Guernsey Financial Services Commission

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2011

Guernsey Financial Services Commission

Appendix

This report, including the financial statements as required by section 18 of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987, as amended (the Commission Law), is made in pursuance of section 6 of the Commission Law to the States Policy Council and submitted by the Chief Minister for consideration by the States of Guernsey.

Note: Throughout this report the Guernsey Financial Services Commission is referred to as "the Commission". The Chairman and other members are referred to collectively as "the Commissioners".

STRUCTURE OF THE COMMISSION

COMMISSIONERS

Nik van Leuven QC
Director General

DIRECTOR GENERAL'S DIVISION

Richard Walker
Director
Policy and International Affairs

Kevin Bown
Deputy Director
Intelligence Services

Samantha Sheen
Legal Counsel

Fionnuala Carvill
Commission Secretary

Philip Marr
Director
Banking Division

Philip Nicol-Gent
Director
Fiduciary Services Division

Neville Johnson
Acting Director
Finance and Operations Division

Dr Jeremy Quick
Director
Insurance Division

Carl Rosumek
Director
Investment Business Division

COMMISSIONERS

Cees Schrauwers
Chairman of the Commission

Cees Schrauwers was appointed as a Commissioner in July 2008. He is a Dutch citizen and has spent most of his career in London with Commercial Union ("CU"). Mergers with General Accident and Norwich Union resulted in the creation of Aviva plc. Cees has occupied a number of positions in the insurance industry, including Managing Director of CU UK and Managing Director of CGU Insurance. Following the mergers he was appointed Managing Director of Aviva International, gaining valuable experience in dealing with regulators across the globe, including North America. Cees is currently Chairman of DriveAssist Holdings Limited, a claims management company, Senior Independent Director of Brit Insurance Holdings plc and Senior Independent Director of Record plc, one of the world's largest currency managers. He lives with his family near London.

Susie Farnon FCA
Vice-Chairman of the Commission

Susie Farnon was appointed as a Commissioner in February 2006. She was a Banking and Finance Partner with KPMG Channel Islands from 1990 until 2001. She has served as President of the Guernsey Society of Chartered and Certified Accountants and as a member of the Guernsey Audit Commission and the Guernsey Public Accounts Committee. She is also director of a number of private and listed companies.

Lord Flight MA (Cantab) MBA, FRSA
Commissioner

Lord Flight was appointed as a Commissioner in 2005. He was the Conservative Member of Parliament for Arundel and South Downs from 1997 to 2005, during which time he was Shadow Economic Secretary, Paymaster General and Chief Secretary to the Treasury. From 1999 to 2004 he had Shadow Treasury responsibilities for the Finance Acts, the financial services industry, financial regulations and pensions. He has worked for over 40 years in the financial services industry, starting his career at Rothschilds. In the second half of the 1970s he worked for HSBC's merchant bank in Hong Kong and India. In 1979 he joined Guinness Mahon and established what became Guinness Flight Global Asset Management, of which he was joint Managing Director until it was acquired by Investec in 1998. He formed, and is Chairman of, Flight & Partners, which is the manager of the Flight & Partners Recovery Fund, and is currently a director of Investec Asset Management Limited, Metrobank plc, Arden Partners and a number of other companies and investment funds.

Alex Rodger MCIBS
Commissioner

Alex Rodger was appointed as a Commissioner in February 2008. He spent over 40 years with the Royal Bank of Scotland ("RBS") Group. Prior to moving to Guernsey in 1989 as Island Director, he occupied senior posts in relationship management and credit control in London and New York. He was executive director of RBS International from its formation in 1996 and was appointed Managing Director of RBS International Securities Services Group in April 2002. Later that year his responsibilities were increased to that of Managing Director of RBS International Corporate Banking Division with responsibility for corporate banking operations in each of Jersey, Guernsey, the Isle of Man and Gibraltar. He led the sale of RBS International's Securities Services business to BNP Paribas in June 2007. He was also Chairman of RBS International Employees Pension Trust. Alex Rodger is the non-executive Chairman of advocates Collas Crill.

Richard Hobbs MCIPD
Commissioner

Richard Hobbs was appointed as a Commissioner in January 2012. His first career was in the UK Civil Service where he concentrated on a variety of consumer protection and European issues. Latterly, he was a director of the Department of Trade and Industry's Insurance Division where he was responsible for overall supervision of the Lloyd's insurance market during its reconstruction in the mid-1990s. He has been Head of Life and Pensions at the Association of British Insurers, and for the past decade has been a consultant advising a wide range of clients in financial services on regulatory, risk and governance issues. He is also chairman of Faber Limited, a wholesale insurance broker, and a non-executive director of Barbican Managing Agency Limited, a Lloyd's managing agent.

Bob Moore
Commissioner

Bob Moore was appointed as a Commissioner in February 2012. He has spent over 30 years in the financial services industry in Guernsey and internationally. From 1979 to 1997, he held positions in international banking and international private banking with the Lloyds Bank/Lloyds TSB Group in South America, the United States ("USA"), the United Kingdom ("UK") and Luxembourg. These included responsibility for Lloyds' international private banking operations in New York and in Luxembourg. From 1997 to 2011, he was jurisdictional Managing Director with responsibility for the Butterfield Group's operations in Guernsey, including banking, investment management, custody and fiduciary services. In June 2011, he was appointed to the position of Executive Vice President and Head of Group Trust for the Butterfield Group. He has also been a director of a number of other Guernsey banks and investment funds.

CHAIRMAN'S STATEMENT

This is my first statement as the new Chairman of the Commission. I am therefore seeking to provide you with an overview of the plans of the Commission for the near future.

I have taken over from Peter Harwood, to whom we all owe a vote of thanks for the way he has guided the Commission over the last six years, during a difficult period. I also would like to thank David Mallett, who served the Commission as its Vice Chairman over the last seven years, who has also retired.

I have no great expectations that the business climate will improve substantially over the next couple of years. Investors continue to struggle to generate real returns on their investments and governments are trying to resuscitate their economies still suffering from the consequences of living above their means. In order to prepare better for the expected difficult times ahead, the Commission announced last year that it would undertake a review and evaluation of the way it is organised and conducts its business. Ernst & Young LLP was engaged to carry out this assignment. The purpose of the Review was to assess the current performance of the Commission and to assist in the design of an organisation that best prepares us for the future we are likely to face. The Review was successfully completed in November and the recommendations were discussed with the States of Guernsey ("the States") and accepted by the Commission.

The main recommendations are:

- A financial services strategy is essential for Guernsey. It should be informed by economic data provided by government, opportunities informed by industry and regulatory consequences informed by the Commission. Government should be responsible for strategy, the Commission for implementation of regulatory strategy.
- Responsibility for regulation should rest with a single government department with clearly defined responsibilities and reporting mechanisms and safeguards in place to ensure that government cannot interfere in the day-to-day business of regulation.
- The Commission creates a unified and centralised regulatory process to gain organisational and operational efficiencies.
- A structured and transparent supervisory programme, adopting a consistent risk-based approach across the Commission, should be implemented to bring greater consistency.
- The electronic submission of data should be prioritised to increase the operational effectiveness of the Commission. Licensees should be encouraged to submit data in electronic form wherever possible and provide their own analysis of significant data movements to facilitate the Commission review.

The Commission has retained Ernst & Young LLP to help with the project management aspects of the implementation of the recommendations. It is however clear to us that it will be the staff who will be required to execute the follow-up of the recommendations. We intend, from time to time, to keep stakeholders abreast of the progress we are making.

The Commission is fully aware of the importance of the financial services industry to Guernsey and it is working closely with the States to make sure that the island continues to play a successful role in the finance industry of the early 21st century. To assist in this task for the Commission, the Policy Council has provided the Commission with the following principles, which I summarise as follows:

The Commission:

- Has operational independence.
- Should maintain and enhance Guernsey's reputation and prospects by applying and enforcing a strong, internationally respected, regulatory regime.
- Should adopt and apply international standards.
- Should at all times bear in mind the importance of the financial services sector to Guernsey.

The ever-increasing level of activity at the Commission and for licensees demands an improvement in the way the Commission communicates with its stakeholders. Commissioners, therefore, intend to step up their communications plan with the relevant representative bodies on the island. To assist all parties, the Commission will be introducing service level agreements ("SLAs") later in the year and intends to provide regular updates on its performance.

The increasing cost of regulation is a concern to all of us and the Commission intends to keep any cost increases to a minimum, whilst meeting its objectives. The fee increases for 2012 were the lowest for some time. The implementation of the recommendations in the Ernst & Young LLP review will assist us in achieving that aim.

The Director General and the divisional Directors summarise the "business as usual" activities of the Commission, but I would like to highlight the time and energy spent by the Commission on taking part in and staying in touch with the numerous international regulatory bodies. The new Basel III and Solvency II requirements are demanding the full attention of the Commission even though Guernsey is outside the European Union. We need to keep abreast of the developments on our doorstep. Of concern to the Commission is the ongoing uncertainty surrounding the euro and the membership of the Eurozone. The stresses and strains within the zone are ever increasing, in particular as a result of the divergence in the development of unit wage costs between members of the Eurozone.

The Commission maintains an active dialogue with departments of the States, the Policy Council and the Department of Commerce and Employment. The Commission also meets periodically with the Fiscal and Economic Policy Group at both Commissioner and executive level.

As already expressed, the effort required from the Commission is substantial and I would like to thank the staff and the Directors of the Commission for their unrelenting endeavour and thank my fellow Commissioners, who have seen their workload increase substantially over the period. I want to use this opportunity to welcome Richard Hobbs and Bob Moore as the newly appointed Commissioners. This brings the Commission close to its full strength and will allow us to deal effectively with our tasks over the next couple of years.

Cees Schrauwers, Chairman

DIRECTOR GENERAL'S STATEMENT

In my statement accompanying the last Annual Report, I suggested that 2010 might be characterised as the Commission in transition. I have no doubt that 2011 and 2012 will come to be identified as the Commission in transformation. I can assert this with cautious confidence now that the Review carried out by Ernst & Young LLP, conducted during 2011, and delivered to the Commission in November, has been endorsed as to its recommendations, and is now in the process of detailed planning and implementation.

It is right to stress that the Review was not about finding fault, but making the Commission fitter for the purpose of financial services regulation and supervision in the Bailiwick in ever-changing, and almost invariably more difficult, circumstances. Of course, those consulted as part of the Review found matters to criticise, but as Ernst & Young LLP make clear, the Commission is widely respected and valued, and believed to be of credit to Guernsey. For that state of affairs I have to thank my preceding Directors General, all the Commissioners who have served the institution since its establishment on 1 February 1988, besides – and particularly – our staff, present and past. But in regulatory terms 24 years is a lifetime, sufficient for cultures to become embedded and ways and means to be taken for granted, all of which should be subject to challenge and revision. I welcome the Review, and thank Ernst & Young LLP for the considerable work they have undertaken in delivering sensible, practicable and, crucially, achievable recommendations.

Of the many matters addressed in the Review, the identification of the need for government and industry to maintain an effective and tolerable modus operandi is significant. Whilst regulation is inevitably underpinned by such legislative regime as government is predisposed to provide, the dialogue between the States and the Commission to achieve better regulation must be mutually positive and supportive. In this respect the Review's recommendation that there needs to be developed under the aegis of the States a financial services strategy within which the Commission can deliver its regulatory objectives is vital.

As I reported last year, in November 2010 the regulatory objectives of the Commission were restated at the Commission's request and with its agreement by the Policy Council, as much for the purposes of the Review as to provide a continuing context within which the Commission should discharge its functions. However – and as current economic circumstances have highlighted – it is clear that some more formal and broader financial services strategy will need to be prepared, to which the Commission will necessarily have a significant contribution. Since I arrived at the Commission I have encouraged between the Commission and the body politic much greater interaction, both at Commissioner and executive level, and this is already producing beneficial results. Amongst the various recommendations and endorsements of Ernst & Young LLP, a number call for comment and explanation.

To my mind, the most important task is the consolidation and co-ordination of the Commission's legislative and regulatory regimes into one piece. This was first proposed internally some years ago, but was deferred because of the financial crisis and the 2010 International Monetary Fund ("IMF") assessments. Both have reinforced its urgency and importance. Through nobody's fault, the Commission is responsible for regulating and supervising businesses under several distinct laws which have been separately developed and enacted by the States, and which reflect not only the needs and wants at the time of their confection, but also the predilections of those instructing or informing their preparation. The result is a pot pourri of primary legislation, directed separately at protection of depositors, i.e. banking (1994), insurance business (2002), insurance managers and intermediaries (2002), investment business (1987) and fiduciary business and company administration (2000). Whilst each has been effective in its own terms in enabling the Commission to discharge its objectives, the differences within and between them, both subtle and obvious, in relation to regulatory and supervisory practices and procedures which should be common across the Commission, make efficient discharge of its functions more difficult. This is no longer acceptable.

It is essential to unify all those legislative and regulatory provisions which should be common to all Divisions within the Commission, and this I have no doubt will be conducive to a much more effective and responsive Commission, besides providing a more accessible and convenient point of call for those who need to read and understand the regimes by which they are bound. The opportunity will be taken to amend or supplement the legislation where appropriate or as recommended or required by external assessors and international standards setters. Whilst the purpose of the consolidation goes more widely, if the only result is the simplification and clarification of the law, then it is to be welcomed. In this the Commission will be working closely with the relevant authorities, particularly the legislative drafting team at St James Chambers. Separately managed, but arising out of the same philosophy, is a review of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987, which presently prescribes for the Commission rather than the sectors regulated and supervised by it. The product will necessarily reflect the greater interaction to which I refer above between the Commission and government.

Another significant project which the Commission has come to recognise is intimately linked with the implementation of the Review's recommendations is "extranet". The desirability – some would say essentiality – of facilitating and improving communication and management of data between regulated businesses and the Commission is obvious, but its purpose goes wider. The Commission is the recipient of vast quantities of information from licensees, which primarily informs our work with respect to each licensee. This, in some respects, is consolidated for divisional purposes. But within that information, and available from other information which should be sought but presently is not, there lies data which, properly deployed, would be of benefit not only to the Commission but also to Guernsey's government for economic and other purposes. I must stress that there can be no question of disclosing confidential information concerning particular licensees: to this, government is not entitled, but Commission data, efficiently collated, suitably anonymised and analysed, and appropriately disclosed, should provide a valuable tool. Furthermore, the internal management of data is under review for improvement, as Ernst & Young LLP have recommended.

Following the Review the planning for the extranet project underwent significant development, in part to reflect the new methodologies which have been urged upon the Commission by Ernst & Young LLP in the delivery of projects, particularly to determine the core issues of costs and benefits. Prediction of costs is always hazardous, and determination of benefits usually less so, and it is never satisfactory to evaluate unquantified non-financial benefits against (usually unpredictable) quantitive costs. However scoped, however scaled and however delivered, extranet will not come cheap.

Of the Review's other recommendations, the development of a pan-divisional anti-money laundering/countering the financing of terrorism ("AML/CFT") unit is the most significant, and is particularly welcome. The Review identified dissatisfaction amongst industry with the way in which the Commission addressed aspects of AML/CFT development. As the importance of this area of the Commission's work increases, there must be effective communication with those affected by AML/CFT developments, and this also because it seems clear that the Commission will be required to assume, and so industry will be required to address, developments in the combating of other aspects of financial crime – including, in particular, bribery and corruption. More generally the criminal law enforcement aspects of the Commission's functions will inevitably increase. So the creation now of a unit specifically devoted to becoming the Commission's centre of excellence for AML/CFT purposes, and which will enable it, as and when required, to address emerging financial crime issues, is timely.

