Guernsey Financial Services Commission

CONSULTATION PAPER

FEE RATE PROPOSALS

Effective from 1 January 2014

The Guernsey Financial Services Commission ("Commission") invites comments on this Consultation Paper. Comments should reach the Commission by 9 October 2013. Responses should either be emailed to the Commission Secretary, Fionnuala Carvill, at feeconsultationresponses@gfsc.gg, or be marked for her attention and sent to:

Guernsey Financial Services Commission
P.O. Box 128
Glategny Court
Glategny Esplanade
St. Peter Port
Guernsey
GY1 3HQ

Telephone: +44 (0) 1481 712706
Facsimile: +44 (0) 1481 733444

Contents

Executive Summary

This Consultation Paper sets out proposals on Commission licensee fees for 2014 and 2015. Rather than take an annual approach, a two-year approach will provide greater certainty for firms. Once the approach for the next two years has been agreed - then the Consultation Paper to be issued next year will broadly follow the proposals set out here. As income forecasts can never be entirely accurate due to additional licensees and licence surrenders, some year-by-year adjustments will be necessary and next year there will be another fee Consultation Paper in line with established procedures.

The Commission proposes two options.

The first is simply to increase the fees tariff across the board by 1.25% p.a. in order to maintain aggregate fee income in 2014 at 2013 levels.

The second is a differential option. The main differences from the first option are that this addresses material anomalies in the current fee structure but also aims to not increase total fee income in 2014 compared to 2013. This option envisages that, other than for the anomalies where significant fee increases would occur, the fees tariff in the investment sector would remain unchanged in 2014 and rise by 0.3% in all other sectors. In 2015, other than for anomalies, fees would rise for all sectors (including investment business) by 1.33%. The Commission has a preference for the second option which it considers the more equitable.

These options have been developed cognisant of the need to bear down on the regulatory costs faced by the Bailiwick's industry. Below inflation fee increases in the short term will be supported going forward by a continuing cultural focus on cost control. The Commission has previously announced that it intended fees to increase by no more than 2% per annum for the three years 2013, 2014, and 2015. A view will be taken before the fees consultation in Summer 2014 on whether an increase for 2015 needs to be as high as 2%.

Consultation

The Commission issues this Consultation Paper in accordance with Section 8(2) of the Financial Services Commission (Bailiwick of Guernsey) Law 1987, as amended ("Law"), under which the Commission "may, in connection with the carrying out of its general functions - ….consult and seek the advice of such persons or bodies as it considers appropriate".

The provisions in this paper affect all licensees, registered businesses and individuals, and applicants for licences or registration, in accordance with applicable laws and regulations.

Fees in context

<u>Fee Income</u>

Assuming the 2014 fee income stays at the same level as that for 2013 with aggregate increases of no more than 2% in 2015 and using projected Guernsey inflation figures, in real terms the Commission's income will reduce by 3.4% over the two years, given reductions in the size of the licence base the Commission anticipates.

Costs

The Commission is committed to managing its controllable expenses. The centralisation of some supervisory processes and automation should in due course increase efficiencies and therefore reduce operating costs. The Commission continues to aim to moderate personnel costs both in terms of overall staff numbers and compensation, though the management of pension costs associated with the Commission's participation in the defined benefit Public Sector Pension Scheme continues to be a great challenge. The Commission is seeking to recover enforcement costs from those who are subject to enforcement.

Nevertheless, cost control always has to be tempered by the reality of the regulatory obligations placed on the Commission by law. In particular the Commission has to deal with a series of new international standards, greater home-host co-operation, as well as significant activity around the periphery of its supervisory activity. The Commission also has to meet higher international requirements – as noted by the last IMF inspection team – around enforcement. The weight of international regulatory obligations – obligations over which the Commission has only the most limited influence – continues to grow. Were the Commission to ignore those obligations Guernsey would not, for long, continue to be regarded as a respectable financial centre. If Guernsey wants to remain a respectable financial centre there needs to be a degree of realism about the external environment in which Guernsey operates and its ever increasing regulatory demands, and the need to resource the Commission to work appropriately on behalf of the Bailiwick.

Inflation has been included at 2.75% p.a. for relevant costs in 2014. Inflation assumptions will be reviewed again as data is released. Salaries however are budgeted to remain unchanged between 2013/14. Salaries, when aggregated with States Insurance contributions and pension costs, comprise approximately 67% of all expenses.

