

# STATES OF JERSEY

## Economic Affairs Scrutiny Panel Depositors' Compensation Scheme

**MONDAY, 17th AUGUST 2009**

**Panel:**

Deputy M.R. Higgins of St. Helier (Chairman)

Deputy J.M. Maçon of St. Saviour

Deputy G.P. Southern of St. Helier

Mr. C. Ahier (Scrutiny Officer)

Ms. K. Boydens (Scrutiny Officer)

**Witnesses:**

Mr. J. Harris (Director General, Jersey Financial Services Commission)

Mr. A. Le Brun (Director of International and Policy, Jersey Financial Services Commission)

**Deputy M.R. Higgins of St. Helier (Chairman):**

Thank you both for coming. The reason we have asked you here is we are trying to gather background information primarily and we are hoping you can help fill in some of the structure and so on. Anyway we will start off first by identifying ourselves for the tape and then if we can ask you to identify yourselves and say who you are. Mike Higgins, Chairman.

**Deputy J.M. Maçon of St. Saviour:**

Deputy Jeremy Maçon of St. Saviour.

**Deputy G.P. Southern of St. Helier:**

Deputy Southern of St. Helier.

**Deputy M.R. Higgins:**

Our 2 scrutiny officers here, Charlie and Kelly.

**Mr. J. Harris (Director General, Jersey Financial Services Commission):**

John Harris, Director General of the Commission.

**Mr. A. Le Brun (Director of International and Policy, Jersey Financial Services Commission):**

Andrew Le Brun, Director of International and Policy at the Commission.

**Ms. A. Siodlak (Institute of Directors):**

Anna . Siodlak, I.O.D. (Institute of Directors).

**Deputy M.R. Higgins:**

You are shadowing?

**Mr. J. Harris:**

My shadow student this week from the Institute of Directors, yes.

**Deputy M.R. Higgins:**

To start off with we are wanting to understand the nature of the banking industry that we have in the Island to start with. So could I ask you if you could explain the licensing policy for banks in the Island for both branches and subsidiaries?

**Mr. J. Harris:**

Okay. The general licensing policy has been very restrictive for a long time. Are you looking for a distinction as to whether we have a preference for subsidiaries and branches or just give you a general view?

**Deputy M.R. Higgins:**

Just give a general and then you can mention your feelings on that.

**Mr. J. Harris:**

It is often referred to as the Top 500 policy, by which is meant the top 500 banks in the world, by tier 1; core capital, in other words market capitalisation. Figures are published regularly, updated in the *Banker* magazine and various other sources. But that is a bit of a misconception because that is really only an initial entry criterion before various other things are considered as to whether a banking group should be entertained for a banking licence in Jersey. Over the years, I think it is fair to say, the licensing policy has been very restrictive and looking really to only allow into the jurisdiction large banks, large groups, which are obviously meeting that top 500 condition but in addition are very likely to be groups which are deemed to be systemically important, in particularly their home country where they are incorporated, their initial and major place of operation. Systemically important in the sense that should they fail, should they get into difficulties, it is likely to be such that they would endanger the financial stability of those home jurisdictions and therefore the governments of the home jurisdictions have a public policy imperative as to whether or not those banking groups can be allowed to fail. Now, I would not pretend that the last part of what I have just said has been a visible and transparent part of the bank licensing policy over many years. I think it has been an implicit part of it. The systemically important condition has been an explicit consideration of bank licensing policy ever since the days of B.C.C.I. (Bank of Credit and Commerce International), which of course was refused a banking licence in the jurisdiction. So there are various other pillars that are also considered and, as you know - and I think I made this clear in my letter to you, Chairman - we recently revised the banking policy to make it more transparent as to the other things that we are looking for in terms of new applicants. There we are going into issues like the international experience and track record of the banking group. The management that they are proposing to put in place, both locally and the track record and the degree of success or otherwise of the group management over a period of time, the type of business that they want to conduct and it is all aimed really at trying to get into a situation where the banks that are allowed to operate in this jurisdiction are, on an international comparison basis, as safe as safe can be because they are systemically important and the public policy imperative is that they should not be allowed to endanger the financial stability of their home jurisdictions. If you follow that reasoning, therefore, that the home country authorities are going to look to bail them out, colloquially put, if they get into trouble, that obviously has implications for us. The thing we are trying to avoid, above all, is to allow marginal banks or banks which do not really meet those imperatives to operate here but equally, also, to operate in the retail space, i.e. man in the street depositors, which arguably was not a guiding principle in some other fellow jurisdictions and that has been shown to be the case in the recent events. So I think those are largely the strategic imperatives behind the bank licence policy.

**Deputy M.R. Higgins:**

Going on to branches or subsidiaries, do you have a particular view on what you would like to see?

**Mr. J. Harris:**

No, historically we have not. Branches obviously benefit rather from the inherent advantage of effectively being the parent group operating here in the jurisdiction with no separate capital requirement. So, you know, it is just a flow through and therefore some prefer that. If I am really honest, I think we have tended to favour subsidiaries historically because there has been this prevailing view that what you see is what you get. So you have your surplus capital requirement here and it is easier for the local host jurisdiction, which is almost always what we are, to really enforce the level of capital requirement on that particular subsidiary as a standalone and relatively isolated matter from the banking group as a whole. But I would think that generally the Commission Board view now would be that that advantage is outweighed by the fact that branches may be less transparent in terms of how their local presence appears to the local regulator but the overall coverage, if you like, the overall weight of the group is much more explicitly there. You do not get into this type of situation of “can the subsidiary be let go quite so easily in the event of financial stability problems?” such as we experienced over the last 12 months. So probably it would still be the case that the Commission Board would not say they have an explicit preference for branches but branches are probably just that smidgen safer, relative to subsidiaries, compared to what we might have thought in the past.

**Deputy M.R. Higgins:**

Because we were speaking with the Guernsey Deposit Compensation Board the other day, their preference was subsidiaries. So, again, it just shows different jurisdictions, different view.

**Mr. J. Harris:**

Yes, and I think the jury is out. I think there are different views. I am not expressing a strong bias either. I think if there is a bias it is slightly towards branches, would you agree?

**Mr. A. Le Brun:**

Yes.

**Deputy M.R. Higgins:**

In terms of ... you mentioned about looking for systemically important banks, can you say categorically that the banks we have in the Island are all systemically important. You can rest assured they will be supported by their home country?

**Mr. J. Harris:**

One of the analyses that was done for this exercise was just that, to see whether there were any outliers that might not be considered systemically important enough for home country jurisdictions to step in. This, of course, is a matter of judgment, speculation and hypothesis but a case could be made that maybe 2 or 3 would not fall into that category and they are the smaller ones right at the end of the spectrum. Of course they also are not banks which have large retail deposits. They are special purpose. I am not in a position to use names but there is one in particular that really has been set up purely to transact group business with the parent and takes no deposits from the general public either in the Island or from international retail clients. So that would be one of those 3. The other 2 are simply a question of size. They have been allowed to come here historically, whether they would get the benefit of a banking licence based on what you know today, in today’s conditions, you know I think that is maybe a good test to apply and that might not go in their favour. But you are looking at 3 out of 46.

**Deputy M.R. Higgins:**

The likes of Landsbanki in Guernsey and we had K.S.F. (Kaupthing, Singer & Friedlander) in the Isle of Man, did either of those apply to the Island for a licence?

**Mr. J. Harris:**

Neither applied. There is a good reason for that. Both of those banks were originally building societies in Guernsey and the Isle of Man, in fact in the home jurisdiction which was initially was the U.K. (United Kingdom). We have never gone down the road of looking to licence building societies because inherently they are small and they are retail so they do not correspond at all to that criteria I was talking about just now. Subsequently they were taken over by Icelandic banks and both the authorities in Guernsey and the Isle of Man must have given permission for that. Then you are into the next stage of the reasoning which is the Icelandic banks, Icelandic home government, does it have the wherewithal, et cetera. So it is a hypothetical question that had they applied would they have got a licence? Certainly not as a building society and I am pretty clear in my own mind not in the incarnation as one of the 2 Icelandic banks.

**Deputy M.R. Higgins:**

Okay, in terms of the branches and subsidiaries we have got in the Island, do you know what the split is between branches and subsidiaries?

**Mr. J. Harris:**

It is almost exactly 50/50, which again it just demonstrates that generally they tend to be driven by the operating preferences of the groups rather than it is driven by a policy issue of us stipulating that it needs to be one or the other. There are pros and cons. It is pretty evenly balanced.

**Deputy M.R. Higgins:**

In terms of the banks that we have in the Island, are they primarily European banks from the European area, United States or do we have them from other destinations? Where are the banks from basically?

**Mr. J. Harris:**

The largest component is the U.K. and they tend to be the biggest retail players as well. The next line would be Continental European, so Dutch, German, French; no Spanish, no Italians. We have got about 33 banking groups and 46 licences so I think it is like 12, 13, 14, U.K. and Ireland and then you have got about a dozen European and then a smattering of others. Two U.S. (United States), one from India, Bank of India, which is again going back a long way when that was originally licensed but that has been here for a long time. Then there are a couple from the Middle East and I think that is probably about the extent of the coverage.

**Mr. A. Le Brun:**

One from South Africa.

**Mr. J. Harris:**

One from South Africa, I beg your pardon, yes.

