5. Options for change

### The case for change

- 5.1 The global economy does not stand still. The global imbalances to which Lord Turner attributes<sup>8</sup> the drastic expansion of the originate and distribute banking model and subsequent "irrational exuberance" have not gone away. China's holdings of other countries' debt, most obviously that of the USA, have continued to rise. The banking system's ability to recycle dollars has only recently resumed and only then because it is on a promise of toxic asset relief in the main jurisdictions. It follows that further shocks cannot be ruled out and the returning of the sector to stand on its own feet could be a long, uncomfortable process.
- 5.2 Guernsey could try to hunker down on the assumption that these macro-challenges will fly over the heads of its relatively small banking sector, (small in the world scheme of things but not to Guernsey), but the complex regulatory changes that authorities internationally believe necessary to prevent another crisis in banking could ensure that when a return to a version of normality, where taxpayers no longer own banks in return for reinsuring their toxic assets, could cause some disruption to Guernsey banking. Guernsey at present depends heavily on deposit gathering and up-streaming. The liquidity control regime the G-20 and EU appear to want to impose may constrain this form of business going forward.
- 5.3 A further risk to a deposit-based model is the drive towards greater tax-transparency which has become associated with the banking crisis, regulatory changes simply because the G-20 forum is a convenient one in which to drive both forward. I should stress that it is not the performance of Guernsey's banks or its regulators that is a potential source of difficulty. Rather it is the performance in other jurisdictions on which Guernsey relies as a source of funds. The Obama administration has given fresh impetus to the initiative. For example, it has negotiated a settlement with the Swiss authorities and a major Swiss bank to reveal

the identities of its nationals with hitherto secret bank accounts in Switzerland<sup>9</sup>. The authorities in other G-20 jurisdictions seem likely to wish to follow this initiative.

5.4 Turning to endogenous factors pointing to change, many of the representations I received were a natural consequence of an island economy displaying resource constraints. It would be rational for Guernsey to seek "the biggest bang for its buck" when it comes to exercising choices on how scarce resources are utilised. So under an array of changing exogenous factors it should ensure that any changes move banking in Guernsey towards higher value-adding activities.

5.5 At the heart of Guernsey's present dilemma is a tightly bound set of issues arising from the fact that a substantial part of its deposit base is driven by deposit-taking and up-streaming and fiduciary deposits at a time when the liquidity of banks has been put under severe pressure. I discuss the issues here to set the scene for the changes I believe Guernsey should make over a period of time. The issues have been brought into sharp focus by the difficulties encountered by the Northern Rock and Landsbanki Groups. They are that:

- i) Guernsey does not have a central bank so it has no lender of last resort;
- ii) Guernsey's tax base is small relative to the amount of risk a deposit-based model can now be seen to present;
- iii) any depositor compensation scheme is inevitably limited in the amount of assistance it can provide;
- iv) depositor compensation schemes do not address the consequences of systemic failure because they do nothing to get

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<sup>8</sup> The Turner Review was published by the FSA in March 2009 and can be viewed at <http://www.fsa.gov.uk/pages/Library/Corporate/turner/index.shtml>

<sup>9</sup> In regard to Switzerland it is worth recording that failure to declare tax (e.g. be late providing a tax return) was an administrative matter rather than a crime (although tax fraud as such is a crime). Under those conditions, a Swiss bank might clear a name which a Guernsey or UK bank would not on the same facts.

the system going again or to mitigate the wider effects on an economy;

- v) Guernsey is vulnerable to the imposition of liquidity controls on banks in other jurisdictions;
- vi) traditional views about whether it is better to have subsidiaries or branches of banks in a jurisdiction appear no longer to hold true;
- vii) there has always been debate about the effectiveness of the Financial Action Task Force rules on money laundering and terrorist financing, and the customer due diligence ("CDD") regime in force around the world may not be robust enough at all times to protect Guernsey from possible reputational risk.

5.6 Leaving aside the banks that provide the Island with its domestic banking services, most banks in Guernsey operate balance sheets that have a large liability side, i.e. they have taken in deposits that they owe to depositors but no corresponding asset side, i.e. they have not made income earning loans to borrowers who owe them money. A significant amount of the surplus is up-streamed, either from subsidiary to parent (who then owes them the money thus making the balance sheet balance) or it happens directly through a branch because it does not have a separate identity.

5.7 The Landsbanki experience reveals the risks of this approach. There is no lender of last resort in Guernsey and if the home state jurisdiction has neither an effective lender of last resort nor a strong tax base, there is severe risk to depositors and to the reputation of Guernsey. I set out later in this chapter an appropriate mix of policies to deal with this problem for the future, recognising that there is no ideal solution.

5.8 The banking crisis has also brought into sharp focus the limits of what depositor compensation schemes can achieve. It is generally well-understood by policymakers in jurisdictions with mature schemes<sup>10</sup> that

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<sup>10</sup> I exclude the USA from this because of its tradition of having very small banks serving local communities.

they are intended to cover the infrequent failure of banks. They cannot address systemic bank failure, that is several failing at once, and they do nothing to recover the system, for example by recapitalising the banks. Neither do they mitigate the wider recessionary effects on the economy. Fortunately, Guernsey appears largely to have escaped this consequence of the crisis.

- 5.9 The exact form of liquidity controls to be imposed by G-20 countries has not become clear during the review, although the UK authorities produced theirs on 5 October 2009<sup>11</sup>. The Guernsey authorities must be alive to the risk that the UK controls might have the effect of increasing the risk inherent in up-streaming. They will need to consider whether countervailing measures are necessary. Strategically this may lead to a down-grading of the value of deposit-gathering and up-streaming to Guernsey.