The Commission continues to seek ways to contain costs. Since 2009, it has been largely successful in doing so. However, the one-off cost of the Review had to be borne in 2011, and this was not insignificant in the context of the Commission's overall financial results which indicate fee income and expenses rising in similar proportions. Salary costs, being the Commission's major expense, rose by less than 1%, though pension costs were substantially higher – the States' review of the Public Sector Pension Scheme, of which the Commission is a member, is awaited, as are initiatives that will help contain its costs. The incongruous results revealed by the two measures for the final salary pension scheme deficit continue to confound many minds, showing a £7.5 million deficit on the Commission's balance sheet, while a deficit of less than £500,000 was the result of the updated actuarial valuation used triennially for funding purposes. I should stress that the Commission closed the final salary pension scheme to those not already members in 2008, and instead makes available a defined contribution scheme. Other costs were stable, although legal and professional costs, often associated with enforcement activity and so less predictable, were more volatile. But overall, the Commission has been markedly successful in controlling costs in those areas within its control.

I do not propose to dwell upon the continuing turmoil in world economies and financial markets. Suffice to say that the Commission is acutely conscious of the need to be vigilant, and to take appropriate action to attempt to mitigate the consequences of stress or failure. Eurozone contingency planning has featured much in this process, as has the Commission's contribution to Guernsey's involvement in the future structure of UK banking operation and regulation, principally as a result of the Vickers report. The Commission, being possessed of appropriate knowledge and experience, is well placed to advise the States on stress in financial services which, depending upon the methodology deployed, deliver somewhere between 40% and 70% of Guernsey's gross domestic product.

The Commission remains alert to the need to leave the place and scope of financial services within Guernsey's economy to the States, advised by industry, but, of course, given the significance of financial services, the consequences of regulation almost inevitably bear upon the community at large. Despite what may be believed, the Commission remains ever aware, particularly in these troublous times, of its responsibilities to maintain Guernsey's reputation, both internally and internationally, which is why effective engagement between the Commission, the States and industry is increasingly important.

2012 will be the last year during which the Commission will part fund the GTA University Centre. One result of the Commission's decision to withdraw its grant has been a welcome commitment by the States to continue to support the GTA. Another has been a thorough-going review of the GTA's resources, expenditures, purposes and ambitions. I stress that the Commission remains wholly supportive of the GTA and will continue to advise and assist it as and when appropriate. The Commission is proud of having been the progenitor of the institution that became the GTA, which has made such an outstanding contribution to the provision of education and training in and for the finance sector.

In conclusion I have to express my particular appreciation to Peter Harwood, who retired as the Commission's Chairman at the end of January 2012, for his invaluable support and advice, not only to me personally but to the Commission, and also to David Mallett, our Vice Chairman, whose long experience with the Bank of England and Standard Chartered Bank proved invaluable.

The Commission is nothing without its staff, and whilst regulation is hardly ever popular – let alone appreciated – the financial services sector besides the community at large should extend their thanks to them all for continuing to discharge the burdens of regulation and supervision so ably, efficiently and cheerfully. I am proud of them, and so should be the community.

Nik van Leuven QC, Director General

BANKING DIVISION

The Market

To review supervisory developments in the year 2011 one needs to recall the market and economic context of that year. 2011 was a year of further consolidation in the banking industry but was marked as a year of continuing uncertainty in large part as a result of the unresolved issues in the Eurozone. Those issues and the fact that progress to economic recovery seemed to stall were driven by the need to bail out Greece and the peripheral countries of the Eurozone and the looming doomsday scenario that there might be a breakup of the Eurozone. What we saw was a long-drawn-out process resulting from the failure to arrive at a clear solution, particularly around how much funding was required to stand behind the vulnerable sovereign countries and who would provide it. Debt refinancing, austerity measures and the deepening uncertainty following several ratings agency downgrades of both sovereign countries and key systemic banks in the Eurozone countries meant that progress to economic recovery gradually ran out of steam in the second half of the year so that at the end of the year there was a widespread feeling that several European countries were on the brink of economic recession.

In the markets interbank lending contracted to a minimum – in effect, bankers did not want to lend to each other – as bankers were concerned by the extent of other banks' exposure to the weaker Eurozone countries. The European Banking Authority continued its stress testing of the major banks in Europe and identified several which needed to raise capital in order to bolster their core Tier One capital base.

International Developments

The principal components of the Basel III initiative were confirmed early in the year and gave a time line for the reinforcement of capital bases by the leading internationally active banks, together with the additional measures, leverage ratios, counter cyclical cushions and the introduction of a global liquidity regime. This included a near-term component, the liquidity coverage ratio and the medium-term more structural liquidity measure, the net stable funding ratio. A key element of the liquidity coverage ratio was that large economically important banks should hold a stock of high-powered liquid assets. This is still a subject of discussion with banking industry representatives. From the lessons learned in the banking crisis there were also issued new definitions of what is acceptable as core capital to be available to support losses. In general terms the quality of capital was being significantly tightened to be either equity or convertible securities which transposed into equity on a trigger event. During the year the Basel Committee also set about reviewing the 25 Core Principles which form the basis for the assessment of effectiveness of regulatory regimes in jurisdictions across the world and against which Guernsey was assessed in 2010.

Parallel to the developments around Basel III, the UK's coalition government took a longer-term view of the lessons to be learned from the banking crisis of 2008 and were proactive as to how to address banking resilience in the UK. The Independent Commission on Banking under the chairmanship of Sir John Vickers made its first preliminary findings in April and subsequently made final recommendations in September. Its conclusions were that it would be beneficial to the UK economy in general and to the UK tax payer in particular, if retail banks could be ring-fenced and formally separated from the riskier investment banking arms of their current business. The ring-fencing attributes were defined, certain criteria were set out and the notion of clear separation and separate funding was articulated. There was a further implication that in order not to be a potential burden on UK tax payers the ring-fenced entities should be additionally capitalised so that there were built-in safety cushions in those structures. There is continuing debate about the separate funding of the investment banking elements and the industry response addressed both the extra capital needed and the additional cost that will be incurred from funding the investment banks separately.

From the point of view of the Crown Dependencies an issue was identified which related to the definition of the ring-fenced banks which was focused around the provision of banking services in the European Economic Area ("EEA"). However Guernsey, Jersey and the Isle of Man are not in the EEA, which meant that on the face of it there was no option to be part of the prospectively ring-fenced elements. The Crown Dependencies worked together to make representations to HM Treasury that this oversight should be addressed and sent a delegation to meet the UK authorities in December 2011. Following the initial meeting further statistical material was provided to HM Treasury to assist in their assessment of whether the retail elements of UK banks operating in the Crown Dependencies could be included within the ring-fenced banks. HM Treasury is due to put out a consultation document in the first half of 2012 to receive representations from interested parties.

Supervision

Our supervision of licensed banks consciously involved no new initiatives. The 2011 supervisory programme was a reinforcement of our existing tools of Internal Capital Adequacy Assessment Process ("ICAAP") and Supervisory Review and Evaluation Process ("SREP") reviews of subsidiary banks, on-site reviews and thematic reviews across the whole sector and the restart of the annual branch meeting programme.

Attendance at Colleges of Supervisors is now embedded in our supervisory programme. The Division participated in four Colleges in 2011 in respect of banks from the UK, Netherlands and Cyprus. These help us to understand better the strategy and capital and liquidity strength of parent banks as well as developing our knowledge of intragroup dependencies. Bilateral meetings with home supervisors remain an important feature of our supervision: meetings were organised in 2011 with banking supervisors from the UK, Switzerland, Bermuda, Jersey and the Isle of Man.

Sector Developments (Local)

There was some unfinished business for the subsidiaries of UK banks in respect of the implementation of the UK's robust liquidity regime which had challenged those banks which relied to a heavy extent on upstreaming funds to their parent. The board of Yorkshire Guernsey Limited decided to exit from the Guernsey market because of the adverse impact on them of upstreaming funds to the UK which could only be used to fund the business if they were at maturities beyond 90 days. In May of 2011 the UK authorities, that is, the Bank of England and the Financial Services Authority ("FSA"), jointly issued a significant new document on their approach to the supervision of banks going forward. This effectively changed the ground rules to remove the expectation that all banks and building societies would be bailed out or rescued by the UK tax payer as a matter of course. That document identified certain types of banks which were more likely to be considered for exceptional government support but made the general point that there should be no expectation of support. Only those large banks which were regarded as systemic and which were critical to the support of the UK economy and the UK payments system were singled out for classification in the category most likely to be supported.

The board of Yorkshire Guernsey Limited took the decision in July to organise an orderly wind-down and repayment of depositors of the Guernsey bank to be effected by mid-December 2011. Yorkshire Guernsey Limited surrendered its licence in the final days of the year. Clearly that leaves retail depositors in Guernsey faced with a reduction in the choice of outlets but it was evident that the majority of the local deposits repaid were placed with other banks in the Bailiwick.

After many years of activity in Guernsey the Hong Kong-based joint venture DAH Hambros Limited closed for business in the third quarter: its original use for accommodating securities transactions and specific mortgage lending had fallen away. The bank had not been able to generate sufficient private banking clients from its Asian network to sustain it for the future and the joint venture partners took the view that it was no longer viable.

The name of Close Bank (Guernsey) Limited was lost to the Bailiwick in September. This followed the acquisition of the Close Offshore Group businesses from the Close Brothers Group after the acquisition of the bank by Kleinwort Benson Channel Islands Limited ("KBCI") following their agreed acquisition of several Close companies in Guernsey, Jersey and the Isle of Man. KBCI spent much of the year integrating those former Close offshore businesses into the new KBCI business. Whilst a licence was lost, the business has remained in the Bailiwick and the other islands and the majority of jobs were retained to provide the staffing for the combined entity going forward. After the legal acquisition was completed in the first half of 2011 the Kleinwort's executive team began the challenging task of integrating the two sets of business teams and achieving the synergies that they had identified at the time of making their bid. The Commission continues to work closely with KBCI as it seeks to implement its integration strategy. During the year, the Swiss private banking company Bank Sarasin (CI) Limited surrendered its licence as a subsidiary but effectively transferred its business to a recently opened Guernsey branch of its parent bank, Bank Sarasin and Company Limited.

Anti-Money Laundering/Countering the Financing of Terrorism ("AML/CFT")

The Division continued its programme of AML/CFT on-site review visits assessing the compliance of eight banks with the Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("AML/CFT Handbook"). There were still some banks catching up with the requirements of the AML/CFT Handbook, particularly around existing customers and customer risk profiling. Encouragingly, we did visit several banks where, at the time of the visit and on the basis of the files reviewed, we assessed that there were no contraventions of the AML/CFT Handbook. Our practice evolved over the year so that if there were no contraventions but we wished to make some suggestions about improvements or refinements of practice, these would be delivered orally in the exit meeting. In a few cases these points were carried forward to a prudential letter which outlined the areas, principally risk profiling where the bank personnel could employ a "smarter" approach to the identification of risk.

One of the thematic on-site reviews conducted during the year – on outsourcing and managing outsourcing risk – was also relevant to AML/CFT procedures and practice. We accept that outsourcing is a fundamental feature of the economic business model employed in Guernsey and the other Crown Dependencies because of the access it allows to larger and deeper pools of expertise and resources (usually in other parts of the group) and leads potentially to economies of scale. Nevertheless, responsibility for complying with Guernsey legal obligations cannot be outsourced. This means that the outsourced performance of automated screening of customer names against sanctions lists by entities (albeit group entities) located in overseas jurisdictions must be managed with appropriate safeguards around delivery and service interruption. This is because the service provider itself does not have the legal obligation to uphold Guernsey law and regulations.

The Thematic Report entitled Managing Outsourcing Risk was published in May 2011 and contained many examples of good practice in outsourcing and also practices which could be improved. A key message was that intragroup outsourcing is not inherently less risky than third-party outsourcing: intragroup outsourcing still contains many risk and performance delivery issues which should be addressed head-on. The Report is on the Commission's website.

Enforcement

Enforcement actions taken by the Division were principally channelled through remediation and remedial action requirements, including the use of third-party assurance work conducted by recognised professional firms.

Industry Liaison

The Division held a bespoke workshop on ICAAPs at its new premises on 10 February 2011 which was structured in two parts, with a morning session for non-executive directors of Guernsey-incorporated banks and an afternoon session for bank executives. Presentations were made by risk consultant Edward Sankey and Cooperative Financial Services Group Non-Executive Director Stephen Kingsley. There was a healthy dialogue in the panel discussion led by Ian Kirk. Commissioner Alex Rodger introduced the second session, aimed at Chief Executive Officers and Chief Risk Officers and the panel discussion was led by Bob Moore with Steve Watts, then chairman of the Association of Guernsey Banks ("AGB"), giving the closing remarks.

The Commission held a finance industry-wide seminar at St James on the morning of 18 October 2011. The event had key note speaker Angela Knight, CEO of the British Bankers Association. Common themes of Corporate Governance and AML/CFT were given as cross-divisional presentations, together with a specialist presentation given on enforcement by the Commission's legal counsel. There was a breakout session for banking sector members in the afternoon covering the most relevant topics for licensees. On ICAAP material we gave a "taking stock" presentation on current thinking about practice and methodology, recognising that we had dealt with "first principles" issues in the February workshop. Further presentations were made on upstreaming and large exposures and the findings of the outsourcing thematic review. An overview presentation was also made of the "regulatory horizons" based on our stock of knowledge of the Basel Committee's intentions as at October 2011.

The text of the presentations is available on the Commission's website for the benefit of attendees and those who were not able to be present.

A second thematic review on data security, which is highly relevant to private banks and those engaged in wealth management but also has relevance across the wider finance sector, was conducted in the second half of 2011 using a combination of survey questionnaire input and on-site review material. The findings were made publicly available in the first quarter of 2012.

The Division continues to engage with the AGB. In 2011 this was mainly around technical issues but there was also much bilateral engagement with licensees about Eurozone exposure and contingency preparedness.

Key Objectives for 2012

- Ongoing banking supervision of licensees, including:
  - Further refinement of the ICAAP/SREP programme
  - Continuation of branch prudential visits
  - Delivery of the AML/CFT programme, continuing the three-year cycle
- Continue bilateral meetings with principal home supervisors:
  - FSA; Swiss Financial Market Supervisory Authority; Bermuda Monetary Authority
  - Attend meetings of Group of International Finance Centre Supervisors (formerly the Offshore Group of Banking Supervisors) and International Conference of Banking Supervisors
- Participate in colleges of supervisors
- Reinstate structured reviews of credit books for those banks actively providing credit facilities
- Complete revision of Code of Conduct on Advertising
- Introduce a standard licence condition for Guernsey-incorporated banks requiring them not to repatriate capital or pay dividends without the Commission's prior consent
- Review Large Exposures Policy and reissue guidance
- Continue engagement with industry and government, including regular briefing meetings with the Association of Guernsey Banks, Policy Council and the Commerce and Employment Department
- Monitor developments in the proposals to implement the Recommendations of the UK Independent Commission on Banking, liaising with our counterparts in Jersey and the Isle of Man

FIDUCIARY DIVISION

The Market

2011 saw the continuing theme of looking to emerging markets, notably Russia and China. These new markets represent opportunities for Guernsey but also require a timely reminder of the need to ensure proper policies and procedures are in place. Licensees need to ensure their organisation recognises the risks as well as the benefits from emerging markets. It is important that anti-money laundering/countering the financing of terrorism procedures are comprehensive and care is taken in other areas such as data security. It is equally important to recognise the cultural differences arising from operating in such markets.