**Deputy M.R. Higgins:**

All right. So by and large most of them are E.E.A. (European Economic Area) type countries.

**Mr. J. Harris:**

E.E.A. countries, yes.

**Deputy M.R. Higgins:**

All right. Moving on then, so is Jersey the home regulator for any bank or are we just the host regulator?

**Mr. J. Harris:**

We are host regulator for 45 of the 46, we are home regulator for HSBC's Bank of the Middle East, which again is a historical construct that just happened to be incorporated in Jersey for group reasons and we therefore ... because it is domiciled from here we are the home regulator. All the other places where it operates around the Middle East are the host regulator. But that is an absolute reversal of the usual stance otherwise we are always the host.

**Deputy M.R. Higgins:**

So with being the host obviously there is a home country regulator, what is the Commission's relationship with the home country regulators? What is the relationship between the 2 of you in terms of banking solution, et cetera?

**Mr. J. Harris:**

You mean quality of the relationship or the nature of the relationship?

**Deputy M.R. Higgins:**

Both, I think.

**Mr. J. Harris:**

Okay, well I will start with quality. We maintain very close contacts with the ones where there is a preponderance of representation; so obviously with the U.K. F.S.A. (Financial Services Authority) and with the United States Federal Reserve and other banking regulators who have a balkanised system in the United States. We have, I would say, good relations but they could benefit from being a little bit closer with many of the Continental European; French, German, Swiss, Dutch. That is not to say that they are not good, the relationship is good but it is not as active and as regular ... the frequency of interchange is not the same as it is with the F.S.A. But generally speaking the quality of interrelationships is good. The nature of the relationship, of course, is problematic as it is for everybody in this game, which is that the host regulator is at the end of the food chain in terms of communication. This is certainly an experience that Guernsey and the Isle of Man had with their problem banks, in that the provision of good timely information from the home regulator would have really assisted them in their decision making over the problems that they had. As came out in the public hearings, particularly the select committee hearings that they were invited to attend, they made a pretty strong case that they had not had the level of communication that they had hoped. In the heat of battle it is probably very understandable that a home regulator struggling with an issue of such magnitude for them is hard pushed ... you know, even in a normal situation is going to have difficulties communicating with all the different subsidiaries and branches and their regulators around the world, but in a crisis situation I think it is fairly understandable that they would not get perfect communication. But an inherent weakness, I think, in the international supervisory system is that the home/host relationships are not as close and as active, particularly in crisis conditions, as one would hope. Interestingly you asked if Mark Sumner, Head of the Banking Commission, could be at the meeting today, and I am sorry he is not here because it certainly would have been appropriate that he was. He is in Stockholm this week looking at this very issue. It is an international group called Cross-Border Banking Resolution Group, trying to improve the quality of home/host communications under fire, in real crisis situations, and have mechanisms and protocols and procedures that people have to follow rather than just making it up as you go along really, which is - to be perfectly honest - what the experience of the last 12 months has been.

**Deputy M.R. Higgins:**

So basically we have a legal ... when I say legal, a M.O.U. (Memorandum of Understanding), an agreement rather than a sort of legal binding agreement with them but obviously, as you are saying, in a crisis we are at the end of the food chain essentially. They have got other more pressing things, perhaps, that they will be dealing with.

**Mr. J. Harris:**

You can do things to remedy that, to a degree. You can improve the relationship to the point where, you know, very often it is a case - and it sounds completely banal really - of “who do you phone?”. So if you have an opposite number in the Jersey regulator, and you are sitting in the F.S.A., that you know well, that you have had a lot of previous contact with, you have worked together in respect of that banking group, you sat together on regulatory colleges - which are now a feature of the new landscape but were not a feature of the past, where all the supervisors get together much more regularly than was the case in the past - you have got a better fighting chance of getting a call from your opposite when you have observed some of those conditions previously than you would have had 12 months ago. So we are getting more of that. But as to whether you will ever get to the degree where you can put your hand on your heart and say: “Look, that is enough, we are sure we are going to get consulted in any given situation” I do not think you could say that.

**Deputy M.R. Higgins:**

Moving on to the next thing, in terms of we are taking the banks here, letters of comfort, letters of guarantee, what have we asked for in Jersey from the banking groups?

**Mr. J. Harris:**

There are one or 2 situations historically where there are guarantees but the basic model is letters of comfort. Letters of comfort are not legally binding. But I think the policy has been that the parent is going to be looked to in any given situation for support. A letter of comfort does codify that but I think if you are reliant on your letter of comfort as your instrument and your basic rationale for licensing that bank, then you are fooling yourself. The letter of comfort is a nice addition, a bit like the M.O.U. example. You do not need an M.O.U. to exchange information with other regulators, it is nice to have but you do not need it. I think if you feel you need letters of comfort then you are barking up the wrong tree because you should not have been looking in that situation of licensing that bank or that banking group, its track record and standing behind its subsidiaries in the first place. So I do not think I would say that we are reliant on those letters of comfort. There are a couple of situations, and one of them arose last year, which we can talk about. There was one U.K. banking group that was particularly threatened by the crisis put in place - voluntarily, not at the request of either the Jersey regulator or any other regulator - a guarantee specifically to replace the letter of comfort. They had their own reasons for doing that, obviously commercially based reasons. So that was a spontaneous example of a banking group suddenly felt its situation vis-à-vis its place in the world generally and its relationship with all of its other banking arms and subsidiaries and branches, needed to replace something which is a tacit acknowledgement of their responsibility with an overt explicit expression of their responsibilities but it is rare. It is very rare.

**Deputy M.R. Higgins:**

Because, I think, Guernsey was relying on a letter of comfort with Landsbanki which showed the worth of it.

**Mr. J. Harris:**

My argument would be that where you deal with a situation is at the point of licensing. That is where your protection is. I think you have got to be very clear in your own mind that you are licensing an institution that may get into trouble because, let us face it, institutions that have got into trouble in the last 12-18 months are not necessarily the ones you would have expected to have done so, but where you are basically endangering financial stability if that jurisdiction is allowed to fail and you fall back on that. To me that is a much greater degree of protection than any other ...

**Deputy G.P. Southern:**

Can I come in? To what extent are you reliant on this: “We will not let the bank fail.” It seems to me

the discussion: “Is too big to fail” is something that is to be avoided if possible in the future and that there is talk about breaking up banks into smaller units which goes with the statement that: “May be allowed to fail.” How do you feel about that?

**Mr. J. Harris:**

I struggle with that, to be honest, because I think banks are different. They are intrinsic to the economic system of any given country and, you know, it is not necessarily the case that you get better financial stability by parcelling up your banks into smaller and smaller entities. Maybe governments have been forced to recognise that the utility of having large banking groups with the wherewithal to do the things they do in order to oil the wheels of the economy comes with this implicit recognition, now explicit recognition, that governments are going to have to be prepared to step in. I do not think that debate is finalised at all. Lord Turner has made it clear, for example, in his review that he does not buy the argument that banks need to split up. That is perfectly acceptable to have large banking groups which operate both the retail side of the business and also the wholesale side of the business. What he basically said is they just need to be better supervised and their business model needs to be tested more regularly. So, for my money, looking at it from where I sit at the moment as a supervisor linked into the system, I think that that argument is by no means finalised and I would be surprised if we do indeed end up going down the road of a forced separation of investment and non investment banking arms.

**Deputy G.P. Southern:**

You talk there about a business model. Have we got several business models in banking in Jersey or is it fairly uniform?

**Mr. J. Harris:**

It is quite uniform. It is basically a relatively risk adverse form of banking, which is garner deposits from customers all around the world, international clients obviously are the majority of those rather than resident clients, and use that liquidity to feed into the wider banking group by way of upstreaming, which of course is another discussion all of itself. So what the banks do not do here is they do not do investment banking activities, they do not underwrite risk in the same way that Lehman Brothers did. We do not have that banking model in Jersey at all. They do not do much lending directly. They tend ... the lending that is done is the deposit that is gathered and lent to the parent. So they do not have a diversified lending book.

**Deputy M.R. Higgins:**

Some of them are putting them into, what, the interbank market and C.D.s (Certificate of Deposit) and various other ...

**Mr. J. Harris:**

It is still a very small percentage of the whole, though. Mostly because the parent groups do not allow them to do it. They take the view, better we have the liquidity, better we manage it centrally in our treasury in London or Frankfurt.

**Deputy G.P. Southern:**

Can I just move on to your role in devising ... in the consultation about the D.C.S. (Depositors' Compensation Scheme). Where do I start? What was your involvement in the consultation process on forming a D.C.S. and where does the J.F.S.C. (Jersey Financial Services Commission) sit in respect of a D.C.S. because there are 2 different things there?