### **The feasibility of making change happen**

- 5.10 Writing a report containing a number of recommendations is one thing; leaving behind a workable blueprint in which a large part of the prescription remains intact is quite another. There are many intervening variables and it is difficult to engineer what the market does not want. In framing my recommendations I have concentrated on things that are within Guernsey's gift. Where an issue is not within its gift, I have framed recommendations in terms of making representations.
- 5.11 Therefore, the recommendations should be capable of implementation, but whether change happens is a different matter. That depends on the will of the stakeholders. As to that, I have tried to produce pragmatic recommendations intended to command their support. But overall, the people I met seemed willing and able to embrace change and some were positively eager to move forward. The resource constraints in Guernsey will never be very far away and I have tried to take these into account. On balance, I consider that the implementation of what follows is feasible and that change will be brought about. I leave it to any post-

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<sup>11</sup> See [http://www.fsa.gov.uk/pages/Library/Policy/Policy/2009/09\\_16.shtml](http://www.fsa.gov.uk/pages/Library/Policy/Policy/2009/09_16.shtml)

implementation review to judge whether the changes would have happened anyway, or whether this report was the catalyst.

### **New overall priorities**

5.12 The first and overriding issue is a broad one about whether or not Guernsey should specialise in particular types of banking. Given the resource constraints one would expect the answer to be "yes" and in a sense it is but not in a detailed, prescriptive way.

5.13 The idea that I or the Department could pick winners was discredited long ago in the British Government's economic policies of the 1960s and 1970s. Moreover, to concentrate excessively in too few activities would concentrate risk. So good risk management must be balanced with the resource constraints that prevent a thousand flowers from growing. Thus the main requirements are to remain diversified at least over a number of banking activities and to be opportunistic in attracting new banking models to Guernsey with a superior offer. Diversification should be construed as meaning both correlated and non-correlated risk taking within banking and financial services more widely.

**1 I recommend that Guernsey's overall strategy for its banking sector should be to promote diversity of business models and to seize the opportunities provided by a superior locational offer in attracting new businesses to the Island.**

5.14 The question immediately arises how much steering should and could be done through regulation and the work of the GFSC. Formally, regulation is beyond my remit although one of my terms of reference gives me authority to look at anything that seems to me to be relevant to my inquiries. I shall use this discretion here, although I should stress I am commenting rather than trying to dictate how the GFSC should act going forward.

5.15 In the first place, the GFSC must be seen to be acting independently of any commercial considerations. It goes without saying that it would be

inappropriate for existing market participants to be involved in decision-making because of the conflict of interest. GFSC must also operate rules and to standards consistent with Guernsey's international obligations. It is not likely, therefore, that the GFSC would often be in a position to, and nor should it, exercise its powers to bring about a strategic outcome unless that outcome was consistent with its regulatory objectives.

5.16 However, it was put to me that the GFSC could exercise control over who should be granted a banking licence consistent with a strategic plan enunciated in this report. It was also put to me that the GFSC could adopt and operate liquidity controls, for instance, that would have the effect of driving away some business models and favour others. I do not think I could go that far. It is perfectly possible, however, for the GFSC to set and publish the criteria by which applications will be judged and assess applications objectively against them. For example, it might be clear from the criteria that applicants who did not demonstrate responsible remuneration policies or planned to rely heavily on up-streaming would face a considerable hurdle. This approach could form part of the good regulation platform that is part of the opportunistic offer I envisage.

5.17 I do not make any specific recommendations for the ideal amount of deposit gathering. If the risks I have already described were to be resolved outside Guernsey or the "tax haven" debate blew itself out, then the issue would fall away. But given the risks, and the possibility that the volume of deposits may fall as a result of changing international standards, I believe Guernsey would achieve better resilience by being more diversified in its banking offerings.

5.18 There is the question whether the Guernsey authorities should actively steer the amount of deposit gathering and up-streaming downwards even if no target is set. This would be mainly to counter the risk of new liquidity controls elsewhere placing Guernsey banks in a more vulnerable position. My conclusion is that, subject to the need for over-riding regulatory intervention by the GFSC, any such steering should take place over some time since significant reductions in the amounts allowed to be

up-streamed may undermine the business case for some banks continuing to use Guernsey. To the extent that significant deposit gathering continues, then a premium will be placed on the governance of those businesses particularly the independent challenge provided by the non-executive directors to the risk profile of the business.

**2 I recommend that the broad thrust of Guernsey banking strategy should be to diversify away from deposit gathering and towards a mix of high value-adding banking services.**

**3 I recommend that the GFSC pay particular attention to the governance of those banks operating business models particularly vulnerable to any squeeze on their liquidity.**

5.19 I have received several representations about the development of the GDICS. I have no doubt that in the circumstances Guernsey should have a scheme to protect both domestic and international depositors. However, the parameters of such a scheme are subject to some quite complex considerations arising from the nature of the Guernsey economy and the position of Guernsey in international markets.

5.20 Globally, the shape of these schemes is broadly consistent and some convergence has been evident since the banking crisis began. The US Federal Deposit Insurance Corporation ("FDIC") covers the first \$100,000 deposited. The UK Financial Services Compensation Scheme ("FSCS") covers the first £50,000. Recent exchange rate movements make these amounts no longer directly comparable but on buying power they are roughly equivalent. Guernsey should and does match this level of protection. The outstanding points concern consequential issues about the realistic maximum size of the pool relative to the deposit risk, how the scheme is funded; the relative degree of risk borne by contributors, and the distortions that may bring to the market both within Guernsey and between international financial centres.

