STATES OF JERSEY

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THE ROLE AND FUNDING OF JERSEY FINANCE LIMITED: REPORT OF THE ECONOMIC AFFAIRS SCRUTINY PANEL (S.R.6/2008) – RESPONSE OF THE MINISTER FOR ECONOMIC DEVELOPMENT

Presented to the States on 10th July 2008
by the Minister for Economic Development

STATES GREFFE

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Introductory comments

1. The Minister for Economic Development welcomed a review of the role and funding of Jersey Finance Limited.

2. It is clear that the industry is likely to be entering a more difficult phase with a combination of pressures from the UK, the EU and further afield, as well as continued scrutiny by supranational bodies such as the OECD, IMF, FATF, etc.

3. At the same time the industry faces mounting pressure from the impact of the credit crunch, rising worldwide inflation, a slowing world economy and mounting pressures as jurisdictions, both onshore and offshore, increase their marketing efforts to compete for a growing share of the lucrative mobile international financial services business.

4. Jersey is at a crossroads and for this reason EDD commissioned an independent review by the London Business School (LBS) of the opportunities and threats to Jersey's continued success as an international finance study.

5. The LBS report highlighted a number of recommendations, but above all it highlighted the importance of the need to diversify the markets that Jersey relies upon and the importance of government and the jurisdiction as a whole providing unqualified support to the industry as the prime generator of government revenues.

6. For this reason the Report by the Scrutiny Panel (the Panel) has been eagerly awaited for the views of another independent body.

7. Whilst it is accepted that it is for the Panel to decide which areas to focus on, it is with some disappointment that it is noted that the Report focuses mostly on the period significantly preceding ministerial government. It concentrates on historical events, rather than on the significant progress made in recent times, under ministerial government, and on the critical issues facing the finance industry and the island's economy at the current time.

8. It is also surprising given the title of the Report, that it makes almost no comment on the role of JFL.

9. The Minister is disappointed that the Report remains almost completely unchanged since the draft report, notwithstanding the detailed evidence EDD and JFL highlighting the numerous errors of fact or interpretation set out in the draft report.

10. In particular it is also noted that –

    (a) neither the Minister for Economic Development, the Economic Development Chief Executive Officer nor the Director of International Finance were called to speak on current or future matters until they *expressly requested* to attend after a draft scrutiny report was issued and the detailed response referred to above had been provided by EDD;

    (b) given the historical focus it may also be considered surprising that neither the former Chief Executive Officer of Jersey Finance or the former Director International Finance, were invited to speak to the Panel, especially given the significant involvement of the former in establishing JFL and the extensive use by the Panel of material from a report written by the latter and his detailed involvement in decisions throughout the period 2002-2006;

    (c) the Report takes almost no account of the detailed responses from EDD, JFL and

Mr. Charles Clarke, and the comments made at the hearings subsequent to the issue of the draft report despite the important matters raised therein;

(d) that no independent experts were called to provide input into these important issues;

(e) that there were no responses from any parties that supported the findings of the Report;

(f) that there are no precedents quoted for the Recommendations made;

(g) that precedents that are contrary to the Recommendations made have been judged not worthy of mention, despite representations made to the Panel that these are important precedents;

(h) that all responses to the Panel were highly supportive of both the achievements to date of JFL and of the current JFL model, its plans and current activities;

(i) the Report appears to have arrived at a number of recommendations – many of which would require significant further time and resource to explore – on the basis only of the views of the members of the political Panel, members only who were not supported with any independent expert advisors.

11. Large parts of the report focus on matters prior to the introduction of ministerial government, in some cases, going back up to 8 years. This has required a significant use of extremely scarce resources within government and JFL.

12. The Minister questions whether such resources could not have been used to inform a much more pertinent debate on the current challenges faced by the industry.

13. Overall, it is considered disappointing that the Report did not feel it appropriate to make a more substantive contribution to a critical debate at a challenging time for the Island.

14. **In conclusion, with regret the Minister for Economic Development feels that the report has added virtually nothing to a hugely important debate. The Minister does not believe that this process has been an effective use of the scrutiny process or States resources.**

Report Recommendations

Key Finding

The Panel has not been able to find evidence of a clear decision as to how Promoco (JFL) was to be funded.

Recommendation 1

The Panel finds that the absence of the appropriate Committee Minutes makes it impossible to establish a clear audit trail for the formation of JFL. The Panel calls on the Council of Ministers to:

(a) investigate and report on how such errors could have occurred, and

(b) take steps to ensure that such un-audited expenditure of public money could not happen under new Ministerial protocols.

Response

15. Recommendation 1 is disappointing. It relates to decisions commencing in 2000, 5 years before the new system of ministerial government.