The Commission participates in the States' defined benefit pension scheme, though the Commission closed the scheme in 2008 to new entrants, in part, to manage costs with more certainty. Compliance with accounting standard FRS17 results in a pension deficit that is volatile and can result in large variances between budgeted and actual results. The final salary pension scheme will continue to impose a high level of uncertainty on the Commission's results for the foreseeable future, despite a steadily reducing number of active members. The Commission, noting the progress of the States' Joint Working Party, continues to actively monitor and manage pension costs – the absence of end 2013 pay rises will help in that endeavour.

Reserves

The Commission needs an appropriate level of reserves to cope with regulatory emergencies and to fight litigious firms to uphold the rule of law. Its policy is to retain sufficient reserves to cover six months' of operating expenditure, yet it presently retains just over one month's. Its substantial cash balances are largely a result of needing to cover its liabilities and enable it to fund capital investment and meet exceptional and unforeseeable expenditure such as enforcement. Currently, reserves remain susceptible to pensions cost fluctuations and need further rebuilding.

Sentinel

The Sentinel programme follows on from the Independent Evaluation Review activities and encompasses a series of transformation projects designed to implement high quality and proportionate risk based supervision. It will also provide the tools - formerly referred to as Extranet - necessary to communicate electronically between ourselves and firms with regard to financial returns and authorisations, enabling better oversight by the Commission. The indications are that if the Commission does not implement an online solution it will become ever more difficult to manage incoming data without increasing headcount. Gathered electronically, the Commission will be capable of more enhanced data analysis, driving up the quality of supervision.

This project is planned to extend over three years and will incur significant capital expenditure. This will be financed from cash reserves. The Commission believes this investment is necessary in order for the Commission to remain a credible regulator. It will assist in driving efficiency gains, such as the automation of the review of quantitative financial returns.

Proposals

The Commission's commitment

Early in 2013, the Commission said that it intended fees to increase by no more than 2% per annum for the three years 2013, 2014, and 2015. By this, the Commission meant that the budget forecast for the next year could be increased by not more than 2% in aggregate; even if individual fees rise by a different amount. For the avoidance of doubt, aggregate fee income includes adjustments for estimated new licensees and surrenders by licensees. In line with this, the Commission now proposes that the overall fee income to be collected in 2014 will remain at the same level as that for 2013 and that the fees tariff for 2015 will increase overall by no more than 2%. The estimated fee income for 2013 is £12.25 million (2012: £12.53 million) and 2014 fee income will remain at this level based on current estimates for new licensees and licence surrenders.

Below we discuss Option 2, rather than Option 1, as Option 1 is very straightforward.

Strategic Overview

Fees from the investment business sector constitute around 40% of the 2014 budget. This has been a consistent annual figure.

The banking and fiduciary sectors at the Commission, both in the past and looking forward to the 2014 budget, are in net budgetary deficit. The Commission accepts that it may be unrealistic to expect all sectors to provide a consistent flat budget outturn, given that both fee income and at least a proportion of costs are in practice largely beyond its control. The Commission also recognises that there is inevitable volatility in sector outturn, depending on year-to-year business.

The Commission abides by the principle that fees should, so far as reasonably practical, be broadly aligned with the cost of supervision. One way of achieving this is to use a fee structure that is item and activity based. However such an approach would be expensive and difficult to administer. Nevertheless the Commission is concerned to ensure that firms whose fees have moved materially out of alignment with supervisory costs are charged more appropriately.

This strategic overview informs the Commission's approach to fees in 2014 and 2015. In particular, the aim is to provide some limited re-balancing of fee income away from the investment business sector whilst charging certain firms fees more in line with regulatory cost. All this should take place within the overall maximum 2% annual increase in fee rates.

Anomalies

The Commission has identified four areas where material anomalies in fee structures exist (for the record no material anomalies are considered to exist in respect of investment fees).

Banking

For banking, the current approach of determining fees, with reference to income only, is inequitable, especially given income volatility and intra-group cross-charging. The Commission therefore wishes to introduce a new approach that takes account of asset size and the degree of risk as defined by whether a licensee is a branch or a subsidiary and whether it serves the retail market.