The growth of the private equity sector has seen an increase in applications for exemptions for general partners within limited partnership structures. It is anticipated that these will continue to grow and consideration is being given to the issuing of guidance to streamline the exemption application process where appropriate.

The provision of overseas pensions from Guernsey also continued to grow. The most common schemes are those recognised by HM Treasury as Qualifying Recognised Overseas Pension Schemes ("QROPS").

International Developments

The principal issue which affected the fiduciary sector over the last year was the introduction by France of a wealth tax. The industry worked hard to ensure compliance with the new requirements before the year-end. The next challenge to face the sector is the Foreign Account Tax Compliance Act ("FATCA") which is being introduced by the United States government. It is recognised that this legislation will produce a heavy workload to ensure full compliance and which the industry will be looking to work towards once the terms of the guidance are clear.

At the end of 2011 changes to UK tax legislation on QROPS were proposed. As a requirement of the recognition of a new overseas scheme the jurisdiction in which the scheme is established must now treat all its members identically for the purposes of taxation of benefits received. Guernsey moved to amend its tax legislation accordingly. However, in response HM Revenue and Customs withdrew and re-issued its list of approved QROPS, leaving only three schemes on the list. The issues arising from this have yet to be fully resolved.

The UK Bribery Act came into force on 1 July 2011 and licensees need to be mindful of the extraterritorial provisions contained within it in respect of British citizens.

Sector Developments

The introduction of the Retirement Annuity Trust Scheme Rules ("the RATS Rules") on 1 January 2011 was a significant step and their impact is being kept under review. Further, the introduction recognised in particular the nature of these products at a time when the importance of saving for retirement is becoming an ever greater issue. The Commission will also continue to watch the QROPS aspect of the sector closely. It welcomes the publishing by the Guernsey Association of Pension Providers ("GAPP") of a voluntary guidance for regulating QROPS and will keep under review the need to introduce rules, as well as ensuring those providing trustee services to QROPS and RATS schemes are complying fully with their obligation to be licensed. The Commission has met with GAPP in this regard.

Preparations continued for the introduction of Foundations into Guernsey Law. Work is underway in the Division with the Guernsey Association of Trustees ("GAT") and the GTA to ensure that appropriate training is available to those within the sector prior to the law being commenced.

Separately, other meetings have taken place with Guernsey Finance and industry.

Supervision

The Division undertook 37 on-site visits in 2011. Whilst breaches still continue to be identified as part of on-site visits, the Commission is pleased to report that following the issue of the Managed Trust Company Guidance by the Commission at the end of 2009, fewer issues seem to be arising in their ownership and governance compared to those mentioned in previous reports.

Issues of anti-money laundering/countering the financing of terrorism ("AML/CFT") continue to form an important part of the on-site visits conducted by the Division in 2011. Whilst the Division continues to see instances of poor collection of customer due diligence in some instances, it is also encouraged that some on-site visits have produced no AML/CFT issues at all. Indeed 2011 saw the first occasion since the Division began on-site reports that it has not had to take up breaches of the regime with a licensee following a visit.

The last year has seen some confusion within the sectors over the need to hold verification of identity data on beneficiaries "likely to benefit". In 2009 GAT issued guidance as to the circumstances when a trustee could or could not consider a beneficiary "likely to benefit". The guidance is available on the GAT website, and the attention of the finance industry as a whole and in particular the banking sector is drawn to the guidance.

In 2011 the Division completed the integration of the registered businesses to it for the purposes of AML/CFT supervision. These businesses fall into two categories: firstly the non-regulated financial services businesses ("NRFSB") which comprise a diverse cohort stretching from lending companies through to bullion and stamp dealers, money brokers and providers of safe custody, and secondly the prescribed businesses ("PB"), being lawyers, accountants and estate agents.

On-site visits were carried out to 15 registered businesses in 2011 and in the second quarter a questionnaire was issued to all registered businesses in order to gain a better understanding of the AML/CFT risks faced by these sectors. At the Industry Seminar the registered businesses team held its first dedicated session targeted at those businesses for which it has responsibility.

The registered businesses are newer to the requirements of the Handbook for Financial Services Businesses and the Handbook for Legal Professionals, Accountants and Estate Agents, on Countering Financial Crime and Terrorist Financing (the "AML/CFT Handbooks") and the Commission has liaised with the GTA to develop AML/CFT training for NRFSBs and PBs, to compensate for the fact that many registered businesses have limited prior experience of regulation. The first sessions were held in December 2011.

For the first time since 2005 the Division made a specific request for the collation of statistics on assets under trusteeship in relation to the fiduciary sector and in response to the International Monetary Fund recommendations.

The Division commenced an internal project to draw together the statistics that it has available to it. The purpose of this project is to ensure in time the smarter targeting of regulatory resources.

Finally, the Division has continued to work closely with the Corporate Governance Working Party to ensure smooth steps are taken towards the implementation of the Code from 1 January 2012.

Enforcement

Over the years the Division has taken a proactive approach to enforcement and this continued in 2011. Conditions were imposed on one licensee and proactive monitoring of two licensees subject to conditions led to their eventual lifting after the problems identified during earlier on-site investigations were remedied.

With regard to the registered businesses, 15 on-site visits were conducted, three of which resulted in conditions being imposed.

Human Resources

There were significant changes within the Division during 2011. The year started with Neville Johnson, the Deputy Director of Finance and Operations, being appointed Acting Director of Fiduciary Services; the Commission is very grateful to Neville Johnson for having fulfilled this role.

In April 2011 Fiona Crocker was promoted to Deputy Director of the Division, having been an Assistant Director since 2005. The new Director, Philip Nicol-Gent, arrived towards the end of June 2011, having previously been the Director of Civil Litigation at the Law Officers of the Crown. 2011 also saw the departure of Matt Hutchison, an Assistant Director, to work in industry. With two vacancies, two new Assistant Directors were appointed to the Division – David McCloskey, formerly a Senior Analyst within the Investment Business Division, and Paul Evans, who joined the Division from industry.

2011 also saw a structural change to the Division notwithstanding which the process of supervision continued with little interruption. The Intelligence Team moved to come within the Director General's Division and with its departure a new Team joined to oversee the registered businesses. The Team is headed by Rosemary Stevens, a newly appointed Assistant Director. Rosemary is a chartered accountant who has worked in private practice, the finance sector and at the Guernsey Financial Investigation Unit, and she is supported by Rosanna Hendry, a Senior Analyst who has been involved with this sector since its inception.

Key Objectives for 2012

- Produce a Code for Foundation Services Providers.
- Ensure the sector has access to appropriate training on Foundations.
- Review the applications process, especially those for exemptions.
- Monitor and respond as necessary to developments in the legislative framework for QROPS.
- Improve the statistical base for supervision.
- Re-engage with other regulators of fiduciary business, especially those in Jersey, the Isle of Man and Gibraltar.
- Continue and develop engagement with industry.

INSURANCE DIVISION

The Market

Losses of US$350–380 billion from disasters such as the Japanese tsunami and the New Zealand earthquakes, together with persistently record low interest rates, the pre-implementation costs of Solvency II and the continuation of the euro crisis made 2011 a challenging year for the insurance industry.

Nevertheless, in comparative terms, the Guernsey insurance sector was less affected by these global developments due to the conservative profile of the captive sector, the limited nature of the re-insurance market in Guernsey, and the fact that the Guernsey insurance sector is more UK than Eurozone-focused.

In 2011, the local market remained relatively stable in terms of licences. In 2011, there were 11 licensed domestic insurers compared to 13 in 2010, 39 licensed insurance intermediaries compared to 38 in 2010, and 19 authorised managers compared to 20 in 2010.

In 2011 the number of international licences grew slightly to 687 from 675 in 2010.

Total licence numbers and monthly trends by licence types are set out in Figure 9 on page 58:

A minor theme has been a fall in the number of companies – to 255 in 2011 from 265 in 2010 – compared to a rise in the number of protected cell company ("PCC") cells to 267 in 2011 from 252 in 2010. This reflects the attractiveness of the PCC structure.

Despite relative stability in the total licence number, 60 licences were surrendered and 72 granted, as illustrated in Figures 10 and 11 on page 58. This is normal but shows the degree of licence activity in the sector in response to business demands.

In 2011, the Commission subjected past business statistics to rigorous review, linking them to annual inflation and correcting previous errors. The results are set out in Figures 12–14 on pages 58–59.

It can be seen that business in nominal terms rose in all areas in 2011. However, in terms of the inflation-linked figures, premium levels continue to be relatively flat, reflecting the continued soft market in the global insurance industry.

Detailed business activity remained largely unchanged in 2011. The captive market remains the most significant in Guernsey, although the non-captive industry also remains important. As Figure 15 on page 59 shows, almost two-thirds of new licences were for UK-based firms, reflecting the UK nature of the Guernsey captive market. Innovation by new licensees continues, especially in the re-insurance sector.

In 2011, eight candidates qualified for the Guernsey Insurance Certificate, reflecting the fact that new entrants to this sector are limited in number.

International Developments

Global insurance standards continued to develop in 2011, with considerable activity at the International Association of Insurance Supervisors ("IAIS") and also in the European Union. International insurance supervisors also considered the potential impact of adverse macro-economic developments on the global insurance market.

In 2011, the Commission rationalised its activities with IAIS so as to concentrate in particular on solvency and captive issues and attendance at the Technical Committee. The Commission visited four overseas regulatory bodies, one of which involved participation in a regulatory college.

The Commission attended three meetings of the Offshore Group of Insurance Supervisors ("OGIS"), and continued to contribute generally to OGIS activities.

The Commission continued in 2011 to take forward residual measures arising from the 2010 International Monetary Fund visit. This included, for example, consideration of issues such as group supervision and insolvency wind-up requirements. In October 2011, IAIS agreed a new set of Insurance Core Principles and by end-year the Commission had completed an initial gap analysis so as to enable gap fill to take place in 2012–2013.

In January 2011, the Commission and the Department of Commerce and Employment issued a public statement on Guernsey's approach to Solvency II equivalence. This statement said that Guernsey was not seeking equivalence but would monitor developments closely.

Supervision

The Commission continues to stay in close touch with industry developments, not least through regular meetings with the local insurance and insurance intermediary trade bodies, as well as periodic meetings with individual insurance managers. The main areas of consideration were the strategic approach to the IAIS Insurance Core Principles and Guernsey's approach to Solvency II equivalence.

In 2011, the Commission completed 23 on-site visits, covering a spectrum of licensees. The main thematic finding of these visits was that several firms paid insufficient attention to the maintenance of appropriate records and documentation. Appropriate action was taken by the Commission in these cases, including the requirement to put in place remedial action plans.

During its on-site visits, the Commission also noted several thematic gaps in anti-money laundering/countering the financing of terrorism compliance. These included, for example, weak business risk assessments. In these cases, firms were required to take appropriate remedial action by the Commission.

The Commission held numerous bilateral meetings with firms to discuss regulatory issues. These meetings covered a wide range of issues, relating to both solvency and more general qualitative issues.

Apart from individual meetings with licensees, the Commission met several local Non-Executive Directors as part of the process for putting together a paper on the use of Own Solvency Capital Assessments ("OSCAs"). This paper recorded the various approaches taken by insurance firms in determining their own respective solvency assessments.

The Commission required 28 firms to stress-test their solvency position, using a combination of pre-determined scenarios set out by the Commission and reverse stress-testing. The consequent papers on both OSCAs and stress-testing, together with a paper on actuarial standards, are all published on the Commission's website.

In order to determine its eventual advice to government on whether in Guernsey to adopt the UK's policy set out in the UK Financial Services Authority's Retail Distribution Review ("RDR"), the Commission liaised closely with, among others, local insurance intermediaries. The Commission will submit its advice in 2012.

The Commission continues to play a part in policing the insurance intermediary perimeter. In 2011, the Insurance Division investigated two allegations of persons acting as an insurance intermediary without a licence. No further action was taken in either case.

As part of the Commission's commitment to transparency, in 2011 the Division outlined the implementation of its business plan during the October 2011 industry-wide seminar. It also published several feed-back papers and enhanced published statistics relating to the insurance sector.

In 2011, the Insurance Division concluded director disqualification proceedings against one individual for providing false and misleading information to the Commission and allowing a company to undertake insurance business without a licence. The Insurance Division has also commenced director disqualification proceedings against another individual who was recently convicted of money laundering offences.

In 2011, there were several staff changes that included the appointment of a new Director and Deputy Director. The Division consists of 18 full-time employees.

In 2010, the Commission committed to continue to support the strengthening of corporate governance standards, meet international standards and maintain on-site visits. The issuance of the new Commission-wide corporate governance code, adherence to the Insurance Core Principles and the completion of the on-site programme meant that the Commission met these objectives.

Key Objectives for 2012

These are:

- To focus more on proactive supervision.
- To define the Commission's response to new international regulations.
- To play a full and active part in the continuing transformation of the Commission resulting from the Review referred to in the Chairman's statement.
- To improve the statistical base for supervision.

INVESTMENT BUSINESS DIVISION

The Market

Global economic conditions, including the ongoing problems within the Eurozone, continued to have an effect upon the Guernsey investment business sector during 2011. Global stock markets saw significant volatility during the course of the year which had an impact on listed investment valuations, albeit there were examples of gains as well as losses. Overall market confidence was generally low and, even when it did begin to show signs of improvement, this experience was not consistent across the sector, rather it was limited to individual firms or groups of firms. There continued to be lack of liquidity in the investment sector and new product offerings were generally on a par with the past couple of years.

This background obviously had an impact on the levels of new business considered by the Commission. Sixty-four new licences to conduct controlled investment business were issued during the year (2010: 48) whilst in the investment fund sector 19 open-ended and 75 closed-ended collective investment schemes were either authorised or registered (2010: 27 and 62 respectively). A total of 125 new classes of existing open-ended collective investment schemes were approved (2010: 131) and finally, 44 approvals for the provision of specific services to non-Guernsey schemes were issued (2010: 106).

The various sectors within the overall investment fund community experienced varying fortunes in terms of valuations. In the open-ended sector the net asset value of Guernsey- regulated funds fell over the course of the year from £57.9 billion to £55.3 billion, a decrease of 4.5%. Net new investment into that sector over the year was £5.2 billion, which means that market movements, including foreign exchange fluctuations, resulted in losses of approximately £7.8 billion. In the closed-ended sector the net asset value of Guernsey-regulated funds increased from £109.5 billion at 1 January to £119.1 billion at 31 December 2011, an increase of 8.8%. This apparently inconsistent performance is probably not unexpected when you consider that the valuation of a significant number of assets within closed-ended structures is not necessarily directly correlated to stock market performance, especially in the private equity arena and vehicles investing in physical assets such as real property. Overall, the net asset value of Guernsey-regulated investment funds rose by some £7 billion to end the year at £174.4 billion, an increase of 4.7%. The value of non-Guernsey open-ended collective investment schemes serviced from Guernsey fell by £3.0 billion to finish the year at £87 billion, a decrease of 3.3%.

The values of assets in the non-fund sector, covering asset managers and stockbrokers, as at 31 December 2011 were £87.3 billion, an increase of £11.8 billion over the year.

International Developments

As reported last year, the International Organization of Securities Commissions ("IOSCO") had previously carried out work, against the background of the international economic crisis, resulting in the introduction of eight new Principles of Securities Regulation, bringing the total to 38. The Principles set out a broad general framework for the regulation of securities, which in the Guernsey context includes investment funds and all licensees under the Protection of Investors legislative framework. The IOSCO Principles are one of the important standards and codes highlighted by the Financial Stability Board as key to sound financial systems. During 2011 IOSCO worked on a revised methodology to support the 38 Principles and this was completed in late 2011. During the first half of 2012 the Commission will update its own self-assessment in terms of the Bailiwick's compliance with the Principles and will identify the possible remedial action that may be required if significant deficiencies are identified. This may necessitate amendments to the Protection of Investors Law and the underlying rules and regulations, with any such proposals obviously being subject to full public consultation.