**Mr. J. Harris:**

Our role is principally an advisory role in the sense that the way we see this, and I think the way the Government see this, is a deposit protection scheme is basically a consumer protection issue on one

hand and on the other hand a macro-prudential financial stability issue. Neither of those 2 issue are within the core remit of the Commission. We are here to supervise financial services, to regulate and supervise sit comfortably within that. Secondly, I think there is an emerging - and I think I would underline the word emerging - public policy concern over deposit protection schemes because of the crisis. Lots of governments have been forced into action as a result. Thirdly, because we do have in our statutory remit an advisory role. We are looked to by government on any matter of financial services and obviously this an element of financial services. So the Government were keen to produce a deposit protection scheme for the imperatives that they saw and we had 2 functions in this advisory role. One was to sense check, I suppose, what they were doing. They could ask us at any given moment whether something was, in our opinion, appropriate. In particular the regulations and our experience of law drafting and financial services legislation generally. That was one area. The second area was probably best described as data modelling. We are the repository of most of the information that they needed to give to their consultants, Oxera, in the Commission. The banking deposit numbers and who has what and who has what in terms of eligible deposits are really only centralised in the Commission. So we took the role of putting that data together in a format that could be used by a third party. Obviously they could not have the names but they could have the distribution of the different eligible deposits across the different banking groups. So we played that role as well. I personally attended a couple of meetings of the Government and J.B.A. (Jersey Banking Association) consultation and we gave a lot of technical input - both Mark Sumner in the banking division and also Andrew and his people in our international and policy division - and in particular to the regulations. So where we played a role it was very much the advisory role. In terms of where we stand, I mean it is a public policy concern and it has become an acute public policy concern since the financial crisis but I personally see it as a role for government because, as I said, it is a macro-prudential stability and a consumer protection issue and those sit more comfortably with the Government of the day than they do with the financial services supervisor. So we certainly were not looking to take the lead but we were looking to be useful and helpful.

**Deputy M.R. Higgins:**

Can I just clarify that a little bit, too, because there seems to be ... certainly compared to when I was in the Commission years ago, you have got J.F.L. (Jersey Finance Limited) doing certain consultations, the Chief Minister's Department doing consultation, J.F.S.C. doing consultations. Also what you are saying about the macro-prudential role, is that sitting in the Chief Minister's Department? So in one sense they have got a role that is like, you could argue, the Bank of England in a sense for a macro-prudential role ...

**Mr. J. Harris:**

Yes and no.

**Deputy M.R. Higgins:**

... and you have the role of the F.S.A., the equivalent of. It seems rather strange, the set up.

**Mr. J. Harris:**

I think that is not a bad description because one thing that has changed, going back 4 or 5 years to the last time this item was topical, is the Government has got a lot more resource now that it had before. It has got 4 or 5 people now whereas previously it had zero basically. I did that role for a while and that was one and now it has grown to 4 or 5. I think the Government must have a macro-prudential role because it is the stability of the overall economic system which in Jersey - if not in Jersey, then nowhere else - is very much integrated with the financial services sector. The Bank of England, they are never going to quite get to that role because, of course, we do not have control over monetary policy, we do not have control over interest rates. So no agency in Jersey can do that role, could be expected to, unless we end up in a situation where we are independent and have our own monetary system. But I do think in some areas of macro-prudential decision making and policy making that it is right that the



Government takes the lead, and it should avail itself of best advice where it can get it. You know, either in modelling and iteration or in testing some of its policy assumptions. Obviously you are doing that but to some extent from within the policy making process we were doing that as well. So, I think it is probably about right.

**Deputy M.R. Higgins:**

J.F.L., as well, your relationship with them?

**Mr. J. Harris:**

I think J.F.L. exists in this context only to funnel, channel, opinion from its constituent members, which in this case is the banking industry. It is interesting that J.F.L. did not play a particularly active role here because what happened was government went straight to the J.B.A. which is as good a representative body as you have got anywhere in Jersey for the members, partly because there are fewer of them than there are in the other sectors. There are only 30-odd. The existing mechanism they have in the association is mature and it has been in place for a long time.

**Deputy G.P. Southern:**

So the meeting on 14th October of E.D. (Economic Department), J.F.S.C. and J.B.A., what was discussed at that? Do you recall what was discussed at that initial meeting?

**Mr. J. Harris:**

The initial meeting was really focused on, we are in the middle of a crisis, 2 or 3 of our banks are directly threatened, and already by 14th October I think the U.K. Government had stepped in and made it clear that the 2 threatened institutions, Royal Bank of Scotland and Lloyds Banking Group (as it was then, having taken over HBOS), were not going to be allowed to fail. But what was being experienced by the banking sector was a large outflow of deposits based on falling confidence and a great deal of worry, anxiety, concern among the international customer base, which did not drill down to the Jersey banking licence model and saying: "These are banks that are going to be capable of being bailed out by home governments because the alternative is too unthinkable." But was really as simple as: "Has this jurisdiction got a deposit protection scheme or has it not?" If it has not it provides one more reason for a flight to what was then perceived as safety, if you like, by moving deposits out of the jurisdiction or perhaps moving deposits from the institution in Jersey to the same institution but somewhere else. In 2 or 3 groups that was clearly happening and I think panic would be too strong but there was clearly a lot of anxiety among the banks that that was happening, and that it should not happen because Jersey was as safe as anywhere else given the nature of the banks that operate here. We keep coming back to that. So the meeting was focused on really this key decision, should there be a deposit protection scheme even though there might not be a need for one? On a rational, objective, sort of dispassionate analysis, there might not be a need for it but should there be one nonetheless because it is a reassurance factor? Interestingly, the ones that were arguing most strongly for there to be a scheme brought in as quickly as possible could have been perceived to be those which were in the strongest position. Not necessarily banks that were in the public eye as immediately threatened but nonetheless they still felt that this had become, almost overnight, like a hygiene factor almost. That you must have a scheme. Almost the details of the schemes were secondary but there must be a scheme advertised on the front door for international clients, for Jersey to not be in a competitive disadvantaged position. So a lot of that meeting was really about that key decision.

**Deputy G.P. Southern:**

About that, dealing with the perception?

**Mr. J. Harris:**

Yes.

**Deputy G.P. Southern:**

Dealing with almost P.R. (public relations). This is about Jersey's ...

**Mr. J. Harris:**

There was a lot of fear around at that time. The whole financial system was in quasi meltdown so ... I mean it was not a panicky atmosphere but it was a robust discussion because some of the smaller players, the more discrete players, and those that did not feel as if they were in the public eye at all but nonetheless were very confident about their own circumstances and the stability of their own client base, obviously they had a differing view, which is that they thought the scheme was not necessary for different reasons. So it was ... the first meeting, the October meeting to which you refer, was really all about should we, should we not, have the scheme.

**Deputy G.P. Southern:**

Right, and part of that seems to have been getting some data together to put to Oxera in terms of advice?

**Mr. J. Harris:**

Yes.

**Deputy G.P. Southern:**

That is certainly what flowed after.

**Mr. J. Harris:**

Absolutely, you had to size the problem. You have to size the real problem.

**Deputy G.P. Southern:**

That was your role?

**Mr. J. Harris:**

We certainly were happy to play that role because we were the only people who had that data in the jurisdiction.

**Deputy M.R. Higgins:**

Okay. Also there were interim solutions proposed and long term solutions. Obviously Oxera were appointed to look at putting in a permanent scheme and then an interim was put in. What was the thinking behind the interim?

**Mr. J. Harris:**

By interim do you mean the blanket guarantee that the politicians announced?

**Deputy M.R. Higgins:**

Yes.

**Mr. J. Harris:**

That was purely a political decision that was felt necessary by the Ministers who were in place at that time, that it was necessary as a reassurance to Jersey residents, which is obviously a distinguishing factor from a long term scheme that would go beyond Jersey residents to international clients. I do not think that meeting focused on that issue at all. I think by that meeting on 14th October, I think we were past the point where that had been announced. The big focus of that meeting was on the international clients and the way they were behaving.

**Deputy M.R. Higgins:**

Coming on to that, though, because the interim one could have ... I say could of, I do not know what the figures were, do we have quantitative data as to the outflow of funds from the Island because obviously the interim one was just protecting local residents at the expense of overseas ones.

**Mr. J. Harris:**

There were 2 different datasets and we were active in producing both. The initial dataset was what do we have by way of resident deposits? The government needed that information to size its potential liability. We produced that for government, for the Ministers then. The second dataset was this wider one of resident and non-resident and eligible or non-eligible by the £50,000 cut and so on. Again, that was a separate and subsequent exercise that we did. There were those 2 datasets. I am not sure I am answering your question.

**Deputy M.R. Higgins:**

I was just wondering about ... you obviously mentioned that at this time there was a perception that we did not have a scheme, we were losing our deposits ...

**Mr. J. Harris:**

Sorry, data in terms of outflows?

**Deputy M.R. Higgins:**

Yes, in terms of data, do we have quantitative data ...

**Mr. J. Harris:**

Well, we had episodic and incidental data arising on a day-by-day basis for that but what I was doing, as a supervisor, was focusing on the ones that had the big drain of outflow because then I was concerned about obviously liquidity ratios and their observance or non observance of that. So I was focused ... we collectively, the Commission, were focused and were getting data for that reason. Obviously what people were saying in meetings, such as the one on 14th October was different banking groups were coming and saying: "We have lost a large amount of money" they were not necessarily quantifying it because they were in front of their peers and their competitors and they do not necessarily want to put a figure on it. We were sitting in the same meeting knowing what the outflow was but obviously not able to say so for the same reasons. The sums involved for 2 or 3 of the banking groups were very substantial, to the point where I was seriously concerned about their liquidity stability at that moment in time. That was not information you could use for the purpose of a deposit protection scheme either being designed *in extremis* or even longer term, but certainly not there and then. So it was difficult, there are really 2 different sets of information.