5.21 The distortions within Guernsey take me straight back to the broad thrust of this report about diversification of risk and the relative over-weighting

of risk concentrated in deposit taking. Inevitably, banks considering themselves to present the least risk protest to me that there is a cross-subsidy flowing from them to those banks perceived at present as being most likely to give rise to a call on the scheme. The banks with the opposite profile have remained silent but my surmise is that the post-crisis regulatory tightening, plus closer attention to risk pricing, in banks' own commercial interests, has moved the risk profiles closer together. There is a case for arguing that scheme levies should be risk-weighted to iron out the cross-subsidy implicit in the scheme. My conclusion, however, is that the risks are likely to shift quite quickly and the regime would struggle to keep up. Moreover, risk measurement for GDCS could be difficult. Using credit rating agencies is unlikely to command any support given their recent record. No other objective measure of credit risk pricing appears to be available so the simpler the scheme the better. The furthest I think the Scheme can go is to be mindful of the risks of market distortion and set its tariff accordingly.

**4 I recommend that the GDCS keeps the risk of cross-subsidy under constant review and amend its contribution regime as soon as distortions of the market become evident.**

- 5.22 Competition between international financial centres should not be based on regulatory considerations. However, the reality is that regulation is a burden on business and it is entirely rational for businesses to seek to control their costs. Any jurisdiction must therefore be mindful of the regulatory burden they impose. The issue for the GDCS seems to be whether it should continue to be pre-funded or not. The signals are conflicting. Pre-funding has been comparatively unusual but that is changing. For example, the UK FSCS is switching to pre-funding and the FDIC is considering do so. But the main comparison is with Jersey and the Isle of Man.
- 5.23 I have no great preference for pre- or post-funding. Instinctively I am against pre-funding since the private sector ought to be able to put the money to better use. I also advocate elsewhere in this report the exploration of greater co-operation between the Crown Dependencies.

Nevertheless, I think this is a case of Guernsey needing to look over its shoulder at what the other competitor jurisdictions are doing. I would prefer this to be done under the banner of co-operation rather than competing on inappropriate issues. There is the risk, however, that where individual institutions have relatively costless options for where to place business, for example operations in both Jersey and Guernsey, significant divergence between scheme costs runs the risk of those costs being arbitrated. If Guernsey's scheme is perceived to be relatively expensive it is likely to drive business away that believes the scheme has little value to them. This could be the very business I believe Guernsey should be attracting in order to diversify risk.

**5 I recommend that the GDCS evolves so as to take into account good practice in competitor jurisdictions.**

- 5.24 I am very conscious that some readers will be thinking that the analysis in this report is all very well, but how can change be achieved and what exactly should be done? I hope many of the recommendations answer those questions but I think that there are a number of things that can be done to move banking further up the value-adding pecking order.
- 5.25 As the centre of gravity of economic activity moves away from North America and Europe, so should Guernsey banking follow it. The numbers of very high net worth individuals in Brazil, Russia, India and China, (the so-called "BRIC" countries), are forecast to rise far faster than elsewhere. Families growing wealthy in these countries will seek to diversify their portfolio holdings and international financial centres will be a natural home for their surplus wealth. No doubt other centres, Singapore most obviously, will compete for this business. However, I suspect their competitiveness will be compromised, not least by being in a less than propitious time zone. Guernsey, with its strong professional services offering and banking skills, should be targeting these customers with a broad wealth management offering rather than a narrower deposit-taking one.
- 5.26 Although there are already a number of banks providing private banking and wealth management services in Guernsey, moving up-market will

place strain on resources on the Island's banking resources. Simply taking deposits implies that it is the higher value-adding services that are being out-sourced, for example up-streaming does not require a treasury function in Guernsey. Rather than out-sourcing its higher value-add operations, Guernsey's long-term plan should be to out-source low value/low productivity banking operations.

5.27 An implication of the strategic approach I have in mind is that Guernsey's international banking operations would move in some degree away from utility banking<sup>12</sup> and towards wholesale banking<sup>13</sup>. This would have implications for the GDCS since even prudent forms of broker/dealer, originate and distribute banking models are likely to be perceived as representing greater risk than narrow utility banking. This may be one instance where Guernsey might take up a leading position in international banking. The argument for the separation of utility and broker/dealer banking has ebbed and flowed over the past year. Of late, separation has gained some traction again. Some banks will naturally hate the idea while others positively welcome it according to the transfer of competitive advantage it could presage. However, in a jurisdiction the size of Guernsey, the innovation might be accepted because, on grounds of scale, it could be seen as managing the risks of the GDCS. Guernsey could also boast of its forward-looking stance.

5.28 I received mixed representations about the practice of allowing managed or administered banks. I suspect some self-interest in some of these representations mainly relating to competition. It so happens that two banks to have encountered severe problems had managed operations in Guernsey. But so far as I can see, the problems were entirely external to Guernsey and cannot be said to have anything to flow from their being managed banks.

5.29 Moreover, it seems to me that the managed bank concept fits well with the scale of operations in Guernsey. Rather than increasing risk, it seems to me that it enables start-ups in the relative safety of the managed environment where services such as compliance can be

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<sup>12</sup> meaning serving retail and commercial clients.

provided by full-time specialists. I can see this argument ebbing and flowing but, on balance, managed banks are good for Guernsey.