Broadly, there would be a minimum fee of £37,550 for small banks rising incrementally to bigger banks with above £1 billion total assets. At that level there would then be the "core fee" (of £51,575) but with a 25% premium added for a subsidiary (because of ICAAP work) or 25% premium for a retail branch. This reflects the need for the Commission to undertake more routine supervisory work on a subsidiary than on a branch and on a bank where there are retail customers – not least to cover conduct issues.

Some firms would as a result of this re-shuffle incur higher and some lower fees. However there would be a net increase in fees and this would be applied in 2014. This increase amounts to £51,000.

The forecast for banking annual fees in 2014 is £1.611 million. £51,000 represents an increase of 3.2%. This increase is reasonable given the need – as explained above – to move the banking sector towards budget equilibrium.

Fiduciary

For the fiduciary sector, the majority of fees are based on reference to fiduciary related turnover for those holding a fiduciary licence. Currently the fees are based on fee bands that range from band 1 to band 5. Band 5 – the top fee band – is applicable to those licensees with a fiduciary turnover of greater than £4 million with a current fee of £24,390.

It is recognised that of the current 149 full fiduciary licence holders there is diversity in both the nature of activities and fiduciary turnover which impacts on regulatory resource effort. In practice, the above fee band does not cover the regulatory resource effort and therefore two new fee bands are proposed, band 6 being £7 million to £10 million and band 7 greater than £10 million.

The Commission considers that an increase in annual fees to £30,000 and £35,000 for these new fee bands respectively, phased equally over two years, is merited and proportional.

This will raise additional fee income of around £86,000 p.a. by 2015. The expectation is that this will affect eleven licensees.

The Commission also considers that the current application fee for a joint licence of £265 does not meet the regulatory cost and that an increase to £530 is merited.

Insurance
Three large life insurance companies are currently charged an annual fee of £20,325. This fee does not align with the supervisory cost. The reason for this is that the Commission, in line with international standards, now uses actuaries to a greater extent than before to review technical provisions and Own Solvency Capital Assessments; there are more routine home/host contacts; and each of these firms now has a particular desk officer for routine oversight purposes – with the option of periodic on-site visits if required. The Commission considers that an increase in the fee to £40,000 is merited, to be phased equally over two years. This fee is at the lower end of the international scale for life companies.

There is also one large general insurer who is currently charged a fee of £2,895. This fee does not cover its regulatory costs, largely for the same reason as for the life companies. The Commission considers that an increase in the annual fee to £15,000 phased equally over two years is merited.

All this will raise additional fee income of £72,000 p.a. by 2015.

There is one small additional note with regard to insurance. Guernsey law has recently been changed to enable an existing cell of a protected cell company to be converted into a non-cellular company. In line with comparable fees, the Commission, whose consent is needed, will charge £973 for this. There will be no material impact on fee income as a result of this.

Non-regulated financial services business
For non-regulated financial services businesses, the Commission is obliged to register certain types of financial services businesses. In recent years, the Commission has found that, while in some cases this can be a relatively simple task, in other cases the costs associated with such registration can be considerable. The main reason for this is the often novel attributes of certain applications, especially in relation to e-commerce, and the fact that such applications can be made by those not currently operating in the Bailiwick. In these consequences, the Commission has found that the current fee of £1,113 has been significantly short of its costs. The Commission therefore proposes to continue with the current fee level (£1,116 for 2014) in the expectation that most applications will be simple. However, for those that are not, the Commission now proposes to charge a deposit of £10,000 to cover its costs whilst the initial application is being investigated. This would be set against costs actually incurred by the Commission, which will vary with each application, and any balance remaining would be refunded to the applicant. This is very similar to the approach taken by the Alderney Gambling Control Commission (“AGC”).

The Commission wishes to take this approach, following the lead of the AGC, to avoid established Guernsey licensees being asked to subsidise speculative applications by firms outside the Bailiwick.

An annual fee may also apply to complex and/or innovative businesses. The Commission will determine the fee in this instance but internally it will have to justify its decisions by references to the following general criteria:

- Risk
- Size and
- Product innovation

The Commission anticipates that this fee will normally be no greater than £10,000 p.a. Given the fact that this business is idiosyncratic, the Commission does not expect an annual income stream from this source. However, the above proposal should allow costs to be covered.

Summary

The forecast for 2014 fee income is £12.25 million with 2015, based on current estimates, being £12.49 million.