Developments within, and emanating from, the European Union ("EU") continued to require a large amount of attention from the Investment Business Division throughout 2011. The Alternative Investment Fund Managers Directive ("AIFMD") remained of particular interest, not just to the Commission but also to the States and the local investment fund sector, and this is likely to continue. The Directive came into force in July 2011, meaning that each Member State is now required to transpose the AIFMD into national law by July 2013.

The European Securities and Markets Authority ("ESMA") issued two consultations during 2011 covering the Directive and the Commission responded to the second consultation that specifically referred to issues relating to third countries. ESMA's initial draft advice on third country arrangements was considered by many to be unworkable, due in particular to equivalence and enforcement requirements. ESMA's final advice to the European Commission is less prescriptive and provides a framework for more workable third country cooperation agreements. However, the current provisions still need to be clarified to ensure consistent treatment by all regulatory authorities. The European Commission is expected to publish the regulations emanating from this advice during the middle of 2012.

On 20 October 2011 the European Commission tabled proposals to revise the Markets in Financial Instruments Directive ("MiFID"). The proposals cover a range of issues but of most interest to the Commission are those relating to third country access to the EU. Currently the access of third country firms to the EU markets is not harmonised under MiFID. Each Member State can introduce its own third country regime, subject to the general principles of the Treaty on the Functioning of the European Union and provided that national provisions do not result in treatment more favourable than that given to EU firms. In order to overcome the existing fragmentation and to ensure a level playing field in the EU for third country players, the European Commission proposes to introduce a harmonised third country equivalence regime in MiFID for the access of third country investment firms and market operators to the EU.

In effect, third country firms wishing to provide investment services or activities with ancillary services to EU retail clients will need to establish a branch in the EU. Third country investment firms seeking to provide services to professional and eligible counterparties will not have to establish a branch in the Member State, rather they will need to be registered with ESMA prior to their offering services. Overarching this is the requirement that the third country (in which the firm is domiciled) regulatory regime should have been subject to some form of assessment in terms of equivalence with the relevant EU regulation. The Commission will continue to keep abreast of developments and will work with the States and industry in considering what measures might be required to enable Guernsey-regulated firms to operate under any new European regime.

In light of the number, and nature, of regulatory directives and regulations being released or considered by the European Union bodies, it is expected that this area will continue to require close attention during 2012 and beyond, specifically as they apply to third countries such as the Bailiwick of Guernsey.

Senior staff of the Investment Business Division have participated in various meetings and conferences of regulatory authorities and organisations during 2011 in order to meet with regulatory counterparts and understand better initiatives and developments that impact, or might impact, the Commission's scope and nature of regulation. Meetings attended included the Annual Meeting of IOSCO, the European Regional Committee of IOSCO, the Enlarged Contact Group of Collective Investment Schemes Supervisors and the United States Securities and Exchange Commission's International Supervisory and Enforcement Program.

Liaison meetings, covering matters of mutual concern and interest, have also specifically been held with regulators including the Jersey Financial Services Commission and the United Kingdom Financial Services Authority ("FSA"). The Director of Investment Business also attended meetings and presentations in Brussels and Paris connected with the AIFMD initiatives, which were variously attended by ESMA, the European Commission, European national securities regulators as well as individual firms and trade associations with an interest in those developments.

Supervision

The Investment Business Division's main regulatory activities are undertaken by functional teams, being: (1) desk-based monitoring, covering routine and ad hoc submissions from regulated firms and collective investment schemes including notifications, pricing errors, rule breaches and complaints; (2) on-site visits, undertaking visits to licensees to review their compliance with regulatory obligations as well as desk top reviews of information provided by licensees in response to Commission requests for information; and (3) applications for new business, including new licences together with collective investment schemes' authorisations and registrations.

As would be expected, the desk-based monitoring function saw considerable activity over the course of 2011 as licensees and collective investment schemes reacted to the wider global economic conditions. A large number of changes were made to existing structures, including various parties to licensees and funds, changes to investment objectives, and in some cases, the closure or winding up of investment structures that were no longer deemed economic or able to achieve the investment aims for which they were established. Desk-based monitoring is one of the primary methods by which the Investment Business Division can become aware of potential or actual concerns relating to regulated firms and/or products and the function is not simply limited to the processing and administration of regulatory submissions.

Another method of identifying or confirming potential or actual concerns of a regulatory nature is that of on-site visits to licensees, covering their operation and activities within the scope of the applicable regulatory regime. During the year a total of 22 visits were conducted, including five undertaken jointly with other divisions. The visits undertaken by the Investment Business Division covered not only the directly licensed firms but 185 administered licensees, 476 regulated collective investment schemes and 51 non-Guernsey schemes. Matters identified during these visits are reported to the licensee's senior management and will be considered for possible enforcement action. Enforcement issues are covered in the relevant section below.

Anti-money laundering and countering the financing of terrorism ("AML/CFT") issues form a significant part of the division's on-site visit process and are undertaken either as part of a full-scope on-site visit or as a stand-alone visit focusing solely on specific AML/CFT matters. As noted below, under Enforcement, where deficiencies have been identified which are considered to be of sufficient concern, proportionate enforcement action is undertaken. In addition, the division, working with colleagues in the Commission's Policy and International Affairs team, has responded to numerous questions and queries in relation to various aspects of the AML/CFT regime.

2011 was a challenging year for the Investment Business Division, taking account of the changing global environment, the increased focus on international regulatory developments, including those emanating from the EU together with involvement in a number of initiatives impacting all of the Commission and which are covered elsewhere in this Annual Report, including the Independent Evaluation Review, the implementation of updated Commission-wide enforcement policies and procedures and the Commission's Code of Corporate Governance for the finance sector.

A workstream that had commenced late in 2010 made progress during 2011. A Working Party, consisting of staff of the Commission's Investment Business Division and representatives of the Guernsey investment fund sector, was established to review the existing rules covering Class B open-ended collective investment schemes to consider what amendments might be required in the light of current experience and taking account of similar rules implemented or revised by the Commission over the past five years. Class B open-ended collective investment schemes form the majority of the open-ended fund sector within the Bailiwick and this was the first substantive review of the rules undertaken since their introduction. The working party was able to progress this consideration and, although it was not possible to issue draft proposed rules for consultation before the end of 2011, consultation commenced in February 2012.

The Investment Business Division, together with the Commission's Insurance Division, kept under review the developments regarding the United Kingdom Financial Services Authority's Retail Distribution Review ("RDR"), which is a key part of their consumer protection strategy.

Staff of the Investment Business Division kept in contact with industry over the course of 2011. Individual bilateral meetings between the Commission and firms are a regular feature of the Investment Business Division's supervisory activities, and covered routine regulatory matters, issues of interest and/or concern as well as introductions to new senior management or members of group operations with a remit covering the Bailiwick. Regular meetings were held between members of the division's senior management team and the senior personnel representing the two investment sector trade bodies, being the Guernsey Investment Funds Association and the Guernsey Investment Managers and Stockbrokers Association. These meetings provided good opportunities to communicate and discuss current and future initiatives and issues arising from the Commission's activities.

Enforcement

As indicated in the Supervision section above, matters identified during on-site visits will be reported to the subject licensee's senior management at the conclusion of the visit and will be considered in terms of whether any enforcement action is considered necessary. That consideration will include, inter alia, the nature, scope and extent of any breaches together with the licensee's previous compliance history and whether the issues have already been identified and steps taken to remediate before the Commission became aware.

As has been previously reported by the Investment Business Division, the most common form of action taken in such circumstances has tended to be the imposition of conditions on the licensee involved. The imposition of conditions is subject to the normal safeguards provided for in the Protection of Investors Law and licensees are fully entitled to contest and appeal to the Courts in respect of any proposal to impose a licence condition. At the start of 2011, seven licensees had conditions imposed on their individual licences with their agreement. During the course of the year four new sets of agreed conditions were imposed on licensees whilst five sets were removed. Therefore, as at 31 December 2011, six licensees had conditions imposed on their licences.

In terms of the new conditions imposed during 2011, three of the cases resulted from failures to meet the relevant requirements of the AML/CFT Handbook. In these cases remedial action was required of the licensees concerned to ensure that the failures were addressed on a timely and complete basis. In the other case the licensee concerned had not met the due diligence requirements expected of firms submitting applications for Qualifying Investor Funds or Registered Funds, both of which require licensees to provide warranties to the Commission confirming that they have undertaken certain minimum due diligence on the relevant parties to the subject fund. This allows the Commission to undertake to process the application within a limited time frame. The imposed condition has resulted in the licensee concerned having to submit additional information to the Commission with the application so that the Commission can assess the level and nature of the due diligence undertaken. The time allowed for the Commission's consideration is increased to allow a more detailed review of this material than would normally be the case under the "fast track" regimes. To date, licensees who have experienced this condition have amended their processes and procedures such that no licensee has yet been totally excluded from the regime.

During the course of the year divisional staff were involved in the implementation of revised enforcement processes and procedures for the Commission. The division has been working with the Commission's Legal Counsel on various matters that required consideration of possible enforcement action, including the late submission of financial statements and breaches of financial resources requirements and other regulatory obligations. The conclusions of those matters have been communicated to the licensees concerned. Divisional staff have also been working on a number of cases that have required significant input due to the nature and complexity of the issues under consideration. Any investigations undertaken by the Commission are confidential and covered by legal provisions. Whilst it is acknowledged that it can be frustrating for affected parties, for example individuals complaining about a licensee or a licensee in dispute with another, not to know what action the Commission is undertaking, it is not possible for the Commission to breach these confidentiality provisions, neither would it wish to undertake investigations of this nature in the public domain.

Human Resources

At the start of 2011 the Investment Business Division had a complement of 29 staff (27 full-time equivalents ("FTEs")). Various staff movements occurred during the year, including the promotion of the previous Deputy Director to Director and the promotion of two former Assistant Directors, to Deputy Directors, as well as the promotion of two former senior analysts to Assistant Directors. Over the course of the year four staff left the division whilst five were recruited, so that at the end of 2011 there were 30 staff (28 FTEs).

Key Objectives for 2012

These are;

- Implement revised Class B Rules during the first half of 2012, having undertaken a public consultation process and provided detailed feedback as part of that process.
- Conduct self-assessments against the updated IOSCO Principles of Securities Regulation and consider the action required, including the extent and nature of any changes to legislation or underlying rules and regulations.
- Continue to engage with European authorities, including the European Securities and Markets Authority, the UK FSA (and successor body) and other European national regulatory authorities in respect of the Alternative Investment Fund Managers to consider the nature of any changes required in Guernsey's regulatory framework, including the access of Guernsey investment funds for marketing to EU-resident investors.
- Continue to prioritise on-site visits undertaken by the Investment Business Division using a risk-based approach and increasing the focus on risk-based supervision more generally.

POLICY AND INTERNATIONAL AFFAIRS DIVISION

General

The Policy and International Affairs team has responsibility for coordinating many of the local and international policy issues facing the Commission, including changes to legislation. The team also has responsibility for the Commission's policies on the anti-money laundering/countering the financing of terrorism ("AML/CFT") framework, including the AML/CFT Handbooks. Together with the Director General, the Policy and International Affairs team is the Commission's main link with the Policy Council and the Procurer's (Attorney General's) Office on policy matters. It is also the main link with certain international bodies, including the International Monetary Fund ("IMF"). In addition, the team coordinates a number of cross-divisional matters such as legislation.

Cooperation, Coordination and Feedback

The AML/CFT Advisory Committee met three times in 2011. The committee is a forum for closer coordination at a strategic level between the Attorney General's Office, the Commission (including the Director of Policy and International Affairs), the Guernsey Border Agency (including the Financial Intelligence Service ("FIS")), Police, Income Tax, the Guernsey Company Registry and the Alderney Gambling Control Commission ("AGCC") in the prevention, detection, investigation and prosecution of money laundering and terrorist financing.

The Financial Crime Group (which includes the Commission's Deputy Director of Intelligence Services) reports to the Advisory Committee. Its objectives are primarily to discuss the implications for policy and practice of particular cases of interest and to provide practical assistance to interested parties. The group met four times in 2011. The Terrorist Finance Team, which was established by the group to coordinate action and responsibilities relating to terrorism matters, met twice in 2011.

In 2010 a new Sanctions Committee was established. This committee reports to the External Relations Group of the Policy Council and the AML/CFT Advisory Committee. It comprises representatives of the Policy Council, the Law Officers' Chambers, the AGCC, the Guernsey Border Agency and the Commission, and replaces the informal network of these organisations which had previously liaised on sanctions matters. The committee, chaired by the Director of Policy and International Affairs, and on which the Deputy Director of Intelligence Services sits as a member, met twice in 2011.

An anti-bribery and corruption committee was also formed towards the end of 2010. This committee reports to the AML/CFT Advisory Committee. The Director of Policy and International Affairs represents the Commission on the committee, which met twice in 2011.

The new committees respond to the increasing global focus on sanctions, bribery and corruption.

AML/CFT Developments and Initiatives

In 2011 the Commission undertook 94 on-site inspections of institutions' AML/CFT frameworks. Sanctions were also issued by the Commission in respect of AML/CFT failings of some licensees.

The Commission maintained its programme of enhancements to the AML/CFT framework to seek to ensure the Bailiwick continues to meet the Financial Action Task Force ("FATF") Recommendations and Special Recommendations. In 2011 the Commission issued four further instructions in respect of business from sensitive sources. Three of these instructions required financial services businesses and prescribed businesses in Guernsey to undertake enhanced customer due diligence measures and to pay special attention to business or transactions from countries or territories specified in the instructions. The fourth instruction resulted from the FATF's particular concern about Iran's failure to address the risk of terrorist financing. It required financial services businesses and prescribed businesses to advise the Commission of any business relationships and transactions with any Iranian banks, including their branches and subsidiaries, or the Central Bank of Iran.

Some modifications were made to the AML/CFT Handbooks during 2011. In July, the AML/CFT Handbooks were amended to take account of the Disclosure (Bailiwick of Guernsey) (Amendment) Regulations, 2011 and the Terrorism and Crime (Amendment) Regulations, 2011, which provided for the electronic reporting of suspicion. In August, appendix C to the AML/CFT Handbooks was revised to add Bulgaria, Estonia, Latvia, Lithuania and Liechtenstein as jurisdictions whose financial services businesses and, in certain cases, prescribed businesses may be treated as if they were local.

Other Developments in 2011

The major objective for the Policy and International Affairs team in 2011 was to issue the Finance Sector Code of Corporate Governance. The Code had been the subject of consultation with the finance sector in 2010. A revised draft was issued for consultation in April 2011. Following consideration of feedback by industry, the final version of the Code was published in September. Financial services businesses subject to the Code had a transitional period until 1 January 2012, at which time the Code came into force. The Commission expects the companies subject to the Code to conduct self-assessments of compliance with it. Early in 2012 the Commission's supervisory Divisions commenced discussion with industry on the language of the assurance statement to be provided by firms, confirming that they meet the Code within the context of the scale, nature and complexity of their businesses.

The Division is responsible for coordinating the signing of cooperation and information exchange agreements, such as Memoranda of Understanding ("MoUs") between the Commission and overseas supervisory bodies. In 2011 the Commission signed two MoUs, one with the Federal Financial Supervisory Authority of Germany ("BaFin") and the other with the Polish Financial Supervision Authority. In November the Commission signed a Statement of Cooperation with the China Banking Regulatory Commission. Effective cooperation and information exchange are attracting increasing global focus. It will be important to continue to ensure that the Commission pays close attention to this area of activity.