**6 I recommend no change is made to the practice of allowing managed or administered banks to obtain a banking licence in Guernsey.**

- 5.30 In my visits to Guernsey I was told about one domestic banking possibility under consideration. This raises the question whether the GFSC should licence indigenous banks to offer retail banking services. The answer to this is plainly that it should not. Guernsey does not have a lender of last resort and without one I cannot see how anyone would make a rational decision to deposit funds with such a bank: it would require them to believe that the GDCS effectively had limitless resources. Indeed, I would see the risk that such depositors might erroneously assume an implicit guarantee was in place from the Guernsey Government, ultimately underwritten by the taxpayers of Guernsey. Avoiding such moral hazard and its attendant financial and reputational risks would be a wise move.

**The benefits and risks**

- 5.31 I believe the benefits of the strategy I have outlined are fairly obvious but for post-implementation review purposes it would be best to record them.
- 5.32 The most obvious benefit is that a stable and prosperous international banking sector would make a major contribution to securing Guernsey's prosperity. It would also improve the prospect of long-term prosperity. It should be borne in mind that this is not simply about the contribution banking itself makes to the economy. Rather, it is about the inter-connected businesses that also thrive because banking services are present. The professional services firms, other financial services and protected cell businesses are strengthened by the presence of banking services.

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<sup>13</sup> meaning serving other banks.

- 5.33 Implementation of my recommendations would also enable banking better to maintain and increase the status of Guernsey as a financial centre on the global map. In turn this would enable other sectors of the Guernsey economy to gain market recognition as the Guernsey brand's value and reputation for excellence is enhanced.
- 5.34 Moreover, some of my recommendations are aimed at reducing risk inherent in current operations. Controlling or reducing these has obvious benefits. But my recommendations are not risk free. If my proposals do not command support, it would suggest to me that public and political support for the banking sector may be lacking and the poor response to the report only served to highlight the fact. In turn, this could lead to the sector gradually diminishing and the significant contribution that banking provides to Guernsey's prosperity diminishing with it.
- 5.35 International financial centres could lose a rhetorical reputational battle within the G-20 and the EU. It is said that a good big one always beats a good little one and there must be some risk that, even if international financial centres, or a sub-set of the better ones, are on the high ground, they lose the argument for reasons of political expediency. I address this risk in my proposed solution.
- 5.36 Interestingly, in discussing these risks in the context of debating the possible way forward, some bankers expressed the fear that the banking community itself might fail to rise to the political challenge in terms of their engagement with the process. I am grateful for the candour in surfacing this anxiety. There is not much I can advocate as a recommendation to combat this since it would sound something like "must try harder". However, given that the issue has surfaced I believe the parties will make sure the engagement is robust. However, my counsel, based on my working lifetime in Parliament is to ensure that overall public policy is clearly enunciated so that the regulatory arm of government can clearly see how its role fits within an overall plan for governing society at large and the markets that serve it.
- 5.37 Generalised from some of the preceding discussion is the risk that regulation is either too light, leading to reputational harm, or else it is too

heavy and competitive advantage is conceded elsewhere. Regulation is an instrument of public policy and policymakers down the ages wrestle with this dilemma. The proposition is a statement of the obvious; Goldilocks wanted her porridge not too hot and not too cold. There is no succinct answer to this wish.

5.38 However, framing the question properly and keeping the risk at front of mind would be mitigants. For example, risk is no respecter of bureaucratic boundaries. Just as banking potentiates other sectors of the Guernsey economy, such as professional services, so those services can do the reverse. They could also harm one another. So the regulatory standards achieved by professional services will need to be equivalent to that applied to and by financial services.

5.39 Cost creep in banks is a further risk. Indeed, some of my proposals might be held to drive cost into the industry. For that reason I advocate careful analysis of the benefits and the costs of each recommendation.

### **Risk mitigation**

5.40 I have largely indicated the mitigants within the foregoing risk analysis and many are self-evident. However, I believe that there is one overriding mitigant that would serve Guernsey well moving forward. That is to cement industry/government liaison in arrangements that are enduring and command broad support. I set out my proposals for that later in the report. My general experience is that these arrangements have to be worked away at to make them a success and they have to be re-invigorated at regular intervals, preferably through pro-active initiatives rather than being driven by external events.

### **Non-banking options for change**

5.41 I was delighted to see that many respondents had thought deeply about changes that would improve the prospects for the banking sector. Many of them were also calculated to benefit financial services on Guernsey more widely. Indeed, some would even benefit commerce as a whole on

the Island. I have necessarily had to draw a line in some cases and exclude specific reference to some ideas because, in the time available, I could not go into the suggestions far enough to satisfy myself about their feasibility.

5.42 A recurring suggestion was that a specific "ministerial"<sup>14</sup> portfolio for financial services, or more specifically banking, would give the sector a bigger voice and in some way improve the prospects for banking. This idea has superficial appeal but I have to say that it is fraught with difficulties and I think there is a better way of releasing what is a good thought within the specific proposal.

5.43 Generally, creating new "ministerial" portfolios that run against the grain of established machinery of government dispositions in any democracy does not have a good record. For any minister in any administration (or in this case a Guernsey Departmental Board) to operate successfully, he or she needs a fully functioning department of civil servants both to bring forward matters for attention and to carry out the ministerial instructions. So creating such a portfolio in Guernsey would require far more than simply appointing a board charged with that responsibility. Moreover, within the confines of a democracy the size of Guernsey there can be little certainty that there would always be five members of the States who would have the required knowledge, skills, experience and understanding of the issues to make their appointment a success. I also heard suggestions that some people from the banking community might stand for election to the States so providing suitably qualified people to constitute a Departmental Board. However, this seems to me too uncertain an approach and it might even bear the risk of conflict of interest in some matters. So for these reasons I am not recommending the creation of such a post.