**Deputy M.R. Higgins:**

I realise it was a difficult situation to be in but I am saying with this announcing of a political guarantee, which effectively said: "We are going to look after our own but the rest of you, you know, you are a problem." Do you think that exacerbated the problem of the outflow?

**Mr. J. Harris:**

I do not think it helped it. I do not think it helped it at all. I think if you were concerned as an international bank about your international clients, any announcement that was being made that said we are only going to look at resident deposits and, you know, at that time it was an open-ended, obviously, commitment, it did not necessarily help and I think people perhaps felt even more anxious than they had previously that that was another factor playing into this uncertainty ... environment of uncertainty where clients would rather not ask themselves ... you know, bother to wait and find out, if you like, but ask yourself no questions, go for certainty. It is an entirely rational way to behave.

**Deputy G.P. Southern:**

From that initial meeting obviously you got together some information in terms of data for Oxera ... I have before me this list of meetings that has been provided by E.D., you had, it seems to me, a relatively low level of involvement in terms of finalising or contributing to the details of the scheme, is that true or not?

**Mr. J. Harris:**

Do you mean design details or the regulations? I think I would answer your question differently depending on what we are talking about as details. In terms of regulation, we had a lot of input.

**Deputy G.P. Southern:**

In fact I will put the question simply, what firm contribution did you make in terms of ...

**Mr. J. Harris:**

We were not looking to say you should have this model and that model. That was not the Commission's stance. We were not saying: "You should have £100,000 limit as opposed to a £50,000 limit" or saying it should not have been 0.3 per cent, it should have been 0.5 percent. Those were ... it comes back to the same issue, the key players are government and the industry trying to agree those. We were trying to facilitate that process, we were not trying take a policy stance. In terms of underlying detail subsequently and regulations, commenting on that, I think we ... a lot of these meetings that are in that list are those sort of technical consultation issues ...

**Deputy M.R. Higgins:**

Were you involved yourself in some of those early technical discussions?

**Mr. J. Harris:**

I was, yes.

**Deputy M.R. Higgins:**

In terms of ... were you at those meetings, for example, where the caps were discussed and the time period and the type of ...

**Mr. J. Harris:**

I was at those meetings.

**Deputy M.R. Higgins:**

... coverage that was going to be on the scheme?

**Mr. J. Harris:**

Yes, I was at those meetings but I was not playing a leading role to say: "You are right and that is wrong" you know, because it comes back to the same point I have been trying to make throughout really, that we were not looking to play that role.

**Deputy M.R. Higgins:**

But did you ... obviously you were reporting back within the Commission to the Commissioners and so on, did you make file notes of those meetings? Do you have copies of minutes of those meetings?

**Mr. J. Harris:**

I did not make file notes of those meetings but there is a file note of those meetings that the J.B.A. make and we receive the J.B.A. minutes of any meeting, whether it is a standard or an ad-hoc meeting and so

those are available to us.

**Deputy M.R. Higgins:**

So all the details of those meetings were recorded in minutes?

**Mr. J. Harris:**

Yes, but they are not our minutes.

**Deputy G.P. Southern:**

That is the impression we are getting, not our minutes.

**Mr. J. Harris:**

No, I am quite resolute about this. Right from the start we were not looking to play the design role, we were looking at facilitating the process.

**Deputy G.P. Southern:**

We are meeting different models as we look at the U.K., Isle of Man, Guernsey, and there are different relationships between the J.F.S.C. or their equivalent and the D.C.S., the board or the administrators of D.C.S. Do you see a role at all, certainly in the U.K. it is almost arm's length, it goes through the J.F.A. (Jersey Funds Association) – I think the Deputy meant the FSA but it is arm's length relationship; in the Isle of Man, the J.F.S.C. is combined; in Guernsey it appears to be almost completely separate. How do you see any role for J.F.S.C. in ...

**Mr. J. Harris:**

I think throughout what we found is that we have a degree of expertise, and certainly lots of information and knowledge, and we should put it at the disposal of public authorities so that we can facilitate the process. But I do not think we have a preference as to which model. What I do have a concern about is that the Commission is dragged more and more into the decision making process for the activation of a scheme because I think there are some conflicts that are there for us. The real core conflict is that these schemes are all about eligible depositors, i.e. man in the street, if you like, £50,000 or less. Our function is that we need to look at the interests of all depositors and all counterparties for any banking group. So a decision that we might be making about the supervision and ongoing management, possible insolvency or liquidation of an entity, or withdrawing or revoking the licence of an entity, must be based on the entirety of its relationships that it maintains with everybody, all its counterparties, all its depositors and so on and other supervisors. Whereas those charged with administering the deposit protection scheme are, by definition, only interested the interests of the eligible depositors and that is my core concern. That there is a really a bit of an inherent conflict there.

**Deputy G.P. Southern:**

There is an inherent conflict in the system we have set up. Do you think you have isolated that ...

**Mr. J. Harris:**

No, I think that is true for all. I think that is true for all supervisors worldwide, that if they get too involved in the mechanics and the operation of a scheme, whatever model that scheme is, the interests of the supervisor go wider than the interests of those who are represented by the body that is administering the scheme.

**Deputy G.P. Southern:**

Absolutely. It was certainly explained to us very clearly that the operators of a D.C.S. have clearly a set of people that they are operating for, which is distinct from the regulator who is also concerned with the integrity of the whole system, which is a different ...

**Mr. J. Harris:**

Yes, but also even within the banking groups relationships with other depositors not covered by the scheme and all the counterparties, which then gets into the stability issues, that the bank maintains. Other banks, interbank and so on.

**Deputy G.P. Southern:**

You said that whatever scheme you propose that is a potential conflict?

**Mr. J. Harris:**

I think so, yes. I think we have discussed this quite a lot and we cannot see that it is any different from anybody else and the supervisor is focused on a bigger picture than just the deposit protection scheme. It needs to be guided by what it is set up to do.

**Deputy G.P. Southern:**

You do not wish to be drawn into that? You can see that problem and you are saying ...

**Mr. J. Harris:**

Again, I think there is a certain ...

**Deputy G.P. Southern:**

Again, I come back to our system, the system that we are proposing, do you think that you can see that conflict is mitigated? Or do you see as still being significant?

**Mr. J. Harris:**

I think it is a conundrum because I would also fully accept that the Commission is a repository of lots of relevant information, it is monitoring the activities of the banking group and knows its affairs better than anybody else. It has some legal mechanisms that could be called upon to immobilise, if you like, or put into a different legal situation, a body at any given time. We have powers, for example, to appoint a manager to run a bank without even having to go to court. It is the one exception, everywhere else we have to go to court and get an order. But a bank ... again, because a bank is capable of endangering the financial stability of the system ... and I can see then that ... I am concerned about being looked to to do things that we are not really expected or should be expected to do. But, at the same time, we are a centre of expertise and we do have relevant information. I think what we are trying to put across is we are always there to co-operate and to assist and to facilitate and to help but we do not want the sole decision making role in terms of triggering a deposit protection scheme.

**Deputy G.P. Southern:**

Which, can I cut to the quick then, the fundamental question is who declares this bank is in trouble or this bank is now bust? Who is going to know that? It seems to us that you are likely to know first. Is that the reality or ...?

**Mr. J. Harris:**

We are likely to know 90 per cent of that. But it is a different thing to make the call to say ... and I come back to my point, what am I making the call about? Am I making the call that the interests of the £50,000 or less depositors take precedence over all the other interests? That is a very difficult position to be put in, I think.

**Deputy G.P. Southern:**

You are then in a position where, and we are getting very specific now, we are talking about a set up for the D.C.S. which says that following a failure the Minister will appoint a board and the board has about

powers about the failure and signalling a failure, it seems to me there is a confusion there.

**Mr. J. Harris:**

But, let us just ...

**Deputy G.P. Southern:**

The J.F.S.C. has a role in ...

**Deputy M.R. Higgins:**

We have a chicken and egg situation ...

**Deputy G.P. Southern:**

Unless we are talking about reading the *Financial Times*.

**Mr. J. Harris:**

Yes, but this is true of all these ... this is exactly what happened in the U.K. with Northern Rock and with other ... you know, the different parties to the arrangements, the tripartite arrangement, in that have their different inputs and there may not be one simple good answer to any given situation but the key issue is communication. What I was going to say in the situation you have just described, the Minister makes the call, he asks the deposit protection board to make the call, the deposit protection board is there in place to make the call that this is now the time to activate the scheme. I would expect and certainly hope that we would have an ability to interface with that board and to say: "Hang on, if you do that now you have X, Y and Z problem that you have not necessarily thought about but which we have to think about, consequent on your decision, that are going to arise. Therefore as a matter of broader public policy is there a need for this to be deferred for a week?" I cannot describe the exact circumstances because it is pure hypothesis but it is this ability to communicate with others making those decisions to make sure that the wider interest I have tried to talk about is also respected. It is not just a case of a bank having depositors with £50,000 or less. Yes, it is important and they must be protected and probably in most circumstances you want to activate the scheme as soon as you can to give people the reassurance to get on with their lives and not be put into the sort of limbo that the others have been ...

**Deputy G.P. Southern:**

I suppose have we achieved sufficient clarity from what we have put together with the D.C.S. in that sense that you are talking about there?