16. It is clear that the Panel have misinterpreted the information provided to the Panel on a number of occasions.

17. In 2000, there were discussions between those parties seeking to establish JFL and the government over several months.

18. During that time the parties seeking to establish JFL went ahead and set up the company. As has been explained, this is a very simple low-cost exercise. Most importantly however, is that JFL was incorporated by the parties seeking to establish the body, not by the then Committee system, who simply agreed to provide funding to the established company at a subsequent date.

19. This explains why there is no minute agreeing to establish JFL because <u>it was not a States decision or action.</u>

20. Critically therefore, the establishment of JFL <u>did not</u> commit States expenditure. (In practice there would have been no significant commitment of funds simply by incorporating JFL even if JFL had been established by government.)

21. There was therefore no un-audited expenditure of States money as the States did not pay for the incorporation.

22. Further, there also appears to some unfortunate confusion over the term “audited”. Clearly, the auditing of expenditure happens after the expenditure, not before, and perhaps what is meant here is unapproved expenditure. For the avoidance of doubt, JFL’s accounts have always been fully audited by a leading accountancy firm as has been explained to the Panel.

23. There are therefore no errors to investigate and it follows that no further steps are required.

<u>Conclusion on Recommendation 1</u>

24. This matter has already been explained in EDD’s response to the draft report. It is therefore deeply disappointing that these responses appear not to have been considered.

25. Recommendation 1 is not accepted.

<u>Recommendation 2</u>

<u>The Economic Development Minister should work with JFL to examine ways to increase the accountability of expended public funds.</u>

<u>Response</u>

26. This Recommendation refers to the ability to ensure the separation of promotional spending from other spending on the grounds that historically, States grant money was provided purely for promotional spend and not other categories of spend, e.g. the merger expenses of JFL and JFIA.

27. The Report then extends this point to suggest that promotional spend should be segregated from staffing and /or technical spend.

28. <u>This distinction is not accepted. The vast majority of staff costs are incurred in respect of individuals employed full-time on marketing and promotional activities.</u>

29. Submissions on this point were also made after the draft report was issued, to point out that within JFL the vast majority of staff costs relate to marketing staff and the Report’s distinction between promotional expenditure and the majority of staffing expenditure was not accepted.

30. It has also been pointed out that the administrative overhead is minimal, that the Chief Executive Officer

spends the majority of his time on marketing and promotional activity and administrative staff and technical staff costs have always been more than covered by industry contributions.

31. Corporate governance of JFL includes an independent board, Economic Development representation on that board, annual audit by a leading accountancy firm and detailed member review of activities undertaken and overall expenditure.

32. There is therefore sufficient evidence to confirm that the accountability of expended public funds is very high, and that specifically, past expenditure has been used for promotional expenditure (including staff costs for those working on promotional matters – the alternative being simply to have employed similar people at an external agency providing the same services at greater expense).

33. However, as has also been explained to the Panel, in response to market demand and recent analysis of the effectiveness of marketing spend, a shift in promotional activity has been implemented to provide much more detailed technical marketing as Jersey seeks to differentiate its detailed product and service offerings.

34. Technical activity is now seen very much as part of the marketing continuum just as R&D spend is typically very customer-focused in other industries.

35. It is now clear that providing grant support to JFL to undertake detailed technical research is an appropriate use of funds and the historic emphasis on pure promotional spend is not a useful metric in today's marketplace.

Conclusion on Recommendation 2

36. There is more than adequate evidence that the JFL grant is being spent on promotion under any definition, but most certainly on promotion in its modern form. There are detailed internal controls, including monthly spending reporting to the board of JFL on which two EDD representatives sit. There is clear accountability for the JFL grant. No further steps at this time are recommended.

37. Recommendation 2 is not accepted.

Key Finding

Despite the presence of a Partnership Agreement there remains a lack of clarity in respect of the level of resources which JFL is committing to delivering its core promotional objective.

Recommendation 3

The Economic Development Minister should review the Partnership Agreement to ensure that tax payers are getting value for money in delivering its core activity of promoting Jersey's image and the benefits of Jersey as an International Finance Centre.

Response

38. There appear to be two separate points raised by the Key Finding and Recommendation 3. The former refers to the "level" of resources JFL is committing to delivering its core promotional objective, and the latter refers to the "value for money" obtained.

39. In respect of the former, there has been a debate for some time whether in the face of growing competition the levels of resources made available to JFL are appropriate, both in absolute terms and relative to other sectors of the economy, especially given the relative return on investment that can be obtained by expenditure on the finance industry compared to that achieved from resources applied to other sectors.

40. In the main this has stemmed from a number of additional tasks that JFL has identified as being necessary to compete effectively with other jurisdictions.

41. In response, EDD commissioned the LBS study which has provided independent support for the need to consider new markets and raise the level of activity currently undertaken.