5.44 However, I have given some thought to what may lie behind this idea. All administrations work at their best when there is an effective flow of ideas, debate and challenge around the issues of the day. It improves decision-

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<sup>14</sup> Guernsey does not have a ministerial system of government as such. I use the term here as that is the nomenclature used by those who made this suggestion. In Guernsey the creation of a Department for financial services would necessitate the appointment of a minister and four deputies of the States of Deliberation.

making and increases well-being through greater levels of trust and understanding. The "minister" suggestion seems to be a *cri de coeur* to achieve that outcome. In that case, I think there may be another way of achieving the objective which I agree is a good one.

5.45 I was very struck by the report of the Welsh Audit Office ("WAO") of its review of good governance of the States. At paragraph 1.113 it reports that representatives of the business community were less critical than members of the public of the way in which the States consulted them. It concluded that efforts within the States to foster and improve relationships with the business community are having an impact. There is no clue as to whether banking or financial services fares better or worse than the rest of the business community. I am assuming that it is about the same. But, in any event, the WAO nevertheless goes on to state (paragraph 1.117) that the States need better arrangements to involve others in decision-making processes.

5.46 The question is how to give effect to the idea and how to ensure it does not run automatically foul of the WAO's general view that States' governance has not been strictly disciplined. I noticed in the WAO report (paragraph 1.3 b) that each government department has a departmental board comprising a minister, a deputy minister and three other deputies elected by the States. Each departmental board may nominate for appointment by the States two non-States' members, although they do not have voting rights on the board. I understand the Department's board has not filled these positions so they remain available. Mindful of other business interests besides banking and financial services I think one of these board positions might go to a person selected from within Guernsey's financial services industry whilst the other goes to another sector of Guernsey commerce.

5.47 By itself, this step would be in the right direction in my view. However, its effectiveness would depend critically on the selected individual having strong communication routes back into the industry. There was some feeling that the risk existed that the industry might not find the time of the right people to drive the debate that would flow through the conduit proposed here. There is no way that I can test this anxiety. All I can say,

from long experience, is that interest groups largely get the outcomes they deserve. If a laissez-faire attitude prevails, the industry will only have itself to blame. I think an appointment to the departmental board would have to be supplemented by an appropriate feeder structure, probably best achieved by an informal committee. I am told that yet more individuals could be appointed to a departmental board although such members could not receive papers. I do not think that would be the right way to go. It could be seen as swamping the board with financial services interests when it has a much wider remit. Rather, I think it falls to the Association of Guernsey Banks and similar organisations to create or modify their representational structures to feed high quality material to a nominated person on the Department's board.

**7 I recommend that the Commerce and Employment Department nominate for appointment a representative from the financial services industry to fill one of the positions on its departmental board.**

- 5.48 An adjacent set of issues to the one of closer government/industry liaison and the strictures of the WAO report concerned the way various agencies worked together for the good name of Guernsey. A number of representations I received across a range of issues led back to an absence of some of the basic management tools in use today in public administration.
- 5.49 The first of these concerned more formal crisis management practice. When there is a crisis to be managed, (for example there is a run on a deposit-gathering bank), time appears to accelerate and events overtake both public and private officials who are reacting to events rather than unfolding a pre-prepared plan which has some variable geometry in it for various foreseeable contingencies. Some candid observers put it to me that some elements of the handling of the Landsbanki failure were the result of there being no pre-determined plan for handling the consequences of a bank failing. Given the uncertainty still surrounding the world's financial system going forward and the risks identified earlier in this report:

**8 I recommend that the Commerce and Employment Department works with the Policy Council and other departments to develop and practice crisis management plans to deal with critical events in banking which embrace all relevant branches of government, the financial institutions and representative bodies themselves.**

- 5.50 It is beyond the scope of my remit but there seems no reason not to suppose that good crisis management should be extended and applied to all parts of the Guernsey government.
- 5.51 The second area where better co-ordination might be required concerns the advocacy of Guernsey as a good place to do business. As a result of the findings of this review there seems to me a need to focus the promotional message on a few factors and to ensure all the agencies with a role are co-ordinated.
- 5.52 The main focus of the promotional message should be to emphasise that Guernsey is an excellent location from which to conduct international banking operations. This excellence should be founded on:
- i) regulatory reputation;
  - ii) skilled workforce;
  - iii) convenient time zone;
  - iv) speed of decision-making;
  - v) availability of professional support services;
  - vi) economic and political stability.
- 5.53 Some readers may be surprised that I omit advantages such as low taxes and existing measures of Guernsey's banking prowess, such as the scale of deposits. On the former, serious re-locators will not be slow to compare tax regimes in any event, but for the foreseeable future, tax is in an ambiguous position since corporate taxes and taxes on individual investors can easily be conflated. On the latter, as I have argued earlier in the report, deposits are a misleading measure of banking success since they appear to add little value to Guernsey; they may decline for reasons largely unconnected with Guernsey, in which case a false failure

will be being portrayed; and they cannot be separated from the weaknesses in the international arrangements for tax transparency.

- 5.54 The main bodies that need to work closely together are Guernsey Finance, the Department, GIBA and the AGB. I should add that the GFSC should also be mindful of the co-ordinated messaging but I treat it separately since a regulatory body should not be seen as an advocate for the very commercial activities it is required to supervise. It will maximise its contribution to Guernsey as a place to do business by achieving excellence in what it does as a regulator.