**Mr. A. Le Brun:**

The law provides for what are referred to as gateways, so to the extent that the D.C.S. board wish to speak to the Commission I think the regulations, as lodged, provide them with adequate powers and similarly our regulatory laws allow us to pass information to the D.C.S.

**Mr. J. Harris:**

Have the same gateways.

**Deputy M.R. Higgins:**

That is the communication side. I think what we are trying to get at is that we seem to have a chicken and egg situation because the law says the board will notify the Minister of a default and will publish a notice to that effect. But the board exists in name only because it is the role of the Minister to appoint the board and he will only appoint the board after a failure. So we have this situation where we do not appear to have someone triggering the event, as such, very clearly. Which is it, the chicken or the egg?

**Mr. A. Le Brun:**

The law itself, that may be the way the law is implemented but the law or the regulations do not say that the Minister can only make an appointment at the time that he is concerned. That may be what happens in practice but the Regs would allow the Minister to make an appointment at whatever ... immediately after the regulations come into force.

**Deputy M.R. Higgins:**

I accept that but what we are trying to look at is in terms of ... I can understand your position, by the way, because I can see the conflict of interest in a sense that the regulator has because there is a definite conflict of interest. On the one hand you have powers and you may want to appoint a manager and try and manage the business out of the difficulty and you may be looking at the wider picture, whereas obviously a depositor protection board will want to shut it down as quickly as possible to minimise any loss to themselves and to depositors. So I can see that conflict but in terms of information flows I would have thought that the Commission was in the best position, if there is advance warning in a sense to notify the Minister. Whether it be the Minister who triggers the whole thing off ... but it does not appear to be in the regulations that there is that information flow and he would respond on what you are saying.

**Mr. J. Harris:**

You are saying the missing element in the regulations is the Commission's advice to the Minister consequent upon which he may or may not make the decision about the deposit protection board.

**Deputy M.R. Higgins:**

Again, that is assuming that you have advance knowledge that there is a bank in trouble, you have been tipped off by the home country regulator and so on, obviously if we read in the *F.T. (Financial Times)* that he can do it himself and he may well consult with you but the point is at the moment we do not have a facility in the law as it is drafted for you to feed in for him to make a decision and then appoint the board if he goes that way.

**Mr. J. Harris:**

I agree, it is not explicit in the law and in the regulations. But in practice I am crystal clear in my mind that we would be in daily contact with the Minister in a situation like that. We would make sure. If for no other reason now that deposit protection scheme is a reality and is capable of being activated, that is one extra complication we now have to factor into any decision making about a banking group and its circumstance at any time. So there would be communication. I do not have any doubt there would be communication with the Minister.

**Deputy M.R. Higgins:**

Should it be explicit in the law that you must communicate with the Minister if you are aware that a bank is in trouble so that at least he is aware and he may decide to activate ... appoint people or whatever?

**Mr. J. Harris:**

It certainly would not do any harm if it was in the law. I would argue that I have got that responsibility anyway because the Commission law confers that on me, that for any given matter of financial services in the jurisdiction I need to advise government and to refer to government. So you could say it is in a different piece of law and it would oblige you to do the same thing but if it makes it even clearer then I certainly say it does no harm.

**Deputy G.P. Southern:**

The second issue, I think, we are coming across around this pinch point of should this be triggered, is the whole idea that a board can be set up from scratch, here we go, when we have certainly been talking



to Guernsey, for example, they have been in place for over 12 months now, they are having fortnightly meetings and discussing all sorts of things. Admittedly they are ...

**Mr. J. Harris:**

They have got some real issues.

**Deputy G.P. Southern:**

... reacting to some big issues because the worst has happened, but nonetheless they are not necessarily dealing with that, they are dealing with: "This will happen in future." They are saying: "We have met once a fortnight for at least a year and we are just getting to the point now where if something happened tomorrow we think we could cope with it." We are saying under our system because we are top 500, because nothing is going to happen, we are so safe - I think we are getting the impression - and it is cheaper to have nothing in place because of the cost to it, it ... certainly we were told by the department that cost was a factor in terms of why you go from the collapse and we set up a board. Now, it seems me, certainly in Guernsey, they are highly sceptical, the eyebrow is raised, that: "Hang on, it has taken us a year to get to a position ... where we think we are in a position if worst happens tomorrow we could go with it."

**Mr. J. Harris:**

There are competitive factors at play, of course, in this whole debate about deposit protection schemes. But leaving that aside, I do think that the department is right to say that it is an unlikely event and if we take the experience of the last 12 months, it is pretty salutary. Jersey had large banks which got into equal trouble as the small banks but they were not allowed to go down and that really helped. Guernsey and the Isle of Man had a marginal - marginal is perhaps a bit of a pejorative term but a less systemically important institution in the retail space and it did go down and, of course, they have reacted differently I think than we have. What I would argue is that there is probably a sensible compromise, rather than setting up standing arrangements, is to recognise that you need to move quickly, you need to have pre-agreed protocols and arrangements in place. The first thing that a deposit board will need will be a capable administrator and liquidator. That is a professional firm. So you get a professional firm in place sooner rather than later and say: "Right, you need to make sure you are not going to be conflicted, you need to make sure you are available at a moment's notice, you are available to us for this purpose." Likewise you need to have a professional lawyer with a insolvency background, and obviously we have quite a few of those in Jersey, appointed on the same basis. I think you can make those sorts of arrangements without necessarily putting the board into a sitting weekly, monthly, whatever situation. That you have an initial foundation meeting or whatever. These are practical arrangements, I think. There is a happy medium, I think, between the 2 so that you do know which way you are going to go if the crisis does erupt, you have got the people and they are in place and you make ...

**Deputy G.P. Southern:**

Can I just take you on to ... in terms of where we are starting with this is about dealing with a perception of risk in the international market. Also we are confusing 2 things, I think. The intrinsic assumption that underlines everything, that banks will not be allowed to go down, systemic banks, and the extrinsic support which is the D.C.S. in the form. It seems to me that there is a factor that says, right, you have got very little in place and you have got systems where the thing is set up and clearly demonstrably likely to support. In terms of dealing with perception, that is a world of difference and for the sake ... For example, it could be argued that for the sake of £250,000 a year, in terms of convincing the market out there that you are safe, notwithstanding the top 500, et cetera, and the regulatory strengths that you see as your system, perceptions - and that is what we are dealing with - out there are better catered for with something real and, look, it is there.

**Mr. J. Harris:**

I am not sure that I would agree that it is not real. It is just a question of readiness. The perception issues goes right to the heart of an international depositor's appetite for research into the mechanics of the scheme and how it would operate should the unthinkable happen. I am an ex-banker, worked with international clients for many years, I can only give you my personal view on that, which is maybe not a Commission view because it is ... as we said we are not trying to articulate the design principles. But I think the perception is a very high level perception. The client wants to see that there is a scheme and that it delivers £50,000 of coverage. But there is a scheme ... I am not sure they want to go to the next level down and say: "So on day X how will the scheme operate? How will your board come into being? Is it there, is it meeting regularly?" I am not sure. I do not see that they have that level of sensitivity to that degree of ...

**Deputy M.R. Higgins:**

We are just jumping ahead on that in one sense. We made quite an explicit commitment in the regulations that we will pay in 7 days' time. Three months, 7 days? Seven days if people want it. If we have not got a scheme ...

**Mr. J. Harris:**

That is not in full, though, is it? That ...

**Deputy J.M. Maçon:**

No, it is £5,000.

**Deputy M.R. Higgins:**

It is £5,000 but it is still an explicit commitment that we will pay in 7 days. If we have not gone through the mechanics of making provision for it and everything else, do you think that is an achievable objective?

**Mr. J. Harris:**

That goes right to this issue of prefunding or, sorry, temporary funding by government, does it not? To meet the £5,000 commitment and then for it to be recovered from the levies that are raised on the bank subsequently. I have always understood the £5,000 to be underwritten by government.

**Deputy M.R. Higgins:**

How would you expect, for example, the claims to be made and verified in 7 days?

**Mr. A. Le Brun:**

Seven days is receipt of the application, that is not 7 days after the notice is published.

**Deputy M.R. Higgins:**

It is 7 days from the receipt of application. But people very often ... in fact, under the law they are supposed to publish the fact that a bank is in default and ask people to make claims within a very short period of time.

**Mr. A. Le Brun:**

But then that comes back to the importance of having whatever you have in reserve ready to roll on day one.

**Deputy M.R. Higgins:**

But with your knowledge of bank systems, do you think it is possible within 7 days to verify, et cetera, and pay out?

**Mr. J. Harris:**

It is certainly possible to identify the claims, yes. Verification, it depends how many layers you want to verify. Obviously if you want it triple-checked, then no. But the systems are capable of giving you the identification of the £50,000 or less depositors eligible. I would argue that the bank should be monitoring that on an ongoing basis anyway because it needs to clarify its contingent liabilities. One of the great sensitivities here is the banking groups wanted to know what they are in for, what their level of liability is at any one time. They cannot obviously monitor other banks but they can certainly monitor their own and certainly their systems should be capable today of identifying that very quickly.

**Deputy M.R. Higgins:**

Can I tell you that other regulators, others deposit protection schemes, have told us it is absolutely dodgy (?), that is how they refer to it.

