Commissioner's speech to the Gibraltar Bankers Association Annual Conference – September 27 2006

[This is a retrospective written version of the speech]

Good afternoon ladies and gentlemen.

Firstly, as you can see, and contrary to the belief of some, I do indeed own a suit. My normal lack of sartorial elegance is therefore a matter of choice rather than a lack of wardrobe. I am however pleased that some leading politicians have adopted a similar approach. Unfortunately it is currently only the Presidents of Iran and Venezuela, but it's a start.

As Ray has said, this is my fourth speech to the annual conference and I am grateful for the invitation. In previous years I have used as my basis my report in our annual accounts. However as I have not yet had to time to write this, I am speaking to you, much as I sing, without the use of any proper notes.

It has been said that one of the roles of a regulator, like a central bank, is to "take away the alcohol just as the party is getting started". Last year I spoke of the danger of "mindless optimism". I make no apologies for this. Like any small international finance centre we are mainly driven by events outside our control. However well we may be doing internally, the external global economy ultimately determines our fate.

Last year I said that in 2004 few would have anticipated a rise in the oil price to $50 a barrel, this year it rose far higher and has only recently fallen to just under $60. There are other clouds, whether the slowdown in the US economy or the risk posed by the ever growing hedge fund industry. The Greenwich Associates have estimated that hedge funds now own half of the distressed debt market, 45% of emerging market bonds and up to one third of risky corporate debt. One fund, Amaranth Advisers, recently lost $6 billion on gas futures. I believe that the hedge fund industry, its size, the nature of many of its investments and the untested nature of its programmes present a real, if unquantified, systemic risk. If that risk becomes real there is nothing that Gibraltar can realistically do to protect itself from the fallout.

It is not just financial issues that should temper our optimism, the US Congressional Budget Office has estimated that a flu pandemic would cost the USA $675 billion, half in fear and confusion alone.

Last year, no one would have considered the risk Louisiana or France could pose to internet gaming.

In a globalised environment, risks can turn into threats and threats into events faster than ever before. We can neither ring fence ourselves from these events nor can we stick our head in the sand ostrich like in the hope they will disappear. We cannot control these events but we can anticipate, prepare and react.

However if we do look locally there is much to be positive about. If I turn first to the IMF review. The Attorney General said in his speech that the IMF review team spent two days at his chambers. I wish we had only had two days. The process seemed to go on forever. However we will respond to the second draft report this week and I hope that the report will be published by the end of this year.

As it is only draft I am not allowed to comment on it apart from to say that I am keen for it to be published as I believe it will further enhance Gibraltar's reputation.

I will also not talk about the recent tripartite agreement, I am sure the Chief Minister will cover that in his speech.

Instead, what I can say is that the Commission has never had so many applications. In previous years the growth has primarily been in insurance, however whilst this area continues to flourish, it has now been joined by far more investment service applications and, following a change to our banking policy, more banking applications.

The banking change under which we now consider quality applications from non banking groups as well as those with banking parents has proved popular and we expect further licences soon.

The granting of investment service passporting into the UK opens up yet another market for our financial services

These are apart from the proposed stock exchange and the Islamic finance initiative.

This latter development, which may or may not prove successful, but is certainly worth the work involved, is an example of how the partnership of regulator, industry and Government works in Gibraltar. As Daniel Feetham said in his speech, regulators cannot create wealth. They can however stifle innovation by overregulation or poor supervision resulting in reputational damage to the jurisdiction.

A recent international survey of banking risks placed the greatest risk perceived by the industry, not hedge funds, terrorism or money laundering but over regulation.

We look to avoid this by our approach to regulation and by encouraging open and honest dialogue. To this end we are introducing a formal feedback process, independent of our onsites, to seek firms views on how we can perform our role better

This year has also seen considerable work preparing for the introduction of the Capital Requirement Directive and MiFiD. I thank the Finance Centre for the way they have put together working parties on these, combining again industry, regulator and Government to achieve a result that is compliant with the requirements and in a way that is "fit for purpose" for Gibraltar. This again shows the partnership in action.

Similarly the creation of the Finance Sector Skills Council, which I hope will meet soon, is a further example of how the Gibraltar partnership works.

It is likely that there will be a change to our founding ordinance, the Financial Services Commission Ordinance, in the months ahead. Whilst the changes are a decision for Government, I hope that I will be the last Commissioner appointed by the Governor on the approval of the Foreign Secretary. Similarly we must get rid of the requirement that four Commission members come from the UK and three from Gibraltar. The appointment process needs to be a local one, picking the best from wherever they are located. Quite how this is done is a matter for Government but we will advise and counsel if so requested.

This year we also hope to see the finalisation of the new Approved Persons Regime. This will allow us to continue our move from a regulation and rules based approach to one that is principle based.

I have been involved in regulation for twenty years. One of my first jobs was to go to Her Majesty's Stationary Office to pick up twenty copies of the Financial Services Act as soon as it was published (that shows how senior I was!). I do not believe that rules and regulations work well. Firms that are naturally compliant spend vast resources trying to comply with technicalities, whilst those who are not simply spend their time looking for loopholes.

A principle based system makes such avoidance more difficult. It is far less easy to avoid the requirement to "treat the customer fairly" than pages of prescriptive rules trying to achieve the same thing. It is also much less of a regulatory burden for those whose culture naturally is to treat their customers in this way.

The Approved Persons Regime will allow us to more directly place compliance responsibility where it should be, on the Board and senior management. Regulators are not good at running the business of those they regulate, that is the job of the board and executive. The new regime will make this division clear. We will now assess whether the management is running the business properly, rather than undertaking a simple tick and bash assessment against individual rules.

We therefore look closely at a firms culture. Our experience is that there are two types of culture that are most likely to lead to regulatory failure. The first is the bullying or "toxic" boss, who does not listen to his staff or hectors and humiliates them. Such bosses may succeed for a while but inevitably they will fail. This is why we have the "four eyes" rule and we look at the style of leadership within this firm.

The second is the board which abdicates responsibility to management, that does not fulfil its duties of oversight and direction. This results in inadequate checks and balances and, again, failure is a likely consequence.

In respect of the latter we look to see for evidence that the board has considered issues appropriately and that this is documented. The documentation is vital as we are not at the firms the whole time. We see snapshots once every one, two or three years. If there is no adequate documentation how can we see whether the board has done its job.

By adopting a principles based approach combined with our risk methodology we can maximise our efficiency. We have to do this because the volume of new EU legislation, the increase in applications and licensees as well as the work entailed in the new exchange and other developments have placed a significant additional workload upon us

However this additional work comes at a cost. We need to continue to recruit and retain quality staff. Like you all we have seen salary levels rise considerably as competition for such staff grows. We have grown from 14 staff in 2003 to 24 now and probably 26 or 27 by the end of the year. Whilst I believe much of the additional cost will be met by the increase in licensee numbers, not all will. I would therefore be dishonest if I did not say that we will be looking to increase fees in the near future.

What I do promise is that we will continue to seek to use these fees in an effective and efficient way.

I warned at the beginning about mindless optimism. We do however have cause for mindful optimism. In Gibraltar we have an industry, regulator and Government that works in partnership to develop and deliver continued growth. The last year has seen the fruits of that partnership.

I believe that if I am still here and you are kind enough to invite me again to your conference, the foundations we have laid will mean that I will be able to say that we have not merely progressed, but accelerated.

Thank you