**9 I recommend that the publication of the value of deposits as a measure of success and as a promotional tool should be reduced; and**

**10 I recommend that the Commerce & Employment Department, the industry and Guernsey Finance initiate a project to identify the best messages with which to promote Guernsey as a location for international banking and develop a process for ensuring consistency of message giving amongst the relevant agencies.**

- 5.55 I am in the luxurious position of being able to spend other people's money when it comes to making recommendations. However, at the beginning of what is likely to be a lengthy period of public spending austerity for most jurisdictions, I have been mindful of the need to ensure that the total cost of my recommendations is proportionate. Although they are not faultless, investment appraisal techniques are now in widespread use in both private and public sectors. Applying the discipline to less overtly commercial activities is difficult, but cost/benefit analysis is a sensible way of validating investment or public spending decisions. Moreover, in an island economy where resources are quite likely to be limited, cost/benefit analysis seems likely to be disproportionately beneficial as an analytical technique. I accept some subjects are quite resistant to analysis in this way, for example lobbying more in Brussels, in which case least cost analysis might be more feasible.

5.56 A number of the proposals put to me and, indeed, a number I am advancing have cost implications. I have been mindful of cost as I have reached my conclusions. Nevertheless:

**11 I recommend that the Commerce and Employment Department subjects those of my recommendations that have public spending implications to cost/benefit analysis or some similar analytical technique to satisfy itself that the benefits would indeed outweigh the costs.**

5.57 A number of submissions and representations I received questioned the States' population policy and the related issue of housing. I do not propose to tackle these issues directly here, other than to report some of the broad assertions presented to me and to examine the direct operational consequences to banking.

5.58 I have no doubt that the States have these points firmly on board but it was put to me that the zero population growth target was unsustainable for reasons of demographics, future economic security and to achieve the economic growth necessary to ensure a sustainable, balanced budget. Since that was so, the argument was that it should be eased to allow banks (and other industries) to bring in some extra personnel with whom to do more business. In a similar vein, it was put to me that the housing licensing system's days were numbered because of human rights legislation. I have no way of validating these views, but granting more housing licences now for senior, internationally experienced bankers would be a good step for banking.

5.59 It is not easy to look inside these propositions with any certainty. However, I was struck by the responses I received to my questions about the operational impact these restrictions were having on banking in the here and now. To my surprise, it seems that most banks rely comparatively little on housing licences using just a small handful in each case and sometimes none. So broadly, I do not find a case exists for a radical change to population or housing policy solely on the grounds of the needs of the banking industry. There is the possibility that utilisation is low because the banks know it is a waste of time even bothering to

apply. The Housing Department would do well to be mindful of the second order impacts of their interventions in the housing market.

5.60 There is, however, one aspect of the operation of the housing licensing system that does seem to have a bad operational consequence and I can think of one potentially novel step to make the labour market work better. Banks using housing licences repeatedly pointed out to me that where an employee is operating on a 5-year licence there comes a point, after about 3½ years, when "planning blight" creeps in, since the individual is either unclear about whether renewal will be granted, or thoughts begin to turn to the next appointment, typically back on the mainland. Indeed, investing further training and development effort in a person who will, or might be, leaving within 18 months becomes increasingly questionable.

5.61 There is no easy solution to this problem which appears intrinsic to any rationing system. Subject to any legislative restrictions, The Housing Department might give thought to offering longer term licences, perhaps in the range of 7-9 years, but this will only put more strain on the housing market that they presumably seek to relieve. It goes without saying that applications for extension should be processed as quickly as possible to minimise uncertainty.

**12 I recommend that the Housing and Commerce and Employment Departments review the housing licensing system with a view to reducing the uncertainty around the running out of 5-year licences.**

5.62 A potential means of making the licensing system more responsive to the needs of the banks (and potentially others for that matter) would be to create a market for these licences in order that the rationing should be sensitive to economic value. Clearly, part of the system would need to be reserved for parts of the economy not subject to clear-cut market disciplines, for example health workers and similarly essential personnel. However, the Housing Department might consider issuing a small number of extra licences which could be sold by them to certain classes of business who would be free to trade them with their competitors. This could both ease the strain to which the banks refer and create price

signals with which the Housing Department could better understand the demand for housing. It would also raise some extra revenue some of which might pay for the extra administration and monitoring.

**13 I recommend that the Housing and Commerce and Employment Departments should examine the scope for introducing a market for housing licences.**

5.63 One other point to arise from my look at the housing licensing system was the process for endorsing applications. It would seem that applications for licences from most of commerce require the endorsement of the C & E Department. However, for financial services, including banks, this endorsement role is played by the GFSC. Endorsing applications for these licences is a sponsorship, rather than a regulatory, role. I think it would be better if this role in respect of financial services, including banks, were to be passed to the C & E Department from GFSC. No doubt suitable liaison arrangements could be put in place so that GFSC's regulatory interests were properly understood by the C & E Department.

**14 I recommend that endorsement of housing licence applications from the financial services sector including banks should pass from GFSC to the Commerce and Employment Department.**

5.64 Another area of the Island's resources where questions of supply surfaced was that of the indigenous labour force and its educational attainment. Representations about this question were less clear-cut than I might have expected. The issues resolved themselves into ones around the availability of school leavers and ones around more mature individuals with tertiary education.

5.65 There was a broadly held view that Guernsey produced good-quality school leavers and the banks were happy to compete for their services. They were less happy with the consequence of a tight market that banks tempted each other's staff away with higher wage offers once school leavers gained work experience, but I am afraid I can do nothing about

market forces. There was also a broad measure of support for the recent addition to the curriculum of formal examinations in financial services.