**Deputy G.P. Southern:**

The F.S.C.S. (Financial Services Compensation Scheme) said that in the U.K. they have got 2 major pieces of regulation in order to ... they have that aim as well, a 7 day response, but they are waiting to have theirs in place by 2011. The suggestion from the scheme that we have knocked together is that that will be in place from day one. It seems to me a difficult thing. One of the things they said was, and we got information, that it was not compatible with our system. So the first thing you have got to say is: "You need to present us with data that is compatible with our systems, in order to do that we have to negotiate a suitable system." Again, that comes back to this: "And if you have not got a body set up to do that negotiation you are making life difficult for yourself in setting up of the whole thing." Again, it comes down to the detail. We appear to have built in some difficulties.

**Mr. J. Harris:**

I think the banks can produce that detail. The degree of verification I think is an open question, I agree with that.

**Deputy G.P. Southern:**

It is a big question.

**Mr. J. Harris:**

Obviously the U.K. is an economy of 60 million people and the Jersey economy is much smaller. The number of eligible deposits and the capability of segregating those by ... what I am really saying is the banks should be capable of doing that already. They should be capable of producing a software package or a software - what is the word I want - data mining capability at the press of a button where they can take their eligible deposits out and produce them at any given moment. That can be replicated and reproduced at any given time and I do think a Jersey bank would be capable of doing that and should be capable of doing that. That is not the same, however - I fully acknowledge - as giving that to a third party and saying: "Right, now we need that to be verified in order to pay out £5,000 of claims." I do not think the funding is a problem; the verification may be the issue.

**Deputy M.R. Higgins:**

I think the other problem too, and one we will come on to shortly, is the idea of the cross-border nature of the banks we operate with, because a lot of the data is not necessarily held within Jersey and it may be held with the parent bank or it may be held by a third party.

**Mr. J. Harris:**

But it should be accessible within Jersey.

**Deputy M.R. Higgins:**

But again, as we say, if a bank goes down then we may not be top of the tree in terms of getting that information.

**Mr. J. Harris:**

Well ... yes, okay. I am struggling to understand how, with a bank going down ... because it does down in another jurisdiction, it is either in the hands of a third party or liquidator where the systems are still going ... the integrity of the systems is everything. They are going to need those systems for their own purposes, so the only issue is if they had been taking a policy decision to deliberately cut off the Jersey subsidiary from core systems capability. Now, why would they do that?

**Deputy M.R. Higgins:**

I am sorry. There have been examples of banks where they have lost the core data.

**Mr. J. Harris:**

Yes, okay.

**Deputy M.R. Higgins:**

Anyway, I will not go into that. It is the subsidiary thing.

**Mr. J. Harris:**

I mean we would have real problems in that respect, as a supervisor, if that were to happen for a lot of other reasons as well.

**Deputy M.R. Higgins:**

Yes. I am sorry, I just want to go back on one thing which is on consultation and then Jeremy can come in. There was a *J.E.P.* (*Jersey Evening Post*) headline that said that around the time of the banking crisis in October that you were going to overseas countries to try and secure guarantees for depositors in the Island.

**Mr. J. Harris:**

Yes. I think that was always a classic bit of *J.E.P.* misunderstanding. We never said that. What we said was that we would, in the circumstances in which we found ourselves, look to consolidate existing relationships so that we would ... You know, the dialogue that we talked about earlier in today's discussion was as good as it could be, given the circumstances. I mean there was never ever an intention that anybody would go and talk to overseas regulators - and they would not be the right people to talk to anyway - to get deposit protection schemes extended to Jersey depositors. For example, in the U.K. experience that would be the U.K. Treasury you would need to talk to and that would be a function of government here. So I think it was a misunderstanding.

**Deputy M.R. Higgins:**

So there were no meetings took place and there was no ...

**Mr. J. Harris:**

There were no meetings that took place around the issue of: "Can deposit protection schemes be extended by you to Jersey clients of your institution." No, definitely not.

**Deputy M.R. Higgins:**

Because I think that is one of the problems that we have, again, with the nature of our model of being host country for these banks in that the E.E.A. does not extend their deposit protection to Jersey. The U.K. does not do it and the United States does not. So, by and large, the vast majority of the banks that we have here are not giving additional protection, in one sense, to depositors who are based in Jersey.

**Mr. J. Harris:**

Why would we expect them to do that? You know, we are not in the European Union. We are not in the E.E.A.

**Deputy M.R. Higgins:**

But, again, within the E.E.A., if one bank went down in one part of the E.E.A. then the home country deposit scheme would pay the first tranche of whatever money is topped up by the host country. But we do not have that facility.

**Mr. J. Harris:**

No, we do not.

**Deputy M.R. Higgins:**

So basically we are on our own if we lose a bank.

**Mr. J. Harris:**

We are on our own and we are back to the central policy, which is that are the banks that we have in this jurisdiction the ones that we can rely on the home country arrangements, at large, to ensure that that banking institution does not fail. Then we come back to the nature of the institution. So if we had a Lehmann Brothers we would not be sleeping easily. If we have subsidiaries and branches of large retail banks, systemically important banks, I mean I think it is the same argument over and over and over again. That is what we are running. It was a very unfortunate article. It was certainly wide of the mark by a long way.

**Deputy M.R. Higgins:**

Although at the time it was giving reassurance to people in the Island, was it not?

**Mr. J. Harris:**

Yes. So you might say: "Mr. Harris, why did you not write a letter to the *J.E.P.* and tell them they were wrong?"

**Deputy G.P. Southern:**

That is very much what I was going to ask you about.

**Mr. J. Harris:**

It would be a perfectly fair question but I am not sure it would have necessarily added to people's peace of mind. They got it wrong. They got it wrong and we ...

**Deputy G.P. Southern:**

Contradicting it would have affected the perception?

**Mr. J. Harris:**

Yes, absolutely.

**Deputy G.P. Southern:**

So it was a mistake made but one you were quite comfortable with?

**Mr. J. Harris:**

No, I was not particularly comfortable with it because I think, Chairman, you said at some public meeting or other that that was not a realistic option that we had and, of course, you were completely

right. It was not a realistic option. You know, you cannot go around ... In fact it is what the Isle of Man did and what got them into such great trouble.

**Deputy M.R. Higgins:**

I know, yes.

**Mr. J. Harris:**

Because they did explicitly say that they wanted the U.K. Treasury to step in and support them and, of course, the U.K. Treasury not only did not want to do that but then it really became pretty irritated with the assumption that they would.

**Deputy M.R. Higgins:**

In fact this is also part of the Foot Review, is it not?

**Mr. J. Harris:**

Yes.

**Deputy M.R. Higgins:**

It is one of the consequences: "What danger are the Crown Dependencies for the U.K.?"

**Mr. J. Harris:**

U.K. Exchequer, for this purpose.

**Deputy M.R. Higgins:**

Yes.

**Mr. J. Harris:**

I mean let us be clear, I think there is no doubt that we are on our own in these circumstances and we are as good as the banks we licence and supervise, particularly the banks we licence. There are perhaps one or 2 that we might not licence today. They are very, very small players. They are certainly capable of being seen out by this particular scheme if need be. But basically we are on our own with those banks and we stand or fall with those decisions.

**Deputy J.M. Maçon:**

Just looking at processes and mechanisms, if a bank were to go down in Jersey or if it was in trouble, how would it find out ... what is the process from the regulatory body's function?

**Mr. J. Harris:**

How would who find out, sorry?

**Deputy M.R. Higgins:**

In other words, how do you see it? In other words, I know that the Commission in the past has got a paper, you know, what you do if a bank went down. But can you just try and explain the process? Let us say a bank goes down. Where could you possibly hear it from? When will you get involved? What actions would have to be taken within the Island to deal with that bank failure?

**Mr. J. Harris:**

Right. First and foremost it seems very unlikely to me. I mean I really do think this is unlikely; that a banking institution, global banking institution, which is in trouble is not going to be something that we do not know about a long time in advance of it happening. When I say: "a long time," it could even be a matter of days which is the experience perhaps of the crisis last year. But, nonetheless, a good

forewarning is clearly there. A cross-border banking resolution is not easy. There are no established mechanisms. That is exactly what we are trying, as an international community now of regulators, to put in place; mechanisms to work out how you deal with a situation like this, because the natural tendency will be for each to look after its own position. Guernsey had exactly that experience with Northern Rock, to try and call back deposits that were upstreamed through the group and threatened to withdraw them if the U.K. guarantee was not extended to them. So, you know, it is not a well-trodden path. There is little, if any, international experience of cross-border banking resolution. What the community are trying to do is to establish, first of all, some principles that work and obviously a lot of those are around communication, information sharing and burden sharing basically; which is that if U.K. F.S.A. decides to act only in U.K. F.S.A.'s interests then by definition a lot of other people around the world are going to find themselves in trouble. So there is a new spirit to try and get some protocols and some mechanisms in place to manage a situation like this. What would happen in practice today without that sort of international accord is that we would almost certainly invoke our powers to appoint a manager of that bank, to put it into the hands of a professional administrator and liquidator.

**Deputy M.R. Higgins:**

But this is a subsidiary as opposed to a branch?