42. The Minister has taken immediate steps in this regard and agreed an additional £505,000 of additional funding this year against specific project proposals.

43. In respect of the latter, the partnership agreement will be reviewed and updated to clarify what constitutes value for money in today's marketplace and how that is best evidenced.

Conclusion on Recommendation 3

44. The level of resources provided to JFL will be kept under continual review to ensure value for money is obtained.

45. It was agreed some time ago and minuted at the JFL board meeting that EDD and JFL should undertake a review of, and update the Partnership agreement to reflect the current improved levels of accountability. It was also agreed that finalisation of such a review should be deferred pending the outcome of the Panel's review.

46. The review of the Partnership agreement will now be finalised.

Recommendation 4

The Economic Development Minister should update the Partnership Agreement in the light of Financial Code of Direction 5.4.

Response

47. The Financial Code of Direction requires the approval of the annual business plan, marketing plan and regular reporting of progress versus plan.

48. The improved processes that have been operating for some time and which have been further enhanced since the arrival of the new JFL CEO and the new Director of International Finance are fully compliant with Financial Code of Direction 5.4.

49. The Partnership Agreement and current monitoring and control already comply with Financial Code of Direction 5.4 and this will be made explicit in the revised Partnership Agreement.

Conclusion on Recommendation 4

50. The Partnership agreement will be updated to make explicit reference to compliance with Financial Code of Direction 5.4, and set what out constitutes such compliance.

Recommendation 5

The Minister for Economic Development should investigate the formation of an overall promotional body for Jersey, to include all aspects of our economy.

Response

51. The matter of a single promotional body was considered during the initial review of possible models in 2000 and was clearly rejected in favour of a separate promotional body for finance at that time.

52. The Report notes only that –

(a) it was considered as an option in 2000;

(b) that it understands that recent work on the launching of a Jersey brand and life enriching logos was holistic;

(c) there has been an example of joint marketing in 2007.

53. The Report –

(a) brings no evidence (expert or otherwise) to support reasoned arguments for an overall promotional body for Jersey;

(b) makes no mention of the lack of submissions to the Panel that were supportive of this recommendation;

(c) ignores the fact that every almost every jurisdiction competing for international finance has targeted marketing, specific to its finance industry (as highlighted in the LBS report) and that the work on the Jersey branding did not involve the finance industry at all due to concerns that the branding would not be appropriate for the finance industry;

(d) fails to mention that the 2007 event was one where the finance industry was undertaking some general "flag-waving" marketing of Jersey and that the Panel has received submissions highlighting that this is exactly the sort of marketing that has been found not to be cost-effective and has therefore been replaced by much more targeted technical promotion.

Conclusion on Recommendation 5

54. There is already a degree of co-operation between marketing efforts undertaken wholly within government, e.g. tourism, and those organised within the PPL structure for JFL.

55. The Public Private Partnership (PPP) model has been found to be a highly effective model for JFL.

56. All the evidence has suggested that financial services marketing has to be increasingly specialised and targeted rather than generic.

57. In the absence of any compelling arguments to justify investing time and resources exploring the matter further, Recommendation 5 is not accepted.

Key finding

The Panel notes that issues of lobbying and influence over what is considered to be in the public interest on the part of JFL have not been resolved.

Recommendation 6

The Economic Development Minister should explore the separation of the technical division of JFL into a new entity.

Response

58. Despite numerous representations that have sought to explain the nature of the interactions between JFL

and government, it appears that the Panel still believes that a significant proportion of the technical division's activity is in the nature of "lobbying" which is perceived to be purely in the interests of its members and against the public interest".

59. The purpose behind this recommendation is to seek to separate promotional work and the so called "lobbying" activity.

60. This view is rejected for the following reasons –

(a) that what the Panel insists on characterising as "lobbying" is in fact, as has been repeatedly explained, almost universally consultation, communication or the provision of expert advice;

(b) that such consultation or advice is in fact clearly in the wider public interest as the Island's economy is dependent on the success of the finance industry and any contribution to the continued or further success of the finance industry must also be in the public interest;

(c) the Panel's distinction between "the creation of new laws to enhance finance company profits and time spent ensuring that legislation is fit for purpose" is unhelpful as it fails to explain or provide an example of why the former is not in the public interest;

(d) the only example of "lobbying" provided is one involving a recent proposal to increase taxes on estates as an apparently easy source of government taxation revenue. If introduced, the proposals would have seriously damaged Jersey's core trust industry and without industry's intervention would in fact have resulted in a very serious loss of tax revenues. Such advice was therefore clearly in the public interest;

(e) **in summary, the view of the Panel appears to be that activity that results in an increase in the profits of the finance industry cannot be in the public interest. This underlying assumption appears to be the basis for the Panel's review rather than a conclusion of the review objectively arrived at**;

(f) finally the Report fails to remind the reader that whatever inputs are received from any source, that there are multiple checks to ensure that they are in the public interest. These checks include review by government officers, Law Officers, the Council of Ministers, Scrutiny and ultimately the States Assembly.