5.66 At the tertiary level, views grew more uncertain. It was not thought viable or commercially worthwhile that young Guernsey people studying for a degree on the mainland should have some sort of "golden handcuffs" applied to bring them straight back to the Island on graduation. Rather, what the banks are interested in is the graduate who has several years international, off-island banking experience who may be looking to return to Guernsey for life-style reasons, for example the education and upbringing of their own children. Certainly, this type of bank employee fits with the vision I have of a high value-add banking sector.

5.67 The question is how to get such people to return instead of putting down roots elsewhere. I do not have any "magic wand" solution to this. However, one rather gentle idea is to create a more or less virtual alumni association. Social networking appears to have become a firmly established phenomenon, apparently invented recently by young people, although I believe it took place before small hand-held devices were invented. Be that as it may, extolling the virtues of life on Guernsey for its expatriates through an alumni association using both traditional and modern methods might prove surprisingly effective.

**15 I recommend an alumni association is set up with the aim of attracting back to Guernsey people who have acquired high value banking expertise elsewhere. The AGB might like to consider ways of kick-starting and administering an association.**

5.68 There is also another category of person Guernsey should think about, namely extremely high net worth individuals and entrepreneurs, particularly those with financial services interests. One consequence of the British Government's decision to increase top rate income tax to 50 per cent is that very wealthy individuals prepared to tolerate a 40 per cent rate will now look to leave the UK. In itself this is not a particularly attractive development. However, some of the most mobile entrepreneurs could be those connected to banking and financial

services where they must endure the additional potential opprobrium of restrictions on how they are paid. If some of these people were to relocate in Guernsey, they might bring some of their activities with them if they saw that the business environment was favourable. In turn, this might give rise to an increase in just the sort of high value-add banking I envisage for the future.

**16 I recommend that the Commerce and Employment Department should increase the priority it gives to its existing efforts to attract financial services entrepreneurs to Guernsey who would be interested in starting up on the Island.**

5.69 The next area of issues I must address is the rather tricky one of Guernsey's relationships with other Crown Dependencies, with the UK Government and with Brussels. One of the harder questions to answer is when one should compete and when to co-operate with those who have closely related interests. There is no simple answer. However, the soundings I have taken suggest that there might be greater scope for co-operation than is generally supposed. The fear is always one of collateral damage; that a close comparator is seen to have done something wrong and guilt by association ensues. However, this rather falls into the "glass half-empty" category and several times I received the clear steer that greater co-operation would be of net benefit to Guernsey.

5.70 The most obvious co-operation partner is Jersey, followed by the Isle of Man. All three have banking sectors and they are often bundled together anyway by larger trading blocs such as the EU. The case for co-operation is that resources are limited in all three jurisdictions and small compared with London and Brussels. Joining forces on suitable issues would have the effect of reducing the ability of counter-parties to divide and rule, whilst also increasing the resources on any one issue available to the Crown Dependencies. I am aware that some co-operation already occurs; for example Guernsey and Jersey are seeking to reduce costs in the civil aviation field. It will not always be possible to co-operate and each jurisdiction would need to pick its issues but nevertheless:

**17 I recommend that the States should explore the scope for greater co-operation with Jersey and the Isle of Man in all issues relevant to financial services where they face larger jurisdictions.**

5.71 The most obvious counter-parties are in London and Brussels. It may seem facile to point it out but these two cities display very different characteristics in the public policy arena so far as the Crown Dependencies are concerned. The former has a much more intimate relationship yet it is paradoxically the more remote in its dealings. London, for example, provides the ultimate legal authority; provides defence of the realm; and provides Guernsey's currency. Yet gaining access to Whitehall for some reason is far harder than gaining access to the European Commission and Parliament in Brussels. By contrast, Brussels almost overlooks the Crown Dependencies, yet its door is always open. As Brussels competency grows more extensive its impact on Guernsey will grow and the open door will need to be used more often. Since Brussels is growing in importance and is more open, Guernsey should increase its engagement there making representations where new proposals, particularly for new Directives, affect its interests.

**18 I recommend that Guernsey should increase the level of its engagement with London and Brussels on issues that affect its interests.**

5.72 Last, and rather prosaically, there are two areas where further investment appears to be required and I am conscious that this is against a background of the need for public expenditure restraint. In the first of these, I received numerous requests for Guernsey's infrastructure to be improved. I shall not produce a list of pet projects. Rather, I would observe that Guernsey's infrastructure is one of the factors that has resulted in such a successful banking sector. If my recommendation on refocusing the promotion of Guernsey as a good place to do business is accepted, then it follows that the infrastructure, particularly around communication will need to be up to it.

5.73 The second small investment is about data gathering by the States' Departments. At several points I have been struck by the paucity of data with which to conduct the review. This led to the review having to collect data I would have assumed would be at the Department's fingertips. For the longer term, it may be that more and better quality data justifies its costs in the extra benefit afforded by the consequential better decision-making.