**Mr. J. Harris:**

This is a subsidiary as opposed to a branch, obviously. If there is a branch then we are absolutely dependent on the home country authority. But that works both ways because we are dependent on them doing the right thing. But if they do the right thing then, by definition, the branch is part of the core beast and is covered by all the same mechanisms that they evolve for their own benefit and extend to us because it is a branch. But in terms of a subsidiary where we have the powers and we have the independence of action and capability we would almost certainly go down the manager route. A very quick route and it is designed specifically for banks to be a quick route because banks are different. As I said earlier, we do not have to go to court. We can make the decision ourselves. It can be a decision that can be made instantaneously by the Commission's board. If the Commission's board is not available then I can make it, *in extremis*, and we then put the manager in place. What that does is it immobilises everything basically, it locks it down, and then in real life you are locked down and you start trying to work your way out of the mess.

**Deputy G.P. Southern:**

The end result of that is effectively ... We were talking to the Isle of Man and they were saying: "Well, yes, we have just declared the end of the K.S.F. saga and it took us 6 months because we had a scheme of arrangement in place and the liquidator was doing exactly what it was doing, trying to salvage in the interests of all the depositors, all the elements, what was the best way forward. Now, 6 months later, we finally got there and the depositors' compensation scheme can now kick in." Effectively, 6 months on and that is that conflict.

**Mr. J. Harris:**

Yes.

**Deputy G.P. Southern:**

Can I take you on to the aspect of the issue of ex-post or ex-ante funding? So who pays for a depositors' compensation scheme in the end. Now, we have got a scheme which is ex-post. Most of the world has gone for ex-ante.

**Mr. J. Harris:**

Some of the world has gone for ex-ante.

**Deputy G.P. Southern:**

I will not argue.

**Mr. J. Harris:**

If you want to weight the U.S. in that then obviously they account for a lot of the financial services activity in the world. So maybe you are right.

**Deputy G.P. Southern:**

I suspect I am right but, nonetheless, we will not argue about that. I suppose it comes down to, certainly hearing from the U.K. authorities, all the banks say: "Well, we could not possibly. We could not possibly. It is not going to happen." Now it has happened and they are looking at setting up a D.C.S. and it is set up and it is ex-post. The cost of doing business in the U.K. as a bank contains: "We are going to set up this fund." To what extent have you heard the banks say: "Well, it must be ex-ante because we are not putting any real money in the pot and if you make us, the cost" ...

**Mr. J. Harris:**

You mean it must be ex-post.

**Deputy G.P. Southern:**

Sorry, ex-post: "Because we are not putting any money in the pot and ultimately we do not want to pay for it and if there is any ..." To this extent we are saying the cost of doing business will be too great and perhaps we might consider moving elsewhere. That is an argument that has been put. Have you heard it?

**Mr. J. Harris:**

Yes, I have heard that.

**Deputy G.P. Southern:**

What weight do you put on it?

**Mr. J. Harris:**

I have heard the competitive argument stridently put.

**Deputy G.P. Southern:**

Right.

**Mr. J. Harris:**

Particularly in respect of Guernsey and the Isle of Man because of the banking groups that operate in all 3 jurisdictions and they do not want to see a situation that is arbitrage. They see that if it is here it is more expensive than here; then obviously here - you know, the place where it is more expensive and it is more threatening in terms of the ultimate contingent liability - that then suggests that we should change our disposition of forces and relocate some activity or all activity from, say, Jersey to Isle of Man or whatever. There is a lot of sensitivity about that. I do not think I have heard, personally, in various iterations and meetings and so on that I have been at, that they do not regard it as anything other than a real liability. In fact I would go the other way. I would say that they really concentrate on how real a liability it is because one of the things they were most acutely anxious about, the banks, at the outset of all this was to try and crystallise the amount, the quantum, so that they could put that into their contingent liabilities. You know, even to the extent of saying: "It is a £10 million liability, as it now emerges, over 5 years. That is what we need to recognise and explicitly state that in a note to the accounts." Now, that does not suggest to me that they do not think that it is a real sum of money that needs to at least be thought about and recorded and crystallised. It does not mean to say they expect to



pay it because they, I think, would themselves be pretty behind the argument that the banks of which they are a member are pretty stable. But they want to know what it is. They want to know how much it is. They want to know what they are in for. They want to be able to record it appropriately and, you know, I do not think they regard it as a fictitious liability at all. That would be my experience.

**Deputy M.R. Higgins:**

But an ex-ante scheme, they would be paying a specific sum into it; as the Guernsey one where they are paying in initially for the administration fund and then they have got a compensation fund. So there is an upfront charge which they know and they can account for within their accounts. Is there not scope for something like that?

**Mr. J. Harris:**

There is but if you do not have to do that they do not see a need to do that and if the authorities agree with them that there is no need to do that, then they are not going to vote for that. I can take my accounting analogy too far, that it is nice to have certainty. Certainty with the contingent liability is probably fine. Certainty by pre-funding a scheme you do not ever expect to have to call upon and the money just accumulates, then I do not see that they have a huge appetite for that. So I think they regard it as a possibility. It is plausible that one day the scheme will be called upon; then we do need to recognise that properly. But the degree of probability of that is quite low and certainly, therefore, we are not at this stage for pre-funding. Although pre-funding is an element of the Guernsey scheme, pre-funding is not an element generally of the Guernsey/Isle of Man schemes; not to the extent anyway that we should, in their eyes, go down the same route in Jersey so that you do get the competitive arguments coming forward.

**Deputy M.R. Higgins:**

Could I ask you then on that, in terms of the Guernsey scheme where they have linked it to insurance. Obviously they are paying their administration fee, there is a compensation fund that will be set up ex-post where they have been making levies but there is also an insurance element. So they are paying in money which is being used for a premium which will generate some money to help with a bank failure. What do you think about that funding mechanism?

**Mr. J. Harris:**

I do not recall that that was greatly discussed here. I think to the extent that it was discussed, it was not seen as being sufficiently large or sufficiently insurable for a sufficiently large sum to make it absolutely worth the while. Guernsey, of course, tends to be a bit more active in the insurance sphere anyway with captive insurance being a key part of their industry. We do not really have that here. So maybe it is just an experience differential that you are dealing with there. But certainly that did not get a lot of air time from my recollection of the scheme and maybe that is the reason. I am kind of speculating.

**Deputy G.P. Southern:**

In comparing the different schemes, one of the things that comes out is ultimately who pays. Now, what we have heard is that with bank assets they are fairly clearly marked and recovery rates of 75-80 per cent are the order of the day and certainly that is looking like the experience. So that provides one channel ultimately that pays through the receiver. The question is who pays the rest. Now, certainly in the U.K. the ... Give me the right initials.

**Deputy M.R. Higgins:**

F.S.C.S.

**Deputy G.P. Southern:**

The F.S.C.S. are clearly saying: "The Government will bung in the cash flow and that is what the way

we will deal the problem.”

**Mr. J. Harris:**

Then you retrospectively levy.

**Deputy G.P. Southern:**

“We retrospectively levy and we are not talking about a 5-year limit. We are talking about you will pay in the good times and bad times because ultimately that will not be government money. We have spent enough doing the rest of the support for the banking system. You will have to pay. This is a cost of doing business.” That is the phrase that is used. How do you feel ... I mean in our scheme we have got up to £35 million of government money. Where is the balance there? I mean what is that? Is that a sweetener to the banks?

**Mr. J. Harris:**

That is a government policy choice which reflects the different circumstances of Jersey as a centre compared to the U.K. I mean if the U.K. is saying we are going to be more expensive as a place to operate and we think that we can survive that in this competitive world then that is their call. I think Jersey is a jurisdiction of choice not a jurisdiction of necessity and there is more sensitivity here to the need to stay competitive than perhaps the U.K. is feeling right now. Time will tell if they are right but there has always been this worry about these ... Particularly with the banking model that exists here, where several banks are represented in all 3 of the Crown Dependency jurisdictions.

**Deputy M.R. Higgins:**

But 2 of those jurisdictions do not have a 5-year limit. Here the banks can be called upon to levy for a period of time; Isle of Man, Guernsey and the U.K. as well

**Mr. J. Harris:**

Well, Guernsey has a 5 year ... Guernsey has a £100 million, sorry, cap do they not?

**Deputy M.R. Higgins:**

They have a £100 million cap, yes.

**Mr. J. Harris:**

And a £5 million cap per banking group, which is less than the £10 million per banking group here. So it is just another way of arriving at the same end game, which is ...

**Deputy M.R. Higgins:**

In a sense, but they have got lower deposits and yet we have got the same cap as they have, £100 million.

**Mr. J. Harris:**

Yes, but I think government is saying, the probability ratio of a default here is less than it is in Guernsey and that is the difference. You know, it is the same argument again.

**Deputy M.R. Higgins:**

Has there been any arguments from the banks that there must be government support for the scheme?

**Mr. J. Harris:**

Well, I have not been at every single meeting and I certainly was not at some of the meetings that were held as a consequence of the Oxera recommendations. I was personally at the early meetings. I can see the attraction. I mean, let us be honest; undeniably there is an attraction to the banks because it is

managing, by whichever mechanism is used ... in this case if government money is available that is fine for the banks because of this trade-off between affordability and coverage. You want a sufficient degree of coverage to meet the perception test but the banks are acutely conscious of the affordability issue. You know, the £10 million, recognising it is more than the Guernsey £5 million cap, you are right into the competition issue. I do not feel that I should be answering a question of competitive ... I can understand why it is done and I understand why government is so keen that this scheme should manage that trade-off in a way that makes the banks here feel that they are at least competitive with these other centres and, if possible, a little bit more competitive with those other centres because we are into banking groups rationalising left right and centre. All sorts of representational activities are up for grabs. Cost-cutting, redundancies; you know, these are other issues I think government should be thinking about and worrying about and trying to avoid. If this is a manifestation of trying to avoid that then I can fully understand it.