Two significant legal projects began in 2011. The first of these was to take forward a consistent and enhanced legal framework for the issue of sanctions by the Commission. The second was to progress the consolidation of the main supervisory legislation. Consultation proposals on sanctions were prepared to the extent that they could be finalised shortly after the issue of the Review report. Following the completion of that report it has been decided that the two projects should be merged and the proposals on sanctions will now be included within the consolidation exercise. Sanctions provisions will form an integral part of the consolidation law. The provisions to do with controllers, directors and managers of licensees in terms of the notification requirements and the Commission's powers in respect of them were also close to finalisation by the end of 2011.

None of the IMF's recommendations in its evaluation reports on Guernsey was substantial. The most important AML/CFT recommendation to be addressed was to increase the frequency of AML/CFT on-site inspections to fiduciaries. This was achieved by the Fiduciary Services Division undertaking 37 inspections in 2011. With reference to insurance supervision, the IMF's recommendation that policy holders should have first priority in a winding up is dependent on the proposed new insolvency law that is to be taken forward by the States Commerce and Employment Department.

The Policy and International Affairs team also began work on refining the Commission's approach to risk. The changing international standards of the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organization of Securities Commissions will require enhanced approaches to risk both at the level of the licensee and at the level of macro prudential supervision. This work was commenced in 2011 with the aim of adopting the new approach in 2013.

International Work

The Policy and International Affairs team monitors developments by the FATF, by attending the three plenaries held each year. During the year the FATF continued a review of its Recommendations and Special Recommendations. The Director and Deputy Director participated in the two main working groups taking forward this work.

The Director is Chair of the International Association of Insurance Supervisors ("IAIS") Supervisory Cooperation Subcommittee and the Multilateral Memorandum of Understanding Signatories Working Group. These groups meet by teleconference and in the margins of the IAIS triannual meetings. During the year the Director chaired an IAIS working group reviewing adherence by IAIS members with the Insurance Core Principles on cooperation and information exchange. The working group's report was issued in early 2012.

IMF Surveys

The Commission provides statistics from Guernsey financial institutions to the IMF for its Coordinated Portfolio Investment Survey on an annual basis. Each year, institutions are asked to provide cross-border statistics in respect of Guernsey banks, open and closed-end collective investment funds, insurers, insurance intermediaries/brokers and special-purpose vehicles. The statistics for 2010 were obtained in respect of 104 institutions, representing 1,119 entities. Table 7 on page 64 provides a summary of the results for 2010.

The total value of assets reported for Guernsey financial institutions as at 31 December 2010 was US$225.7 billion, an increase of US$32.6 billion over the assets reported in the 2009 survey. Figure 25 on page 64 shows the results from Guernsey institutions over the last four years. By the end of 2010 the total assets held by investment funds were, at US$172.1 billion, nearly back to the level of US$184.0 billion seen in 2007.

During 2011 the Commission participated for the seventh time in the IMF's information dissemination and monitoring framework initiative. The information provided helps to improve transparency in the activities of finance centres around the world and aids the IMF and policymakers in the major countries in formulating a view as to the size, type and global impact of individual finance centres. Participating jurisdictions provide the IMF with statistics relating to banks, insurers, collective investment funds and company and trust service providers, together with high-level data for the finance sector and the jurisdiction as a whole.

Key Objectives for 2012

- Finalise and issue a consultation paper on consolidation of the main supervisory legislation.
- Update and pilot enhanced Commission-wide approaches to risk-profiling licensees and macro-prudential risk.
- Coordinate the Commission's responses to international regulatory and supervisory standards as they evolve.
- Plan, coordinate and oversee the Commission's relationships with international authorities and bodies.

FINANCE AND OPERATIONS DIVISION

General

The Division is responsible for the provision of key support services to the Commission, covering financial and management information, communication and information systems, human resources, facilities management and general administration.

Financial Information

The financial statements are shown on pages 39 to 51.

The overall surplus for the year 2011 is £1,643,645 compared to the surplus in 2010 of £916,224. This improved result is primarily due to a one-time net gain of £540,568 arising from a transfer of pension liabilities for staff previously seconded to the GTA University Centre, but also combines an increase in fee revenue and increases in direct costs and, largely as a result of legal and professional expenses, common costs. Income and expenses by sector are set out in Table 8 on page 65.

Salary and related costs for the year, excluding the pension liabilities transfer referred to above, were £7,917,626 compared to £7,671,235 (3.2%) in 2010. An analysis of this figure is provided in Table 9 on page 65, and an analysis of the number of staff in each salary band is shown in Table 10 on page 65.

The increase in common costs in 2011 reflects, in part, the expenses associated with the Review, which is described elsewhere in this report. The Review had been completed and had advanced to the implementation phase by the end of 2011, with costs incurred of £437,000. Costs associated with investigative and enforcement activity increased in 2011 to £308,000 from £104,000. Staff costs were overall approximately 4% lower than in the previous year. Overall, expenses for the year ended 31 December 2011 were 4.9% higher than in 2010.

The Commission faces a further period of cost in 2012 and possibly beyond as the recommendations of the Review are implemented, though the financial impact cannot yet be established.

A breakdown of Commissioners' fees is shown in Table 11 on page 65; the increase in late 2011 reflects a review of the Commissioner roles and responsibilities.

The deficit in the pension scheme at December 2011 reported under Financial Reporting Standard 17 ("FRS17") is £7,577,179, an increase of £3,032,916 compared to 2010, reflecting a lower discount rate used to present-value the future liabilities of the scheme and the actual investment return for the year being lower than expected. As this valuation is a point-in-time calculation, it can be expected to vary from year to year, without prejudicing the scheme's long-term ability to provide the required benefits. The scheme's actuary carried out a full actuarial valuation of the scheme as at 31 December 2010, for funding calculation purposes, which showed a funding surplus of £1,145,000. We have also requested the scheme actuary prepare an estimated funding valuation as at 31 December 2011, which showed a shortfall of £529,000, a figure well below that disclosed by the FRS17 valuation of £7,577,179.

FRS17 includes the following requirements:

Pension scheme assets are to be measured using market values.

Pension scheme liabilities are to be discounted at an AA corporate bond rate.

The pension scheme surplus (to the extent it can be recovered) or deficit is recognised in full on the balance sheet in the accounts of the sponsoring employer.

There are extensive disclosures required under FRS17 which are intended to be an aid in comparing pensions costs and liabilities between companies. FRS17 is prepared for accounting purposes whereas an actuarial valuation is carried out to compare the value of the scheme's assets, with a funding target which calculates the value of the benefits that will be paid from the scheme in the future using information about the scheme at the valuation date.

The basis of preparing FRS17 is very prescriptive and, whilst many of the assumptions used are the same as or very similar to those used in the actuarial valuation, there is a major variance in the key assumption of discount rate which makes a substantial difference in the calculation of liabilities and the resultant net funding position of the scheme.

Defined benefit pension scheme

The defined benefit pension scheme is part of the States of Guernsey Superannuation Fund (the "Fund"). The decision was made in 2007 that the Commission could no longer accept the ongoing uncertainties associated with all defined benefit schemes which arise from the increasing levels of life expectancy and the varying investment performance of the funds. It therefore adopted a new defined contribution scheme for staff joining from 1 January 2008 onwards. Those staff who were already members of the defined benefit scheme at that date continue to be eligible for membership of that scheme, although the terms of the scheme are

Financial Information *(continued)*

currently under review by a working party recently established by the States, but under the present arrangements the need remains for proper resourcing. The States has confirmed that in the final resort the claims of the Commission's pensioners and employees would be met from the whole Fund and any shortfall in the scheme would then be met by the States from general revenue.

Fees

When setting fees for 2012, the Commission was conscious of the substantial fee increases in 2010 and 2011 and the Commission's stronger financial position as a result. It also recognised the partial success it had achieved in rebalancing fees between sectors, to the extent that by the end of 2011 only one sector was in deficit on an absorbed costs basis. In view of these factors, fees have largely remained unchanged for 2012, though an extra fee band was inserted below the uppermost annual fee income band for full fiduciary licences.

GTA University Centre (GTA)

The Commission has continued its relationship with the GTA. It contributed £440,000 in 2011 and has committed to provide funding at the same level in 2012. This will be the final year of the subsidy as the Commission believes that the provision of funding for an external training institution is no longer a core function of a financial services regulator, particularly as its funding of the GTA cannot be isolated for finance sector training.

Fee Legislation

The fees regulations for the banking, fiduciary, insurance and investment sectors were revised with effect from 1 January 2011.

A list of the current regulations prescribing fees payable to the Commission is included below:

- The Financial Services Commission (Fees) Regulations, 2011
- The Protected Cell Companies and Incorporated Cell Companies (Fees for Insurers) Regulations, 2010
- The Criminal Justice (Proceeds of Crime) (Legal Professionals, Accountants and Estate Agents) (Bailiwick of Guernsey) (Amendment) (No.3) Regulations, 2010
- The Registration of Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) (Fees) Regulations, 2010
- The Amalgamation and Migration of Companies (Fees Payable to the Guernsey Financial Services Commission) Regulations, 2010

Copies of the fees regulations and a summary of the fees payable are available on the Commission's website at www.gfsc.gg.

Communications and Information Systems

Information systems remain critical to the efficiency of the Commission's operation and during 2011 further enhancements were made to our central regulatory database and its integration with other Commission systems continued, including:

- New functionality to generate penalty fee invoices automatically and to centralise records for the assessment of money laundering/financing of terrorism risks across all licensees and registered businesses
- Further enhancements to our correspondence-tracking systems.

We installed a telephone recording system for the better efficiency and effectiveness of the Commission, and as the security and protection of our information remain key elements in the development and enhancement of our systems, we instructed an independent contractor to conduct security and penetration tests against our network infrastructure and our website.

We commenced an integrated regulatory reporting system project with a view to providing a secure method for the submission of licensee data to the Commission, and its automated validation and processing. We held meetings with relevant industry bodies seeking their input to the project as representative of one of the key stakeholders and primary users of the system once implemented. We have identified and appointed an external project manager to provide dedicated resource to control the project.

Human Resources

The Commission is keen to support the staff in continuing professional development and training. Internal training has increased considerably over the last year and more training is planned for 2012.

2011 saw a change in senior management with Carl Rosumek being appointed to Director of Investment Business and Jeremy Quick to Director of Insurance in the first quarter of 2011. Philip Nicol-Gent joined the Commission as Director of Fiduciary Services in the second quarter of 2011.

Emma Bailey and Louise Bougourd were appointed to Deputy Directors of Investment Business, Audrey Branch to Deputy Director of Banking, Caroline Bradley to Deputy Director of Insurance and Fiona Crocker to Deputy Director of Fiduciary Services in the second quarter of 2011.

Neville Johnson was appointed Acting Director of Finance and Operations in advance of the retirement of Neville Roberts in April 2012.

Commissioners

In February 2011 Peter Harwood was re-elected as Chairman for a further term of one year and retired from his role at the end of January 2012. Cees Schrauwers was elected as Chairman with effect from February 2012. David Mallett resigned from his role of Vice Chair at the end of October but remained an ordinary Commissioner until he retired at the end of January. Susie Farnon was appointed Vice Chair in November 2011.

Facilities Management

The lease on Le Marchant House expired in December 2011 and we have now located our business continuity recovery site from those offices to a dedicated area at a service provider's premises in Pitronnerie Road. This will provide the Commission with a long-term business recovery solution.

We conducted a successful advanced business continuity desktop exercise in May 2011 which focused on the content and structure of our plan, ensuring it remains effective and adaptable.

Key Objectives for 2012

- Prepare licensee data for the commencement of the first phase of electronic document submission, allowing licensees to submit a range of documents and notifications, thus providing benefits to both regulated entities and the Commission.
- Continue the implementation of the Commission's human resources strategy to encourage staff development; to encourage movement between divisions; and to facilitate short-term secondments to industry and medium-term secondments to international organisations.
- Participate in the implementation of Commissioner-approved recommendations arising out of the Review.

Independent Auditor's Report to the Commissioners of the Guernsey Financial Services Commission

We have audited the financial statements of the Guernsey Financial Services Commission (the "Commission") for the year ended 31 December 2011 which comprise the Income and Expenditure Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards.

This report is made solely to the Commissioners, as a body, in accordance with our Terms of Engagement as detailed in our letter dated 13 November 2009. Our audit work has been undertaken so that we might state to the Commissioners, as a body, those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Commission and the Commissioners as a body, for our audit work, for this report, or for the opinions we have formed.

Statement of Commissioners' responsibilities

The Commissioners are required by the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended to prepare financial statements for each financial year which give a true and fair view, in accordance with applicable Guernsey law and United Kingdom Accounting Standards. In preparing these financial statements, the Commissioners are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Commission will continue to operate.

The Commissioners are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Commission and to enable them to ensure that the financial statements have been prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. They are also responsible for safeguarding the assets of the Commission and hence for taking reasonable steps for the prevention and detection of fraud, error and other irregularities.

Respective responsibilities of Commissioners and Auditor

As explained more fully above, the Commissioners are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ("APB's") Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Commission's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Commissioners; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Commission's affairs as at 31 December 2011 and of its surplus for the year then ended;
- are in accordance with United Kingdom Accounting Standards; and
- have been properly prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

KPMG Channel Islands Limited
Chartered Accountants
Guernsey
2 May 2012

It is and shall remain the responsibility of the Commission to ensure that any electronic publication or distribution of the financial statements properly presents the financial information and our report. The Commission shall ensure that financial information on the Commission's website distinguishes clearly between financial information that we have audited and other information and avoids any inappropriate association. The Commission shall retain responsibility for the controls over and the security of the Commission's website and our work shall not extend to any consideration or examination of such matters, which shall be beyond the scope of our audit of the financial statements.

FINANCIAL STATEMENTS

INCOME AND EXPENDITURE ACCOUNT

For the year ended 31 December 2011

	Note	2011	2010
		£	£
Income	2		
Fees receivable	1(b)	12,596,240	11,362,101
Interest on deposits with States Treasury and banks	1(c)	122,162	106,676
		12,718,402	11,468,777
Expenses			
Salaries, pension costs, staff recruitment and training		7,917,626	7,671,235
GTA University Centre net gain on pension transfer	7(l)	(540,568)	–
Commissioners' fees		132,250	118,000
Legal and professional fees		971,282	310,143
Premises and equipment, including depreciation	1(e), 1(f), 4, 10	1,411,098	1,058,709
Other operating expenses		689,077	737,928
Other finance costs	1(g), 7(b)	42,756	205,818
Auditor's remuneration		11,236	10,720
		10,634,757	10,112,553
Commission's contribution to expenses of GTA University Centre	9	440,000	440,000
		11,074,757	10,552,553
Surplus for the year		£1,643,645	£916,224

There is no difference between the surplus for the financial year as stated above and its historical cost equivalent.

The notes on pages 44 to 51 form an integral part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2011

	Note	2011	2010
		£	£
Surplus for the year		1,643,645	916,224
Actuarial (loss)/gain	7(e), (k)	(3,436,142)	228,181
Total recognised (loss) / gain for the year		£(1,792,497)	£1,144,405

The notes on pages 44 to 51 form an integral part of these financial statements.

