Guernsey Financial Services Commission

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2013

Guernsey Financial Services Commission

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".

CHAIRMAN'S STATEMENT

Delivering Good Regulation from a Sustainable Cost Base

In my statement last year I set out the direction that the Commission was intending to take and the objectives we had established following discussions with our stakeholders. Although the Commission encountered some turbulence during the year, I am pleased to report that we have made good progress in beginning to deliver those objectives.

One of the Commission's key objectives is to endeavour to exercise good, effective and proportionate supervision and this will remain our focus moving forward. You can read more about how we are delivering this in the Director General's statement together with details on the considerable preparatory work being undertaken in developing and introducing our new risk-based system called PRISM. This will underpin our supervisory approach.

The Commission's focus continues to remain firmly on the future, both in terms of delivering our objectives and also in managing internal and external change and improving relationships with our stakeholders. During my address at the Commission's presentations to industry held in December, I recommitted the Commission to working closely with representatives of Government and the financial services industry. To assist in that process and explain how we will all move forward together to the benefit of the Bailiwick, the Commission notes the publication, earlier this year, by the Commerce and Employment Department, of the Bailiwick's new strategy for the financial services sector.

Further afield, the struggle to restore growth to a large number of the world's economies is beginning to bear fruit and, although some limited gross domestic product growth has returned to most of the Bailiwick's business partner countries, looking forward there needs to be a period of focused effort by the world's large economies to make that growth more sustainable.

I have also commented in the recent past on the burden which the financial services industry faces as a result of regulation, with its inevitable consequence of limiting growth in the developed world's economies. To a large extent the industry has brought this upon itself, in particular within the banking sector, albeit assisted by a lack of effective regulation, resulting in unacceptable risk taking.

The balance between risk and reward was out of kilter for most of the middle of the last decade. The subsequent and inevitable demand by politicians for banks and insurers to carry more risk capital has had the, not inconsiderable, side effect of reducing the capital available and necessary to restore growth. I expect that it will take a while before we see a workable balance between the reduction of risk, reflected in high solvency ratios, and the need to fund growth.

Alongside higher solvency requirements, there has been the introduction of many monitoring instruments with periodic reports to the various regulatory bodies in the UK, USA and the EU. The specific requirements are often very detailed, resulting in considerable extra overheads and opportunities for regulatory arbitrage. The restoration of growth would be assisted by the simplification and consolidation of the many new rules.

Whilst the Bailiwick operates within the purview of these large economic blocs, it is inevitable that we need to stay abreast of, and respond to, the global regulatory developments in these jurisdictions. It is one of the responsibilities of the Commission, working closely with Government and industry, to assess the many new proposals that emanate from the various international and European bodies and identify what steps are required to ensure that the Bailiwick retains its position as a respected and effective member of the international business community while remaining a good place to do business.

In this respect, the position of Guernsey as an international financial centre places an emphasis, in particular, on its Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") rules and practices. It is recognised by Government, industry and by the Commission that the international standing and reputation of the Bailiwick rely, to a considerable extent, upon the quality of our AML/CFT laws, practices and enforcement. The Commission considers this to be a very important part of its brief.

The considerable effort required to stay abreast of all the legal and regulatory developments falls largely on the Commission's Directors and staff. I should like to thank them for their dedication and for their significant contribution to the progress we have made during the year. I must also thank my colleague Commissioners for their guidance, support and commitment as their workload continues to increase.

During 2013, the Commission was strengthened by the appointment of Advocate Simon Howitt as a Commissioner, following a thorough selection process conducted by the Policy Council. In addition, the Commission appointed its new Director General, William Mason, who has taken admirably to Island life and all that it encompasses. He has made a considerable effort to connect with both politicians and the business community and his efforts are clearly bearing fruit.

In closing, I believe the Commission is in now a stronger position which will help us to deal effectively with the ever-changing regulatory environment and to respond in a manner which has, at its heart, the best interests of the Bailiwick.

Cees Schrauwers, Chairman

DIRECTOR GENERAL'S STATEMENT

I came to the Bailiwick at the beginning of April 2013 and took over from Nik van Leuven as Director General on 1 July 2013; thus this section of our annual report may have a slight bias towards events in the second half of the year. As I begin this statement I would like to thank Nik for his help and support during our handover. Whilst Nik and I may have some different perspectives on financial services regulation, no one should underestimate how hard he worked each day, both to further the Bailiwick's interests, and to ensure that the Commission had a very high quota of bright and dedicated staff whom I am now privileged to lead.