**Deputy G.P. Southern:**

Okay. I will look at that form of words with interest when we see the transcript.

**Mr. J. Harris:**

I am trying to be straightforward. It is a balance.

**Deputy M.R. Higgins:**

It is a balance, yes.

**Mr. J. Harris:**

I am not trying to say government policy in Jersey is right or wrong. I am trying to say I understand the reasoning why they have come up with that. It is a competitive issue. It is as simple as that.

**Mr. A. Le Brun:**

The regulations themselves do allow a board to insure against its liability. So the law provides for that flexibility.

**Deputy M.R. Higgins:**

Sorry, explain that again?

**Mr. A. Le Brun:**

The regulations say that the board may insure against its liabilities. So that would not preclude, at a later point in time, the board picking up the insurance as you suggest. My point is there is nothing in the law that stops them from doing that.

**Deputy M.R. Higgins:**

Has anybody got anything else on funding? Can we move on to coverage then? Obviously you said you were at meetings very early on where coverage was talked about. The scheme that we have got is talking about personal accounts, basically individuals, and we are looking at joint accounts, personal account. We do not include partnerships and we do not include small-medium enterprises. We do not include pension pots essentially. Can you give the reasoning why these things ... you know, from the discussions that took place?

**Mr. J. Harris:**

That level of detail was not inherent in the first set of meetings. You know, that has subsequently emerged through the Oxera process, through all the Government sort of iterations of its drafts of its proposed legislation. So if it is about recall of what was discussed back in October, no; no way. I mean it was simply at that stage about £50,000. Does that meet the general acceptability test internationally?

Yes. You know, 0.3 of deposits gets you to a certain, you know, coverage. Yes. Caps. Very important for all the competitive reasons we have just discussed. That was the sort of level of formulation of design principles at that point. What has subsequently come out here is not something we at the Commission have been involved in, as in should S.M.E.s (small and medium enterprises) be in or not in, should charities be in or not in.

**Deputy G.P. Southern:**

That is of no interest to you as a board or it is?

**Mr. J. Harris:**

Well, from a professional point of view that is not of direct day-to-day interest, no. You know, I do not want to give you the same answer again as I can understand why they have, because it is the same answer; which is again we are trying to trade off affordability with coverage. Again, obviously everybody involved in this design has looked at different international models. I mean £50,000 or £100,000? Will the E.U. (European Union) go to £100,000? I mean it is a question mark still. Will blanket guarantees out of the Island be withdrawn? That is still a question mark that is posed. Could the Island ever meet that obligation and so on. I think it is important though any scheme must have certainty. So, you know, it is necessary to codify what is in and, therefore, what is out. Certainly pensions, the one where you will draw me in terms of pensions is that depositor protection schemes should not be looked to to deal with pension pots. That is a whole different area. That comes under investor compensation schemes, I would argue. I think you are definitely confusing 2 different types of potential coverage there. Charities in Jersey have a particular importance to this community and a lot of them are very small and vulnerable. So there is an obvious policy choice there that has been made. It is relatively small as well because, you know, the amount of eligible depositors which are deposited by charities as a percentage of the total must be pretty small. It is pretty small, I am sure of that. So that is another understandable choice.

**Deputy G.P. Southern:**

But you have, just there, pointed out the need for clarity in terms of this is protected, this is not protected, and the need to put that message out there; with depositors in particular but in general saying: "This is the scheme you get. This is what you are buying into." That is an important factor, I think.

**Mr. A. Le Brun:**

Yes. Whether the scope is right or not ... I mean one of the benefits of the regulations is that the definition of an eligible depositor is quite simple. So going back to your point about 7 days in other jurisdictions, I can remember when we were considering a long, long time ago there was a ... we were looking at the possibility of covering small and medium sized entities and then you run into all sorts of difficulties about whether or not they have turnover over X. Going back to the point about 7 days, I am not suggesting it is as simple as that but it may be that ... Well, it is always important to compare apples with apples. The U.K. regime, perhaps its scope is much wider and, therefore, they will inevitably run into greater difficulty in verifying that somebody has an entitlement.

**Deputy G.P. Southern:**

It is a minor point but I have just got hold of an email from James to Andrew Le Brun himself which says, towards the end of the process: "Also I do not know whether the Commission wish to write or send an email either recommending or some other form of words concerning the scheme as a whole before we lodge. In the absence of such I was intending to comment in my report that the Commission have been consulted about the scheme and have no objections to the scheme being presented to the States or similar words." I think it certainly ended in one document that I can see of no objections. Were there any reservations you had towards the end when you were asked to finally comment on the scheme at all?

**Mr. A. Le Brun:**

I think fundamentally we were content with ...

**Deputy G.P. Southern:**

No objections or recommend the scheme, you were asked do you want to use the word "recommend".

**Mr. J. Harris:**

I think he has got a bit confused again. I mean, we do have to recommend our own legislation to the Minister. This is not our legislation. So we should have been saying: "No objection," because we were fulfilling an advisory thing(?) role?.

**Deputy G.P. Southern:**

That is what you said.

**Mr. J. Harris:**

So I think there is a distinction.

**Deputy G.P. Southern:**

Nothing to be read into that?

**Mr. J. Harris:**

No.

**Deputy G.P. Southern:**

Okay.

**Mr. J. Harris:**

I mean, you know, we are trying to do the right thing here too. We are trying to advise because we have expertise and we have information but we are not looking to run this process. I know I have said that a lot of times this morning but it is ...

**Deputy G.P. Southern:**

You need to maintain that distance from the D.C.S.

**Mr. J. Harris:**

Yes, I think we do. I think we do for the reasons we discussed. I do worry about this conflict and it is ... So, for example, going back to mechanics in terms of setting up a body and having pre-ordained and pre-agreed arrangements, the Commission will be more than happy to put somebody forward for a steering group to set up such a body, you know, because we deal with the Viscount on a general basis.? because we have some expertise?... and in fact I think it was James Mews or one of his people has come in to see our company secretary who previously worked in the Viscount's office, you know, for some advice. We are very happy to put somebody forward on to a steering group but I am not happy that we have somebody on the board. I just think that is a non-starter. So with that difference; we are very happy to help with the articulation and the process of putting the mechanism in place but not beyond it.

**Deputy M.R. Higgins:**

In fact, just going back to the mechanism for a moment, obviously one of the problems with a cross-border failure is the difference in insolvency laws and pecking orders and everything else, as well as information flows. In the case of a subsidiary locally -and, yes, hopefully the Viscount could get involved and be far more active and far more in control of the process - again it is a sort of worrying aspect of the nature of all these banks and they have got all those systems out and you have already

mentioned that there is say, for example, a country preference; you know, they are going to look after their own first which there have been examples of, we have seen. Does it concern you, that problem? You know, if one of these goes down, that it is not going to be a straightforward process. It could be a drawn out process. We may not recover the 75 per cent that we think we may get if it is a local one?

**Mr. J. Harris:**

Well, I am not quite sure what question I am answering here. I mean does it concern me? Yes, it ...

**Deputy M.R. Higgins:**

I was throwing the whole lot in there.

**Mr. J. Harris:**

... is a nightmare. I mean we do not want banking failure in Jersey. I think it is a nightmare. Look at the experience ...

**Deputy M.R. Higgins:**

We all do not want that.

**Mr. J. Harris:**

I got into tremendous strife just with my opposite number in Guernsey as a consequence of them having had a banking failure and us not having had a banking failure. I felt the need on occasions, and others felt the need here, to put that into the public domain with some force. But, of course, the more you insist that you have got a good system and it worked out the more you throw their problem into relief and put the spotlight on it. So having seen that up close, reasonably personal, from the Guernsey experience and I have got a very good relationship with the Isle of Man, John Aston Aspden who I know you have been to see ... You know, having seen the effect that it has had on them and how difficult it has been, it is just a thoroughly miserable experience and we certainly do not want it here. So, yes, it concerns me as a sort of concept, absolutely. Do I believe that the likelihood of it happening is relatively low? Yes, for the reasons we have talked about. Can we design foolproof mechanisms that are going to make it absolutely plain sailing if it does happen? No. I just do not think that that is ... You know, we could spend a huge amount of research time and a huge amount of administration time in doing that and you have just got to balance the resources inherent in that against the risk and I do not see a case for that, to be honest. I really do not. If I had unlimited resources you could always make a case.

**Deputy M.R. Higgins:**

All right. Geoff, have you got anything more?

**Deputy G.P. Southern:**

I am done, no.

**Deputy J.M. Maçon:**

No further questions, thank you.

**Deputy M.R. Higgins:**

There was one I thought of earlier which went out of my head, so I may contact you at a later date. But, no, thank you very much for coming and for the explanation.

**Mr. J. Harris:**

Thank you. I hope we have been clear.

**Deputy M.R. Higgins:**

No, very helpful. Thank you.

**Deputy J.M. Maçon:**

Very useful.