BALANCE SHEET
As at 31 December 2011

	Note	2011	2010
		£	£
Fixed assets			
Tangible assets	4	2,522,976	2,631,530
Current assets			
Debtors	5	499,928	410,473
Deposits with States Treasury	14	20,761	20,565
Cash at bank and in hand	14	7,591,669	5,190,073
		8,112,358	5,621,111
Creditors – amounts falling due within one year	6a	(2,368,753)	(1,265,479)
Net current assets		5,743,605	4,355,632
Creditors – amounts falling due after one year	6b	(39,000)	–
Net assets before post-retirement liability		8,227,581	6,987,162
Post-retirement liability	7(a), (k)	(7,577,179)	(4,544,263)
Net assets		£650,402	£2,442,899
Reserves	8	£650,402	£2,442,899

The financial statements on pages 39 to 51 were approved by the Commissioners and signed on their behalf on 27 April 2012 by:

Cees Schrauwers
Chairman

Susie Farnon
Vice-Chairman

JN van Leuven
Director General

The notes on pages 44 to 51 form an integral part of these financial statements.

CASH FLOW STATEMENT

For the year ended 31 December 2011

	Note	2011 £	2010 £
Reconciliation of surplus of income less expenditure for the year to net cash inflow from operating activities			
Surplus of income less expenditure		1,643,645	916,224
Other finance costs	7(b)	42,756	205,818
Current pension service cost	7(c)	838,586	832,738
Loss on curtailment	7(c)	25,641	–
Gain on settlements	7(c)	(586,209)	–
Contributions made to pension schemes	7(d)	(724,000)	(759,356)
Depreciation on tangible fixed assets	4	412,872	341,345
Interest receivable		(122,162)	(106,676)
Increase in debtors		(89,455)	(16,189)
Increase in creditors		1,142,274	418,333
Net cash inflow from operating activities		£2,583,948	£1,832,237
Return on investments and capital expenditure			
Returns on investments and servicing of finance – interest		122,162	106,676
Capital expenditure	4	(304,318)	(1,612,428)
Increase in cash in the year		£2,401,792	£326,485
Reconciliation of net cash flow to movements in net cash			
Increase in cash in the year	14	2,401,792	326,485
Net cash at 1 January	14	5,210,638	4,884,153
Net cash at 31 December	14	£7,612,430	£5,210,638

The notes on pages 44 to 51 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2011

1. Accounting policies

(a) Convention

These financial statements have been prepared in accordance with the historical cost convention and under applicable accounting standards in the UK. The principal accounting policies which the Commissioners have adopted within that convention are set out below. They have been applied consistently in dealing with items which are considered material to the financial statements of the Commission.

(b) Fees receivable

Fees receivable are accounted for on an accruals basis.

(c) Interest

Bank and States Treasury deposit interest is accounted for on an accruals basis.

(d) Investigation and litigation

Costs arising from investigation and litigation are accounted for as expenditure is incurred, whether or not it had been billed at the balance sheet date. Such costs recovered from third parties are accounted for in the year in which they are received. No provision is made for expenditure or recoveries which may arise in future years.

(e) Tangible fixed assets and depreciation

Depreciation on tangible fixed assets is calculated to write down their cost to their estimated residual values over the period of their estimated useful economic lives at the following annual rates:

Leasehold improvements	over the shorter of the term of the lease and the estimated useful economic life of the assets
Office equipment and fittings	25% straight-line
Furniture	10% straight-line
Computer equipment:	
Hardware	33⅓% straight-line
Software	over the shorter of 10 years and the estimated useful economic life of the assets

(f) Leases

Rental payments made in relation to office accommodation are treated as operating leases and are charged to the income and expenditure account on a straight-line basis over the lease term.

(g) Pensions

Employees of the Commission who generally joined before 1 January 2008 are eligible to be members of the States of Guernsey Superannuation Fund ("the Fund") which is a defined benefit pension scheme funded by contributions from both the member and the employer.

A separate Actuarial Account comprising the assets and liabilities of the Fund attributable to the Commission's members ("the scheme") was established with effect from 1 January 2004. Regular valuations are prepared by independent professionally qualified actuaries.

In accordance with Financial Reporting Standard 17 - Retirement Benefits ("FRS 17"), the regular service costs of providing retirement benefits to employees during the year, together with any past service costs, are charged to the income and expenditure account in the year.

A debit is included within other finance costs, representing the interest cost on the scheme's liabilities, less the expected return on the scheme's assets, for the year. A credit is included within other finance income where the expected return on the scheme's assets exceeds the interest cost.

The difference between the market value of assets and the present value of accrued pension liabilities is shown as an asset or liability in the balance sheet.

Differences between the actual and expected returns on assets during the year are recognised in the statement of total recognised gains and losses in the year together with differences arising from changes in assumptions and experience gains and losses arising on the scheme liabilities.

Employees of the Commission joining since 1 January 2008 are generally eligible to be members of the Island Trust Pension Plan ("the DC Plan") which is a defined contribution pension scheme funded by contributions from both the member and the employer. Employer contributions are charged to the income and expenditure account in the year in which they become payable to the DC Plan.

2. Income

Income is derived wholly from continuing activities.

3. Taxation

The Commission is exempt from the provisions of the Income Tax (Guernsey) Law, 1975 as amended.

4. Tangible assets

	Leasehold improvements	Office equipment, furniture and fittings	Computer hardware	Computer software	Total
	£	£	£	£	£
Cost					
At 1 January 2011	1,256,577	372,298	446,798	1,400,709	3,476,382
Additions	22,804	46,074	60,561	174,879	304,318
Disposals	(6,858)	(13,770)	(8,423)	–	(29,051)
At 31 December 2011	1,272,523	404,602	498,936	1,575,588	3,751,649
Depreciation					
At 1 January 2011	20,336	89,306	312,564	422,646	844,852
Charge for the year	57,396	50,368	107,636	197,472	412,872
On disposals	(6,858)	(13,770)	(8,423)	–	(29,051)
At 31 December 2011	70,874	125,904	411,777	620,118	1,228,673
Net book value at 31 December 2010	£1,236,241	£282,992	£134,234	£978,063	£2,631,530
Net book value at 31 December 2011	£1,201,649	£278,698	£87,159	£955,470	£2,522,976

5. Debtors

	2011	2010
	£	£
Amount due from GTA University Centre	80,702	25,006
Other debtors	49,985	53,000
Prepayments	369,241	332,467
	£499,928	£410,473

6a. Creditors – amounts falling due within one year

	2011	2010
	£	£
Expense creditors and accruals	1,220,176	341,779
Fees received in advance	1,148,577	923,700
	£2,368,753	£1,265,479

6b. Creditors – amounts falling due after one year

	2011	2010
	£	£
Expense accruals	39,000	–
	£39,000	–

7. Superannuation

(i) FRS17 Disclosure for the Guernsey Financial Services Commission Actuarial Account of the States of Guernsey Superannuation Fund

Employee benefit obligations

This is a defined benefit pension scheme funded by contributions from both the member and the employer which provides retirement benefits based on final pensionable salary. The employer contributions are determined on the basis of independent actuarial advice and are calculated to meet the cost of benefit accrual over the next year of pensionable service.

A separate Actuarial Account comprising the assets and liabilities of the Fund attributable to the Commission's members was established with effect from 1 January 2004 within the Fund following an instruction from the former States Advisory and Finance Committee. The Actuarial Account is used solely for the purpose of determining the contributions payable to the Fund by the Commission and to avoid the possibility of inappropriate subsidisation of one employer by another.

A full actuarial valuation of the scheme was carried out at 31 December 2010 by the scheme's actuary, which resulted in a funding surplus of £1,145,000. An interim actuarial valuation at 31 December 2011 resulted in a funding deficit of £529,000. The scheme's actuary has also completed valuations annually as at 31 December since 2005, for the purposes of FRS17.

The valuation used for FRS17 disclosures has been based on a full assessment of the liabilities of the Fund. The present values of the defined benefit obligation, the related current service cost and any past service costs (if applicable) were measured using the projected unit method.

(a) The amounts recognised in the balance sheet are as follows:

	2011	2010
	£	£
Fair value of scheme assets	13,455,961	14,811,865
Present value of funded obligations	(21,033,140)	(19,356,128)
Net pension liability	£(7,577,179)	£(4,544,263)

The asset and liability values on the FRS17 basis reflect market conditions at the Commission's year-end date and, as point-in-time calculations, can be expected to vary greatly from year to year, without prejudicing the scheme's long-term ability to provide the required benefits.

7. Superannuation (continued)

(b) The amounts recognised in the income and expenditure account are as follows:

	2011 £	2010 £
Interest on obligation	1,040,352	955,312
Expected return on scheme assets	(997,596)	(749,494)
Other finance costs	42,756	205,818
Current service cost	838,586	832,738
Loss on curtailment	25,641	–
Gain on settlement	(586,209)	–
Expense recognised in income and expenditure account	£320,774	£1,038,556
Actual return on scheme assets	£(584,759)	£1,542,554

(c) Changes in the present value of the defined benefit obligation are as follows:

	2011 £	2010 £
Opening defined benefit obligation	(19,356,128)	(16,837,302)
Current service cost	(838,586)	(832,738)
Interest on obligation	(1,040,352)	(955,312)
Contributions by members	(289,855)	(318,054)
Actuarial losses on obligations	(1,853,787)	(564,879)
Loss on curtailments	(25,641)	–
Gain on settlements	586,209	–
Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values – general	109,961	152,157
– GTA University Centre	1,675,039	–
Closing defined benefit obligation	(21,033,140)	£(19,356,128)

(d) Changes in the fair value of scheme assets are as follows:

	2011 £	2010 £
Opening fair value of scheme assets	14,811,865	12,344,058
Expected return on scheme assets	997,596	749,494
Actuarial (losses)/gains on scheme assets	(1,582,355)	793,060
Contributions by employer	724,000	759,356
Contributions by members	289,855	318,054
Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values	(1,785,000)	(152,157)
Closing fair value of scheme assets	£13,455,961	£14,811,865

7. Superannuation (continued)

(e) Analysis of amount recognised in statement of total recognised gains and losses ("STRGL")

	2011	2010
	£	£
Opening amount of losses recognised in STRGL	(4,276,166)	(4,504,347)
Actuarial losses on obligations for the year	(1,853,787)	(564,879)
Actuarial (losses)/gains on scheme assets for the year	(1,582,355)	793,060
Total actuarial (losses)/gains for the year	(3,436,142)	228,181
Cumulative amount of losses recognised in STRGL	**(£7,712,308)**	**£(4,276,166)**

(f) The employer expects to contribute £581,025 to the scheme in the year ended 31 December 2012. Following the actuarial valuation of the scheme as at 31 December 2010, the actuary calculated that the Commission's contribution rate payable to the scheme, to reflect the future service cost, be decreased to 15.6% from 17.8% (the rate recommended by the actuary after the previous actuarial valuation on 31 December 2007). The contribution rate was decreased to 15.6% with effect from 1 January 2012. However, the current service cost, calculated in accordance with FRS17 and representing the cost to the Commission of the benefits accrued to active members of the scheme during the financial year ended 31 December 2011, has been reflected in the Commission's income and expenditure account.

(g) The major categories of Fund assets as a percentage of the total Fund assets are as follows:

	2011	2010
	%	%
Equities	64	69
Gilts	5	4
Corporate bonds	13	15
Property	10	4
Other assets	8	8

This allocation is at the discretion of the States.

(h) Long-term principal actuarial assumptions at the balance sheet date (expressed as weighted averages where applicable):

	2011	2010
	%	%
Discount rate as at 31 December	4.7	5.4
Expected return on Fund assets at 31 December	5.7	6.6
Rate of increase in pensionable salaries	4.1	5.1
Rate of increase in deferred pensions	3.3	3.8
Rate of increase in pensions in payment	3.3	3.8

The FRS17 standard refers to a discount rate determined as the current rate of return on high quality corporate bonds (normally taken to be rated as AA) of equivalent currency and term to the Actuarial Account's liabilities.

7. Superannuation (continued)

(i) Mortality assumptions

The mortality assumptions are based on standard mortality tables which allow for future mortality improvements. The assumptions are that members aged 60 will live on average until age 89 if they are male and until 90 if female. For members currently aged 45, the assumptions are that if they attain age 60 they will live on average until age 90 if they are male and until 92 if female.

(j) Description of the basis used to determine return on Fund assets

The States adopts a building block approach in determining the expected rate of return on the Fund's assets. The States retains full responsibility for the management of the Fund's assets. Historic markets are studied and assets with high volatility are assumed to generate higher returns consistent with widely accepted capital market principles.

Each different asset class is given a different expected rate of return. The overall rate of return is then derived by aggregating the expected return for each asset class over the actual asset allocation for the Fund at the disclosure year end.

(k) Amounts for the current and previous periods are as follows:

	2011	2010	2009	2008	2007
	£	£	£	£	£
Defined benefit obligation	21,033,140	19,356,128	16,837,302	11,987,385	11,267,735
Fair value of scheme assets	13,455,961	14,811,865	12,344,058	8,424,935	9,701,884
Deficit in the scheme	(7,577,179)	(4,544,263)	(4,493,244)	(3,562,450)	(1,565,851)
Actuarial (losses) / gains on scheme assets	(1,582,355)	793,060	940,303	(2,660,642)	(113,976)
Actuarial (losses) / gains on defined benefit obligation	(1,853,787)	(564,879)	(2,793,117)	1,086,777	45,858
Actuarial (losses) / gains recognised in STRGL	(£3,436,142)	£228,181	£(1,852,814)	£(1,573,865)	£(68,118)

The States has confirmed that in the final resort the claims of the Commission's pensioners and employees would be met from the whole Fund and any shortfall in the scheme would then be met by the States from General Revenue.

(l) As a result of the transfer of certain staff, and their pension liabilities, on 31 December 2011, to the employment of the GTA University Centre, a net gain of £540,568 was credited to the income and expenditure account. This includes a payment to the States of Guernsey Superannuation Fund to facilitate a transfer of GTA University Centre pension obligations, on a fully funded basis, partially offset by a contribution by the GTA University Centre. The composition is as follows.

	2011	2010
	£	£
Gain on settlement	(586,209)	–
Loss on curtailment	25,641	–
Payment to the States of Guernsey	50,000	–
Contribution by the GTA University Centre	(30,000)	–
GTA University Centre net gain on pension transfer	£(540,568)	–

(ii) FRS17 Disclosure for the Island Trust Pension Plan ("the DC Plan")

The net cost of employer contributions to the DC Plan for the year ended 31 December 2011 was £195,338 (2010: £143,370). Contributions of £12,785 were outstanding as at 31 December 2011 (2010: £4,034). No contributions were prepaid as at 31 December 2011 or 2010. Employer contributions are calculated at 12% of pensionable salary and mandatory employee contributions are at a rate of 5% of pensionable salary.

NOTES TO THE FINANCIAL STATEMENTS (continued)

8. Reconciliation of movements in reserves

		2011	2010
		£	£
Reserves brought forward		2,442,899	1,298,494
Surplus of income less expenditure for the year		1,643,645	916,224
Actuarial (loss) / gain on post-retirement liability	7(e)	(3,436,142)	228,181
Reserves carried forward		£650,402	£2,442,899

Reserves are stated after deducting the accumulated pension liability of £7,577,179 (2010: £4,544,263) which equates to the post-retirement liability under FRS17 (see note 7).

9. GTA University Centre

The GTA University Centre (GTA) arranges training for the finance industry and for other industry sectors. The company's staff, excluding those joining since 2007, were employed by the Commission and permanently seconded to the company, up to 31 December 2011. The Commission provided a grant of £440,000 in 2011 (2010: £440,000) to the company in order to meet approximately 50% of its budgeted net operating expenditure, with £470,000 being provided by the States via the Commerce and Employment Department. 2012 will be the final year of the grant.