61. Separately, the suggestion that the technical division of JFL be subsumed into EDD fundamentally fails to understand the benefits of the PPP model and how it ensures the continued involvement of technical expertise at almost zero cost.

62. Further, notwithstanding detailed explanation by JFL and the Director of International Finance, the Panel has ignored or failed to understand the shift in JFL's marketing activity from general promotion to targeted technical promotion. The importance of this point is that so-called technical and marketing activity are now heavily integrated and such benefits would be lost if the two activities were to be separated.

63. The Report fails to consider the additional corporate governance costs of setting up an additional separate entity.

64. Finally, the Report also fails to note that membership contributions are material at almost £0.5 millior and that this more than covers all expenditure on technical activity.

65. Once again, the Report also fails to identify any expert evidence or examples of third-party submissions that suggest that there might be a case for the separation of the technical department.

Conclusion on Recommendation 6

66. There are no apparent grounds for considering the separation of the technical division of JFL into a new entity.

67. Recommendation 6 is not accepted.

Key Finding

The Panel is very supportive of the concept of 'pound-for-pound' matched funding. The Panel notes that this has been identified as the only achievable saving to be made by the Economic Development Department at this point.

Recommendation 7

The Economic Development Minister should take steps to restore the principle of pound-for-pound matched funding for JFL.

Response

68. Once again, the Report brings very little evidence (expert or otherwise) to support reasoned arguments for restoring the principle of pound-for-pound matched funding for JFL.

69. The Report does not present any examples of this model, either as local precedents, or as comparators from competing jurisdictions.

70. The Report ignores the fact that promotional funding for other sectors of the economy is fully funded by government expenditure.

71. The Panel does note that Guernsey and the IoM are fully funded by government.

72. There were no submissions to the Panel that were supportive of this recommendation and therefore the Minister is at a loss to understand the basis for this proposal.

73. The main grounds put forward in the report are firstly that this was discussed as an option in 2000 when JFL was first established and that it appeared to be a factor that was considered during funding decisions during the first few years of its operation.

74. In response, at the time JFL was being established, it was sensible to require the finance industry to clearly demonstrate its own support for the initiative and therefore matched funding was an appropriate model to adopt at that time.

75. Today, the sensible approach must simply be to consider the current prevailing circumstances and the appropriate level of government funding paying due regard to all the circumstances, not what was discussed as a suitable option 5 years or more ago.

76. The only other grounds for the recommendation is that the Comptroller and Auditor General (CAG), in a recent report, recommended the long-term reduction of £250,000 in States funding for JFL to "lead to a balancing of the direct and "in kind" contributions made by these two parties".

77. In fact however, the CAG report did not recommend the reduction in funding, it only highlighted it as an option for consideration. Further, the option for consideration was "to balance the direct and "in kind" contributions of the two parties and detailed submissions by JFL on the level of "in kind" contributions estimated these at c. £2 million during 2007. Both of these points have been ignored by the Report.

78. The Panel's Report also does not highlight the following points made to the Panel –

(a) that the finance industry generates well over 50% of government tax revenues, over 13,000 jobs and local expenditure of over £315 million on goods and services;

(b) that the level of the JFL grant therefore represents less than 0.3% of government revenues raised from the industry;

(c) that the level of grant funding is significantly less than that spent in supporting other sectors of the community that generate less than 5% of government revenues;

(d) that around the world the competition from offshore and onshore jurisdictions is increasing all the time, and that the recent independent LBS study recommended that Jersey needed to demonstrate a greater level of commitment to the industry if it was going to sustain its success over the coming years.

Conclusion on Recommendation 7

79. The Panel has ignored evidence and facts submitted to the Panel – this is regrettable

80. The level of the JFL grant should be reviewed on a regular basis, paying due regard to the current and long-term interests of the Island's economy and the competitive landscape at the time the funding is being considered.

81. There do not appear to be any grounds for setting an automatic level of government or industry funding at the current time.

82. Recommendation 7 is not accepted.

Recommendation 8

The development of a permanent presence in China or India should be subject to careful consideration by the Economic Development Minister and supported by a detailed Business Plan.

Response

83. The Minister has for some time been considering matters in this regard. As a result, further funding of £505,000 has been agreed, a proportion of which has been allocated to undertake more detailed fact-finding research in order to assess the viability of any such plans, and a proportion of which is allocated to the recruitment of a contract projects manager to undertake the work necessary for a detailed business plan and to oversee the effective implementation of the work if it is decided to proceed.

Conclusion on Recommendation 8

84. Recommendation 8 is already being progressed.