## 6. Concluding remarks

- 6.1 My work in Guernsey makes me optimistic about the ability of its banking sector to thrive in future and, in turn, drive prosperity in other sectors. Plainly, it must undergo its own particular transition as banking globally adjusts to life after the crisis of 2007-8. But I am encouraged by the overall quality and competence of its people notwithstanding the limitations inevitably arising from an economy so obviously constrained by geographic scale. Perhaps it is those limitations that drive it towards excellence in all it does: that seems a winning strategy to me.
- 6.2 I hope my recommendations command broad support. Even if it is finally concluded that some are not worthy of pursuit, I hope the discussion will have acted as a catalyst for forward momentum. I was very conscious that in the time it took to conduct the review events moved on and were likely to continue apace. For example, the Obama Administration seems very determined to advance its tax transparency agenda (something with which Guernsey is very well-placed to engage at the regulatory level). The global economy appears to be pulling out of recession and its banks slowly returning to a healthier condition. Even as this is happening, however, official and expert commentators continued to be wary of a “double dip”. I think it follows from this that the response to this review must be alive to change and to continue to evolve as the business and regulatory environment changes. The recommendations of this review must be viewed in that light.
- 6.3 That it has been possible to produce a report at all is in no small part down to the widespread assistance I received from individual banks and the various representatives bodies I met and who provided written submissions to the review. The review would not have been possible without their contributions. Nor would it have been possible without the support and endeavour of the two civil servants assigned to the review and to the Minister who sponsored my work. Without the assiduous hard work of Jarrod Cowley-Grimmond and Mat Desforges, it would not have been possible to undertake the review. I should also like to express my thanks to Deputy Carla McNulty Bauer, the Commerce and Employment

Minister, whose encouragement and endorsement left me in no doubt that this review was in earnest and I was to leave no stone unturned.

## Appendix A: List of organisations making submissions to the review

Adam & Company International Limited  
Association of Guernsey Banks  
Bank Sarasin (CI) Limited  
Barclays Bank Plc  
Barclays Private Clients International Limited  
Butterfield Bank (Guernsey) Limited  
Credit Suisse (Guernsey) Limited  
Deutsche Bank International Limited  
EFG Bank SA, Guernsey Branch  
EFG Private bank (Channel Islands) Ltd  
Guernsey International Business Association  
HSBC Bank plc  
Investec Bank (CI) Ltd  
Kleinwort Benson (Channel Islands) Limited  
Lloyds TSB Offshore Limited  
Mees Pierson  
Northern Trust (Guernsey) Limited  
RBS International Limited  
Rothschild Bank International Limited  
Schroders (C.I.) Limited  
SG Hambros Bank (CI) Ltd  
Skipton Guernsey Limited  
Yorkshire Guernsey limited

## Appendix B: Full list of recommendations

I recommend that:

- 1 Guernsey's overall strategy for its banking sector should be to promote diversity of business models and to seize the opportunities provided by a superior locational offer in attracting new businesses to the Island.
- 2 The broad thrust of Guernsey banking strategy should be to diversify away from deposit gathering and towards a mix of high value-adding banking services.
- 3 The GFSC should pay particular attention to the governance of those banks operating business models particularly vulnerable to any squeeze on their liquidity.
- 4 The GDCS should keep the risk of cross-subsidy under constant review and amend its contribution regime as soon as distortions of the market become evident.
- 5 The GDCS should evolve so as to take into account good practice in competitor jurisdictions.
- 6 That no change should be made to the practice of allowing managed or administered banks to obtain a banking licence in Guernsey.
- 7 The Commerce and Employment Department should nominate for appointment a representative from the financial services industry to fill one of the positions on its departmental board.
- 8 The Commerce and Employment Department should work with the Policy Council and other departments to develop and practice crisis management plans to deal with critical events in banking which embrace all relevant branches of government, the financial institutions and representative bodies themselves.
- 9 The publication of the value of deposits as a measure of success and as a promotional tool should be reduced.

- 10 The Commerce & Employment Department, the industry and Guernsey Finance should initiate a project to identify the best messages with which to promote Guernsey as a location for international banking and develop a process for ensuring consistency of message giving amongst the relevant agencies.
- 11 The Commerce and Employment Department should subject those of my recommendations that have public spending implications to cost/benefit analysis or some similar analytical technique to satisfy itself that the benefits would indeed outweigh the costs.
- 12 The Housing and Commerce and Employment Departments should review the housing licensing system with a view to reducing the uncertainty around the running out of 5-year licences.
- 13 The Housing and Commerce and Employment Departments should examine the scope for introducing a market for housing licences.
- 14 Endorsement of housing licence applications from the financial services sector, including banks, should pass from GFSC to the Commerce and Employment Department.
- 15 An alumni association should be set up with the aim of attracting back to Guernsey people who have acquired high value banking expertise elsewhere. The AGB might like to consider ways of kick-starting and administering an association.
- 16 The Commerce and Employment Department should increase the priority it gives to its existing efforts to attract financial services entrepreneurs to Guernsey who would be interested in starting up on the Island.
- 17 The States should explore the scope for greater co-operation with Jersey and the Isle of Man in all issues relevant to financial services where they face larger jurisdictions.
- 18 Guernsey should increase the level of its engagement with London and Brussels on issues that affect its interests.

## Appendix C: List of abbreviations used

AGB	Association of Guernsey Banks
BRIC	Brazil, Russia, India and China
CDD	Customer Due Diligence
EU	European Union
FATF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
G-20	Group of Twenty Finance Ministers and Central Bank Governors
GDCS	Guernsey Depositor Compensation Scheme
GFSC	Guernsey Financial Services Commission
GIBA	Guernsey International Business Association
HNW	High Net Worth
HNWE	High Net Worth Entrepreneur
HNWI	High Net Worth Individual
HSBC	Hong Kong and Shanghai Banking Corporation
IT	Information Technology
LIBOR	London Inter-bank Offer Rate
OECD	Organisation for Economic Co-operation and Development
RBS	Royal Bank of Scotland
TIEA	Tax Information Exchange Agreement
UK	The United Kingdom of Great Britain and Northern Ireland
USA	The United States of America
WAO	Welsh Audit Office