10. Lease commitments

The Commission leased office accommodation at Glategny Court, and Le Marchant House during the year. Cessation of the underlease for Le Marchant House occurred on 10 December 2011. The lease for Glategny Court expires on 16 September 2034 and the rental payable in 2011 under the terms of the leases amount to £679,820 (2010: £414,218).

Commitments to make payments during the next year in respect of an operating lease are as follows:

Land and buildings

	2011	2010
	£	£
Leases which expire up to 1 year after balance sheet date	–	£39,310
Leases which expire between 1 and 5 years after balance sheet date	–	–
Leases which expire more than 5 years after balance sheet date	£646,338	£631,078

11. Investigation and litigation costs

As a consequence of fulfilling its regulatory responsibilities, from time to time the Commission undertakes investigations and is a party to legal actions, the costs of which may be significant. No provision has been made in the financial statements for any future costs in respect of current investigations or legal actions because the nature, complexity and duration of such actions remain uncertain.

In a few cases, some or all of the Commission's investigation and legal costs may be recoverable, although not necessarily in the same financial year as the expenditure is incurred. In such cases the recovery is recognised when received.

12. Related-party transactions

The States appointed Peter Harwood as a Commissioner in August 2004. He was a partner of Ozannes, now Mourant Ozannes, until 31 December 2009. During the year the Commission engaged Mourant Ozannes to provide certain legal and professional services. These were contracted on an arm's-length basis and are not considered to be significant in the context of the business of the parties.

13. Controlling party

In the opinion of the Commissioners there is no controlling party of the Commission, as defined by Financial Reporting Standard No. 8 – Related Party Disclosures, as no party has the ability to direct the financial and operating policies of the Commission with a view to gaining economic benefits from their direction.

14. Analysis of net cash

	At 1 January 2011	Cash flow	At 31 December 2011
	£	£	£
Deposits with States Treasury	20,565	196	20,761
Cash at bank and in hand	5,190,073	2,401,596	7,591,669
	£5,210,638	£2,401,792	£7,612,430

STATISTICAL DATA

Banking Division

Table 1. **Licences and deposits at the year end**

End	Banks licensed	Deposits £mns	Annual % change in deposits
1990	72	15,476	19.1
1991	72	16,250	5.0
1992	76	27,442	68.9
1993	75	37,482	36.6
1994	73	42,191	12.6
1995	73	46,855	11.1
1996	72	43,324	-7.5
1997	78	49,357	13.9
1998	78	52,922	7.2
1999	79	57,059	7.8
2000	77	68,474	20.0
2001	72	77,211	12.8
2002	67	71,943	-6.8
2003	61	69,703	-3.1
2004	54	70,426	1.0
2005	50	80,728	14.6
2006	50	92,349	14.4
2007	47	119,170	29.0
2008	48	157,009	31.8
2009	44	117,415	-25.2
2010	38	111,030	-5.4
2011	35	107,545	-3.1

Table 2. **Assets and liabilities of licensed banks at the year end**

	2005 Total £mns	2006 Total £mns	2007 Total £mns	2008 Total £mns	2009 Total £mns	2010 Total £mns	2011 Total £mns
Liabilities							
Tier 1 capital*	1,385	1,491	1,570	1,981	2,093	2,288	2,182
Tier 2 capital**	29	51	52	49	166	52	28
Deposits by							
British Isles banks and financial corporations	11,845	16,681	20,306	20,866	23,130	25,087	23,336
Other banks	35,265	42,757	59,582	87,490	53,827	44,966	45,199
British Isles public sector	36	48	43	49	39	30	29
Companies, persons, other	32,191	31,977	38,138	45,898	37,706	38,250	36,102
Other liabilities	6,731	7,579	12,209	22,785	18,851	23,455	26,710
Total liabilities	**87,482**	**100,584**	**131,900**	**179,117**	**135,812**	**134,128**	**133,586**
Assets							
Loans, advances and market loans with:							
Banks and financial institutions	59,731	71,177	86,738	111,222	78,925	79,424	79,530
British Isles public sector	10	10	10	13	28	25	29
Companies, persons, other	6,067	5,931	17,647	27,111	23,673	25,656	27,278
Government securities	6,965	5,127	3,694	3,179	2,092	2,964	1,858
Company shares/securities	10,337	7,085	9,894	8,580	8,913	10,709	11,645
CDs*** and all other assets	4,372	11,254	13,917	29,012	22,181	15,350	13,245
Total assets	**87,482**	**100,584**	**131,900**	**179,117**	**135,812**	**134,128**	**133,586**

*Paid-up share capital and disclosed reserves
**Undisclosed reserves, revaluation reserves, general provisions, debt/equity instruments and subordinated debts
***CDs plus FRNS and commercial paper

Figure 1. **Asset at the year end**

Year	£mns
2002	42,521
	6,521
	11,257
	8,014
	6,447
2003	37,654
	7,062
	13,129
	8,811
	6,195
2004	40,076
	8,212
	12,733
	8,169
	5,758
2005	59,731
	10,337
	6,965
	4,372
	6,077
2006	71,177
	7,085
	5,127
	11,254
	5,941
2007	86,738
	9,894
	3,694
	13,917
	17,657
2008	111,222
	8,580
	3,179
	29,012
	27,124
2009	78,925
	8,913
	2,092
	22,181
	23,702
2010	79,424
	10,709
	2,964
	15,350
	25,681
2011	79,530
	11,645
	1,858
	13,245
	27,307

- Loans to banks and financial institutions
- Company shares/securities
- Government securities
- CDs, commercial paper and all other assets
- Loans to companies, persons and other

Figure 2. **Analysis of deposits with Guernsey banks by currency at end December 2011**

Country	%
United States Dollar	48.2
United Kingdom Sterling	24.3
Euro	19.8
Swiss Franc	3.4
Australian Dollar	1.3
Canadian Dollar	0.9
Japanese Yen	0.2
Hong Kong Dollar	0.1
Other	1.8

Figure 3. **Selected loans and advances since 2008**

Month	£mns
Mar 08	2,891
	2,166
	2,281
Jun 08	3,167
	2,291
	2,445
Sep 08	2,813
	2,922
	2,556
Dec 08	3,340
	3,756
	2,605
Mar 09	2,544
	3,264
	2,634
Jun 09	2,163
	2,879
	2,649
Sep 09	2,136
	2,854
	2,694
Dec 09	2,166
	2,541
	2,730
Mar 10	2,386
	2,283
	2,816
Jun 10	2,302
	2,319
	2,837
Sep 10	2,288
	2,279
	3,386
Dec 10	2,261
	2,420
	3,468
Mar 11	2,091
	2,333
	3,543
Jun 11	2,239
	2,196
	3,658
Sep 11	2,320
	2,268
	3,815
Dec 11	2,366
	2,263
	3,784

Corporate loans
Retail and private client loans
Residential mortgages

Figure 4. **Disposition of bank assets at December 2011**

Location of bank assets	%
United Kingdom	40
United States	17
Other European Union	16
Switzerland	9
Guernsey	8
Jersey	5
Caribbean	5
Ireland	0
Other	2

Figure 5. **Source of bank deposits at December 2011**

Location of bank deposit	%
Switzerland	35
Guernsey	30
United States	10
Jersey	7
United Kingdom	4
Caribbean	3
Ireland	2
Other European Union	1
Other	7

Figure 6. **Total Tier 1 capital at the year end**

Year	£mns
1999	1,357
2000	1,715
2001	1,841
2002	1,686
2003	1,585
2004	1,479
2005	1,385
2006	1,491
2007	1,570
2008	1,981
2009	2,093
2010	2,288
2011	2,182

Figure 7. **Country of origin of Guernsey-licensed banks – subsidiaries at end 2011**

Country	Number of banks
United Kingdom	4
Switzerland	2
Cyprus	2
United States	2
France	2
Belgium	1
Bermuda	1
Canada	1
Netherlands	1
South Africa	1

Figure 8. **Country of origin of Guernsey-licensed banks – branches at end 2011**

Country	Number of banks
United Kingdom	8
Switzerland	4
France	3
Germany	1
Bahrain	1
Australia	1

Figure 9. **December 2011: Last 12 months, number of licences issued by type of licence**

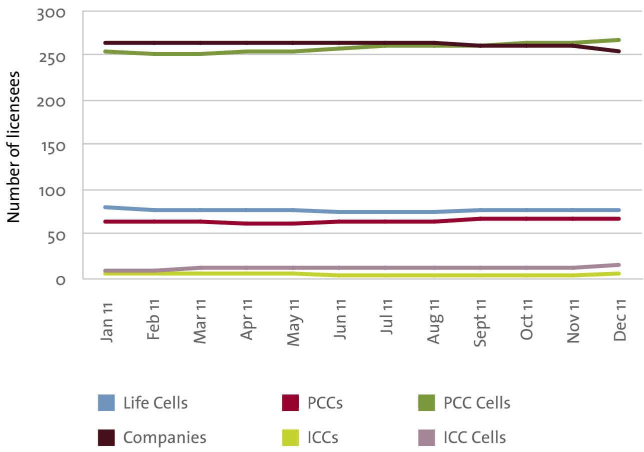


Figure 11. **December 2011: 12-month rolling summary of licences surrendered**

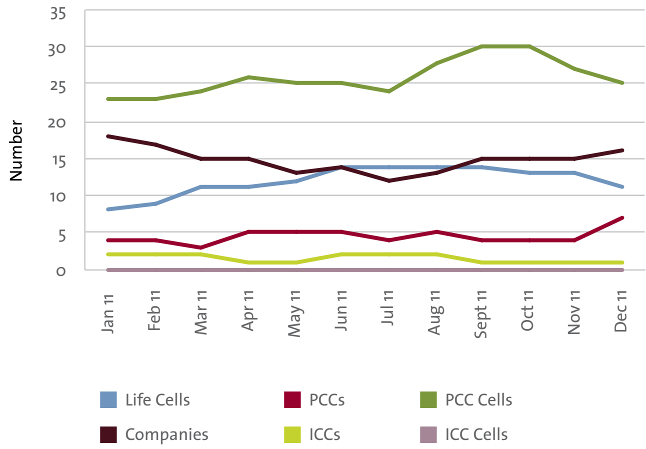


Figure 10. **December 2011: 12-month rolling summary of licences issued**

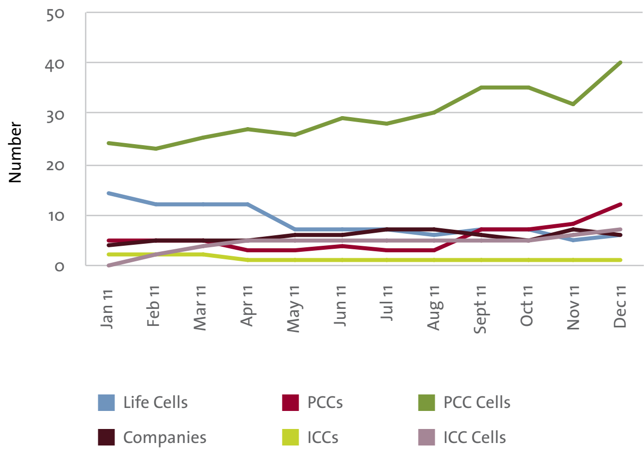


Figure 12. **Gross assets**

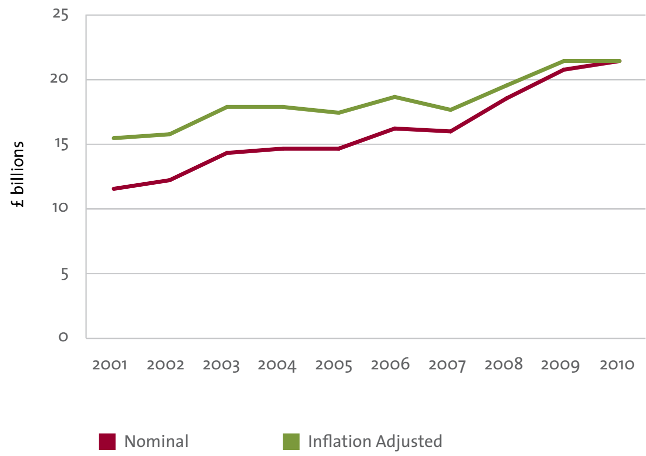


Figure 13. **Net worth**

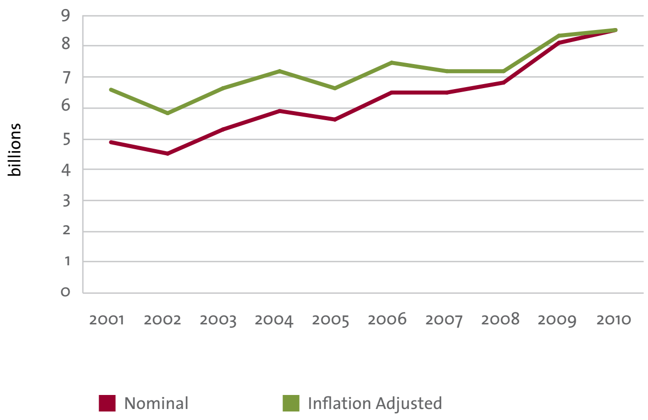


Figure 15. **2011 new licences by parent location**

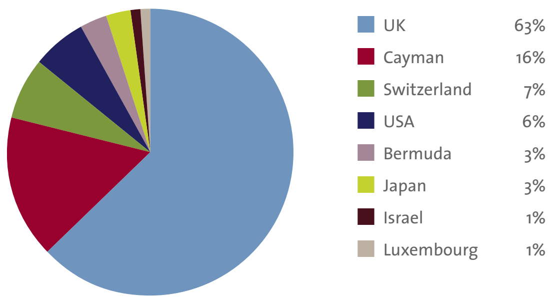
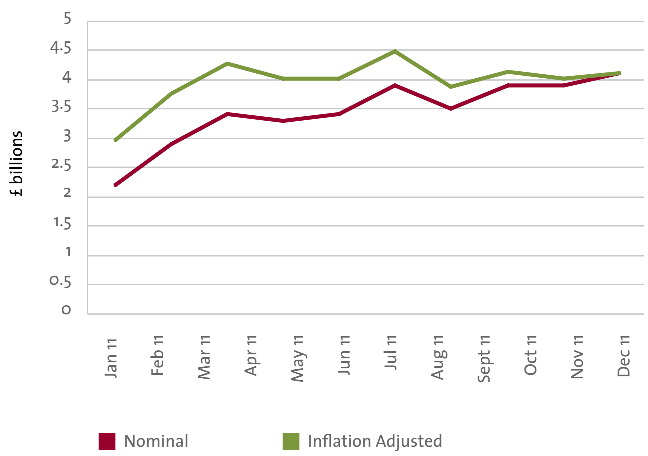


Figure 14. **Premium**



Investment Division

Table 3. **New collective investment funds during the year**

	2010	2011
Open-ended funds – authorised/registered	27	19
Open-ended funds – new classes approved	131	125
Closed-ended funds – authorised/registered	62	75

Table 4. **Open-ended funds at the year end**

	2010	2011	% change
Number of funds	262	244	-6.8
Number of investment pools	1722	1545	-10.2
Value of assets (£bns)	57.95	55.35	-4.5
Net new investment over year (£mns)	5,157	5,193	0.6
Number of registered holders ('000s)	60.516	53.313	-11.9
Stock exchange-listed	157	144	-8.2

Guernsey-authorised open-ended funds are funds in which shares/units are offered for sale throughout their life and which investors are entitled to redeem on demand subject to any applicable notice period.