As set out above the anomalies in the three relevant divisions provide additional fee income in 2014 of £51,000 for banking; £43,000 for fiduciary and £36,000 for insurance. In 2015 the relevant numbers are zero for banking; another £43,000 for fiduciary and another £36,000 for insurance. In total this means that the anomalies fee income is in aggregate £130,000 in 2014 and another £79,000 in 2015. This will increase the Commission's income by circa £209,000 in 2015. For 2014, an additional £23,000 will need to be raised from other tariff increases (0.3%) in order to maintain aggregate fee income at 2013 levels.

The Commission proposes – for the reasons given above – the option to avoid any increase in fees for the investment sector in 2014. This would mean that in 2014 non-anomalies fees in all other sectors, other than the investment sector, will rise by 0.3%. In 2015 all non-anomalies fees in all sectors will rise by another circa 1.33% to ensure that 2015 fees do not increase by more than an average of 2%.

Application Fees

It is proposed that application fees will rise in the same way as will be agreed for annual fees. So, for example, application fees for investment business will remain flat if the differential option is preferred; whereas most other fees will increase by 0.3% in 2014 and 1.33% in 2015.

For the avoidance of doubt, income from this source is about 8% of total fee income; so any percentage increase has limited impact. However, for the further avoidance of doubt, application fees have been included in the overall fee income estimate.

The Commission does not charge for licence surrenders.

Penalty fees will remain unchanged as in previous years. These also have been included in the overall fee estimate but this category comprises less than 1% of the total.

Conclusion

The Commission's strategy is designed to 'win for the Bailiwick'. In order to do this the Commission needs an appropriate income from fees. This income needs to be fair both in relation to inflation and to the distribution of fees. It is also proposing that those firms that routinely absorb more supervisory resources are charged fees more in line with this cost. This is fairer to other licensees.

Appendix A: List of representative bodies who have been sent this Consultation Paper

- States of Guernsey Policy Council
- States of Guernsey Commerce and Employment Department
- States of Alderney Policy and Finance Committee
- Chief Pleas of Sark General Purposes and Advisory Committee
- Guernsey Finance
- Chamber of Commerce Guernsey
- Guernsey International Business Association
- Association of Guernsey Banks
- Guernsey Investment Fund Association
- Guernsey Investment Managers and Stockbrokers Association
- Guernsey International Insurance Association
- Bailiwick Insurance Intermediary Association
- Guernsey Association of Trustees
- Institute of Directors

Appendix B – Tariff changes using the differential option

Tariff – Banking Sector

The current tariff is set out below:

Income band	
Application fee	£37,440
Annual licence fees:	
Under £5 million	£37,440
£5 million to £10 million	£42,960
£10 million to £20 million	£51,420
Over £20 million	£64,360
Branches outside jurisdiction	£12,855

The new proposed tariff is set out below:

Proposed Tariff	**2014**
Application fee:	£37,550
Annual licence fees on recalibrated "total assets" basis:	
Total Assets less than £500 million	£37,550
Total assets of £500 million and over but less than £1,000 million pro rata fee applying multiplicand x (x = 0.00005156)	as calculated per quarterly return (broadly within the range £38,000 - £51,000)
Total assets of £1,000 million and over: core fee	£51,575
plus 25% premium for a Guernsey subsidiary bank	£12,895
Or	
plus 25% premium for a retail branch bank	£12,895
(if both characteristics apply, only one applies)	
Branches outside the Bailiwick	£12,895

Tariff – Insurance Sector

The proposed tariff is set out below:

	Current Fee	Proposed fee for 2014
Application fees:		
Insurance Manager	£4,785	£4,800
Insurance Manager – Lloyd's	£2,630	£2,637
Insurer/Reinsurer/Captive	£5,140	£5,155
Protected/Incorporated Cell Company	£5,140	£5,155
Cell of a PCC/ICC	£1,450	£1,455
Domestic Insurer	£2,895	£2,904
Intermediary	£4,835	£4,850
(addition of licence categories)	£173 to £1,660	£174 to £1,665
Annual fees:		
Insurance Managers – pure	£4,540	£4,554
Insurance Managers – commercial	£7,600	£7,623
Insurance Manager – Lloyd's	£2,630	£2,638
Insurer/Reinsurer/Captive	£5,140	£5,155
Protected or Incorporated Cell Company	£5,140	£5,155
Cell of a PCC or ICC	£1,680	£1,685
Transformer cell	£765	£767
Dormant cell	£135	£135
Life Insurer (from/to)	£5,140 to £20,325	£5,155 to £30,000
Domestic Insurer (turnover < £12,000)	£430	£431
Domestic Insurer (turnover £12,000+)	£2,895	£2,904 to £8,950
Intermediary (base fee)	£2,335	£2,342
Intermediary (licence type)	£173 to £1,660	£174 to £1,665
Intermediary (turnover level)	£1,650 to £6,630	£1,655 to £6,650
Member of association for travel insurance	£1,325	£1,329
Other fees:		
Conversion of a company to a regulated PCC or ICC	£970	£973
Conversion of a regulated PCC to a regulated ICC	£970	£973
Conversion of a PCC or ICC to a regulated non-cellular company	£970	£973

Tariff – Fiduciary Services Sector

The proposed tariff is set out below:

	Current Fee	Proposed fee for 2014
Application fees:		
Personal fiduciary licence	£877	£880
Full fiduciary licence – lead applicant	£1,980	£1,986
Full fiduciary licence – joint applicant	£265	£530
Annual licence fees:		
Personal fiduciary licence	£990	£993
Full fiduciary licence		
Income band (annual):		
Under £250,000	£5,940	£5,953
£250,000 to £1 million	£9,885	£9,910
£1 million to £2 million	£20,120	£20,180
£2 million to £4 million	£22,235	£22,300
£4 million to £7 million	£24,390	£24,465
£7 million to £10 million	£24,390	£27,200
Over £10 million	£24,390	£29,700
Other fees:		
Personal discretionary exemption	£439	£440
Company/partnership discretionary Exemption	£877	£880
Consent to use a name	£1,670	£1,675

Tariff – Investment Sector

The tariff is set out below:

	Current Fee	Proposed fee for 2014
Application fees:		
Open-ended Collective Investment Schemes		
Schemes*	£3,165	£3,165
New classes of existing schemes*	£665	£665
Non-Guernsey schemes	£1,020	£1,020
Designated Territories scheme notification (EX) (Jersey schemes remain at nil)	£1,020	£1,020
Closed-ended Collective Investment Schemes		
Schemes*	£3,165	£3,165
Licensees	£2,140	£2,140
Annual fees:		
Open-ended Collective Investment Schemes		
Schemes*	£3,165	£3,165
Additional classes	£204	£204
Non-Guernsey schemes	£510	£510
Designated Territories scheme (EX)	£510	£510
Closed-ended Collective Investment Schemes		
Schemes*	£3,165	£3,165
Licensees		
Designated Persons of open-ended schemes	£3,060	£3,060
Principal Managers of open-ended schemes	£1,530	£1,530
Designated Managers of closed-ended schemes	£3,060	£3,060
Managers of closed-ended schemes	£1,530	£1,530
Investment exchanges	£11,220	£11,220
Other Licensees	£3,060	£3,060

** Authorised and Registered*

Tariff – Non-Regulated Financial Services Businesses and Prescribed Businesses

The tariff for NRFSBs is detailed below:

	Current Fee	Proposed fee for 2014
Application fee	£1,113	£1,116
Annual fees:		
Base fee	£1,113	£1,116
Fee for 1-5 additional outlets	£60	£60
Fee for 6-10 additional outlets	£132	£132
Fee for 11-15 additional outlets	£204	£205
Fee for more than 15 additional outlets	£264	£265

The tariff for PBs is detailed below:

Number of full time or full time equivalent staff	Current Fee	Revised for 2014
1-5	£601.80	£604
6	£693.60	£696
7	£785.40	£788
8	£877.20	£880
9	£969.00	£972
10	£1,060.80	£1,064
11	£1,152.60	£1,156
12	£1,244.40	£1,248
13	£1,336.20	£1,340
14	£1,428.00	£1,432
15	£1,519.80	£1,524
16	£1,611.60	£1,616
17	£1,703.40	£1,708
18	£1,795.20	£1.800
19	£1,887.00	£1,892
20	£1,978.80	£1,984
21	£2,070.60	£2,076
22	£2,162.40	£2,168
23	£2,254.20	£2,260
24	£2,346.00	£2,352
25 or more	£2,437.80	£2,444