Figure 16. **Open-ended funds – geographic breakdown of investments**

Country	%
Guernsey	23
United Kingdom	21
Cayman Islands	14
USA	9
Other	8
Luxembourg	4
Ireland	3
Bermuda	2
Canada	2
Japan	2
Russia	2
Australia	1
British Virgin Islands	1
China	1
Denmark	1
France	1
Germany	1
Jersey	1
Netherlands	1
Switzerland	1
Turkey	1

Figure 17. **Open-ended funds – analysis by investment style**

Investment Style	
Equity / Securities	95
Fund of Hedge Fund	64
Debt	34
Other	32
Real Property	28
Derivatives	24
Hedge Fund	24
Money Market / Cash	21
Emerging Markets	15
Balanced	9
Managed Currency	9
Private Equity	4
Venture Capital	1

Figure 18. **Nationality of sponsors/joint sponsors of Guernsey open-ended funds at year end 2011**

Country	
Guernsey	83
United Kingdom	77
Switzerland	38
South Africa	8
United States	7
British Virgin Islands	6
France	6
Australia	4
Cayman Islands	4
Luxembourg	4
New Zealand	4
Canada	3
Bahamas	3
Kuwait	2
Austria	1
Belgium	1
Hong Kong	1
Japan	1
Jersey	1
The State of Abu Dhabi	1
Turkey	1

Note: some funds may have more than one sponsor

Figure 19. **Nationality of sponsors/joint sponsors of Guernsey closed-ended funds at year end 2011**

Country	
United Kingdom	301
Guernsey	88
Switzerland	60
United States	43
Germany	18
Netherlands	14
Norway	12
France	11
Cayman Islands	10
Finland	9
South Africa	6
Sweden	5
China	4
Turkey	4
British Virgin Islands	3
Greece	3
Italy	3
Japan	3
Spain	3
Czech Republic	2
Estonia	2
Hungary	2
Israel	2
Luxembourg	2
Portugal	2
Republic of Ireland	2
Australia	1
Bahamas	1
Belgium	1
Canada	1
Curaçao	1
Cyprus	1
Dubai	1
Hong Kong	1
Iceland	1
Isle of Man	1
Jersey	1
Kuwait	1
Lebanon	1
Netherland Antilles	1
Russia	1
Singapore	1
United Arab Emirates	1

Note: Some funds may have more than one sponsor

Table 5. **Closed-ended funds at the year end**

	2010	2011	% change
Number of funds	599	610	1.8
Value of assets (£bns)	109.5	119.11	8.8
Number of registered holders ('000s)	70.35	68.57	-2.5
Stock exchange-listed	229	217	-5.2

Guernsey-approved closed-ended funds normally have a fixed capital issued once and for all and investors have no absolute entitlement to redeem their shares/units.

Figure 20. **Closed-ended funds – geographic breakdown of investments**

Country	%
United Kingdom	21
USA	13
Guernsey	10
Cayman Islands	7
Germany	6
Luxembourg	6
Other	6
China	2
Cyprus	2
France	2
Netherlands	2
Russia	2
Sweden	2
Switzerland	2
Australia	1
Bermuda	1
Brazil	1
British Virgin Islands	1
Canada	1
Denmark	1
Egypt	1
Finland	1
Ireland	1
Italy	1
Japan	1
Jersey	1
Malta	1
Mauritius	1
Norway	1
Poland	1
Spain	1

Figure 21. **Closed-ended funds – analysis by Investment style**

Investment	
Private Equity	302
Real Property	125
Equity / Securities	70
Other	49
Debt	45
Venture Capital	38
Infrastructure	22
Fund of Hedge Fund	17
Derivatives	16
Emerging Markets	11
Hedge Fund	8
Balanced	2
Money Market / Cash	2

Figure 22. **Total funds authorised and registered at the year end**

Year	Number of funds
2004	516
2005	584
2006	724
2007	851
2008	919
2009	884
2010	861
2011	854

Figure 23. **Total Guernsey funds under management at the year end**

Year	Number of funds
2004	56,567
2005	79,334
2006	105,139
2007	145,616
2008	155,046
2009	136,079
2010	167,453
2011	174,473

Table 6. Non-Guernsey schemes at year end

	2010	2011	% change
Number of funds	332	308	-7.2%
Value of assets (£mns)	90.00	87.08	-3.3%
Stock exchange-listed	41	35	-14.6%

These open-ended schemes incorporated/established in other jurisdictions are not Guernsey-authorised/registered. However, Guernsey institutions licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 provide management/administration or custody services to such schemes with specific approval from the Commission.

Figure 24. **Number of institutions licensed under the Protection of Investors Law at year end**

Year	Number of institutions
2004	446
2005	486
2006	554
2007	636
2008	680
2009	661
2010	652
2011	654

Enforcement Statistics

Introduction

The Commission introduced its Enforcement Policy, describing the manner in which it would approach the use of its enforcement powers and sanctions, in cases of regulatory non-compliance. In 2011, a number of regulatory matters were resolved through agreement with the subject concerned, while in a smaller number of cases the following regulatory sanctions were imposed, either with the agreement of the subject or decided upon by the Commission:

Warnings	6
Conditions imposed on licence, authorisation, registration or consent	9
Refusal to grant request to vary or remove a prohibition order	1
Requirement to provide information, documents or produce a report concerning identified regulatory areas of concern	5

Table 7. **International Monetary Fund ("IMF") Coordinated Portfolio Investment Survey 2010**

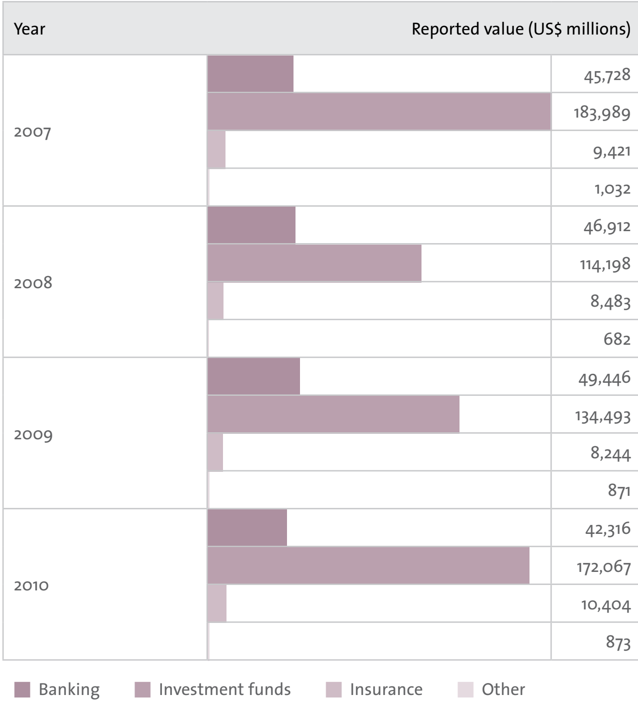
Cross-border securities* owned by institutions in the Bailiwick of Guernsey at end 2010 (US$ millions)

Sector	Equities	Short-term debt	Long-term debt	Total
Banks	644	19,870	21,802	42,316
Domestic insurers	–	–	32	32
Life insurers	4,973	5	1,920	6,898
Insurance managers and captives	160	2,454	859	3,473
Insurance intermediaries	–	–	–	0
Open and closed-ended collective investment funds	126,132	5,002	40,933	172,067
States of Guernsey	242	209	423	874
Total	**132,151**	**27,540**	**65,969**	**225,660**

*The IMF Coordinated Portfolio Investment Survey includes information on cross-border holdings of equities, short-term debt and long-term debt. It does not include other assets, such as cash, derivatives, Islamic investments or property.

Figure 25. **International Monetary Fund ("IMF") Coordinated Portfolio Investment Survey**

Cross-border securities by business sector at the year end



Finance and Operations Division

Table 8. Income and expenses by sector

	Banking		Fiduciary		Insurance		Investment business		Non regulated financial services businesses and prescribed businesses		Total	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Number of regulated & registered entities	35	38	183	187	756	746	1,816	1,845	153	144	2,943	2,960
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Fee income	1,880	1,533	2,347	1,976	2,838	2,483	5,368	5,271	163	99	12,596	11,362
Direct costs	(1,286)	(1,403)	(1,431)	(1,248)	(1,857)	(1,806)	(2,693)	(2,610)	(140)	(60)	(7,407)	(7,127)
Interest income	18	13	22	17	28	24	54	53	0	0	122	107
Common costs	(480)	(496)	(575)	(513)	(766)	(731)	(1,322)	(1,206)	(84)	(40)	(3,227)	(2,986)
Surplus/(deficit)	132	(353)	363	232	243	(30)	1,407	1,508	(61)	(1)	2,084	1,356
Contribution to costs of GTA University Centre											(440)	(440)
Surplus, net of GTA contribution											1,644	916

Table 9. Salaries and related costs

	2011	2010
	£'000	£'000
Salaries	5,944	5,928
Consultants/ secondees	118	76
Pension costs	1,005	875
Social insurance, permanent health and medical insurance	567	548
Recruitment and training	283	244
Total	7,917	7,671

Table 11. Commissioners' fees (increase effective October 2011)

Annual fees	2011	2010
	£'000	£'000
Chairman of Commissioners	35	22
Non-resident Commissioners	30	22
Resident Commissioners	25	15

Table 10. Number of staff by salary band

Annual salary	2011	2010
£0- £39,999 p.a.	30	36
£40,000 - £79,999 p.a.	53	52
£80,000 - £119,999 p.a.	10	10
£120,000 p.a. and above	9	7
	102	105

APPENDIX

Functions, structure and corporate governance and other control systems of the Commission

Functions of the Commission

The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended (the Commission Law) established the Commission with both general and statutory functions. The general functions include the taking of "such steps as the Commission considers necessary or expedient for the effective supervision of finance business in the Bailiwick". The statutory functions include those prescribed under or arising pursuant to the following regulatory laws:

- the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended;
- the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended;
- the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 as amended;
- the Insurance Business (Bailiwick of Guernsey) Law, 2002 as amended;
- the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 as amended.

Relationship with the States

The States Policy Council is responsible for international financial matters and for establishing the policy framework for financial regulation, including the government's relationship with, and reporting lines for, the Commission. The Commission Law states that the Commission shall issue its audited financial statements and the two reports, referred to later in this appendix, annually to the Policy Council. The Policy Council is also responsible for the administration of the Control of Borrowing Ordinances. Individual officials of the Commission act for the Policy Council in matters requiring consent under the Ordinances.

The Commissioners

The activities of the Commission's executive are overseen by the members of the Commission (Commissioners). The Commission Law provides that the Commission shall consist of a minimum of five members and a maximum of seven members elected by the States from persons nominated by the Policy Council and appearing to it to be persons having knowledge, qualifications or experience appropriate to the development and supervision of finance business in the Bailiwick. The Chairman is appointed for a period of one year from amongst the Commissioners and is elected by the States following nomination by the Policy Council. The Vice-Chairman is appointed for a period of one year by the Commissioners. Each member is appointed as a Commissioner for a period not exceeding three years. A member whose term of office has come to an end is eligible for re-election. The Chairman and Vice-Chairman are also eligible for re-election to their positions. A member of the Commission must retire on reaching the age of 72 years.

The Commission currently has six Commissioners: Cees Schrauwers, Susie Farnon, Howard Flight, Alex Rodger, Richard Hobbs and Bob Moore. A brief résumé for each Commissioner is provided on pages 4 and 5 of this report. All of the Commissioners are non-executive – three reside in Guernsey, with the remainder living in the UK.

There were 13 meetings of the Commissioners in 2011. The attendance of the individual Commissioners at these meetings was as follows: Peter Harwood 13, David Mallett 11, Susie Farnon 13, Howard Flight 11, Alex Rodger 13, Cees Schrauwers 12. Prior to each meeting, Commissioners are provided with a full information pack to support the meeting's agenda.

An induction programme is in place for new Commissioners. The Commissioners periodically consider their roles, responsibilities and accountabilities.

The Commission Law also makes provision for the appointment of such officers and servants as are necessary for carrying out the Commission's functions and for the most senior officer to have the title of Director General.

Delegation of functions to executive staff

The Commissioners have delegated certain of their statutory functions to the executive staff of the Commission. These statutory functions are exercised by the executives both jointly and severally. All statutory functions of the Commission may be delegated to the executives except:

- the power of the Commissioners to delegate functions;
- the Commissioners' duty to make an annual report on the Commission's activities during the previous year to the Policy Council;
- any statutory functions which:
  - (i) require the Commissioners to consider representations concerning a decision which they propose to take; or
  - (ii) empower the Commission to cancel, revoke, suspend or withdraw a licence, consent, registration, permission or authorisation (except where the cancellation, revocation, suspension or withdrawal is done with the consent of the person who is, or who is acting on behalf of, the holder of the licence, consent, registration, permission or authorisation); or
  - (iii) empower the Commission to petition for the winding-up of a body corporate.

Annual report and financial statements

The Commission must, as soon as possible in each year, make a report to the Policy Council on its activities during the preceding year. The Chief Minister shall, as soon as possible, submit that report for consideration by the States.

The Commission Law also provides that the Commission shall:

(a) keep proper accounts and proper records in relation to those accounts; and

(b) prepare in respect of each year a statement of accounts giving a true and fair view of the state of affairs of the Commission;

and that the accounts of the Commission shall be:

(a) audited by auditors appointed by the States; and

(b) laid before the States.

The Commission includes a copy of its audited financial statements in the annual report to the Policy Council referred to above.

Report on internal control and corporate governance

Under the Commission Law, the Commission must also review in each year, by the appointment of appropriately qualified and independent professional persons or otherwise:

(a) the adequacy and application of the Commission's systems of internal control;

(b) the selection and application of the Commission's accounting policies and accounting procedures;

(c) the effective, efficient and economical management of the Commission's assets and resources; and

(d) the Commission's compliance with such generally accepted principles of good corporate governance as it is reasonable to regard as being applicable to the Commission.

The Commissioners are required to satisfy themselves in connection with the conclusions of each review and provide the Policy Council with a separate annual report on the matters covered by it.

The Commissioners are responsible for overseeing the Commission's corporate governance regime and for monitoring the effectiveness of management's systems of internal control. These systems are subject to regular review by management and address the risks to which the Commission is exposed. The Commission has an ongoing process for identifying, evaluating and managing operational risks (including regulatory and financial risks). In this connection, the Commission takes account of the guidance contained in the UK Code on Corporate Governance.

In accordance with the Commission Law, the Commissioners have reviewed the Commission's approach to risk management policies and processes. The annual report required by the law on internal control and corporate governance has been provided by the Commission to the Policy Council.

Audit and Risk Committee

The Commission's Audit and Risk Committee, which comprises Alex Rodger and Richard Hobbs (who was appointed in January 2012) and is chaired by Susie Farnon, covers oversight of the management of risk – it reviews corporate governance and the systems of internal control and makes reports routinely to meetings of the Commissioners as a whole. Meetings are usually attended by the Director General, the Head of Finance and Operations and the Commission Secretary (who is the committee's secretary). The committee met twice in 2011. The attendance of the individual members at these meetings was as follows: David Mallett (who retired in November 2011) 2, Susie Farnon 2, Alex Rodger 2.

Review systems

Rather than appoint its own internal auditor to monitor the Commission's non-regulatory internal audit standards, the Commission has retained specialist external consultants to ensure that the Commission is up to date with current expectations. The corporate governance standards of the Commission have been reviewed by the Audit and Risk Committee and by the Commission's officers. The Commission is satisfied that it meets expectations in connection with internal audit and corporate governance. The International Monetary Fund ("IMF") undertook an evaluation of the Bailiwick with international regulatory and supervisory standard in 2010 under its Financial Stability Assessment Program. The Commission and the other authorities in Guernsey were found by the IMF to have a high level of compliance with these standards.