2013 was a tough year for the Commission's staff in some ways. The Commissioners and I decided that, in order to stabilise the costs of regulation, in 2014 we needed both to impose a pay freeze on all staff and to consult on closing our final salary scheme to new contributions – a measure affecting approximately half of our staff – the others already being part of a money purchase pension scheme. We took the difficult decision to proceed with pension scheme closure in December and we will close the scheme with effect from 1 July 2014. These measures – the benefits of which will only become apparent from the 2014 accounts onwards – whilst not the first measures I would have wished to take, were necessary to control the Commission's cost base, allowing us to fund essential internal modernisation without significantly raising costs for the Bailiwick firms we regulate. The Financial Reporting Standard 17 ("FRS 17") valuation of our segment of the final salary Public Sector Pension Scheme ("PSPS") shows that our net pension scheme liabilities increased by £2.6 million over 2013, resulting in negative net assets, as at 31 December 2013, despite an operating surplus in 2013 of over half a million pounds. This deficit and the resulting negative net assets would make a compelling case for scheme closure, were we not to have decided to close it already. The Commissioners and I are hopeful that the negative net assets position we show this year may be reversed going forwards, as the impact of the FRS 17 liabilities diminishes once the scheme is closed to future accrual.

The major plank of our modernisation effort is the Sentinel programme which the Commission approved in June 2013. This will see the Commission, by the end of 2015, renew the way it works through the installation of new software and new internal operating approaches. It will also alter the way the Commission gathers standardised information from firms, ensuring that accurate data can be gathered and analysed electronically, reducing the need for a large number of repetitive and error-prone internal procedures whilst allowing our supervisory cadre to focus more of their energies on higher-value activities. This is one facet of risk-based supervision.

Risk-Based Supervision

Risk-based supervision means focusing on the firms which, by virtue of their potential impact – if they failed – pose the greatest risk to the Bailiwick in terms of financial stability, financial crime or consumer protection. Risk-based supervision is far from a panacea but it is designed to allow us to use our necessarily finite resources to focus on the biggest risks. It is also about being a little more forward looking. Supervisors are not auditors – finding out why a firm failed after it has failed may be interesting for academics but a supervisor's task is to try to identify issues others may have missed before they cause a firm to fail. Having identified such issues a supervisor then works to ensure that they are managed effectively. Risk-based supervision, fully implemented, should also mean that supervisors spend relatively more of their time forming judgments on business models and governance effectiveness rather than on systems and controls issues, narrowly defined. We are adopting PRISM as our risk-based supervision methodology. The Commissioners and I believe this will keep Guernsey in touch with international supervisory best practice and increase our effectiveness.

It is a truism that most regulatory triumphs will never be heard about because, being triumphs, they averted crises which would otherwise have been both damaging and newsworthy. Given this necessary dynamic, one has to be sanguine about the bad publicity that our failures (and the failings of financial services firms) will often attract while still working to ensure that we are doing the right thing at the right time as often as reasonably possible. Risk-based supervision is about helping us make sure we are focusing our efforts on the right things. There will still be firm failures, there will still be consumer mistreatment and there will still be attempts by criminals to misuse the financial system but, statistically speaking, they should be less frequent and less severe than if we were not to have a risk-based system of supervision.

New Teams

At this juncture it is perhaps helpful to make a few remarks about enforcement and its proper place in a modern financial services regulator. On arriving in the Bailiwick I noted that a large number of people I spoke to did not differentiate between supervision and enforcement. Supervision, which is most of the front-line work a regulator does, is about preventing failure through analysing, using good judgment and working with firms to resolve problems before they become crises. Enforcement, on the other hand, is about dealing with the consequences of failure and deterring wrongdoing in the financial services sector to make it safer for decent firms and consumers.

Supervision and enforcement are quite distinct, requiring different skills and competencies. To make this distinction clearer, in mid-2013 we created an enforcement division to ensure that enforcement was appropriately separate from other parts of the Commission and to make it easier for those outside the Commission to recognise that enforcement activity was a relatively small, albeit a very public, part of our activity on behalf of the Bailiwick.

Other reforms we made at the mid-year point included establishing:

- a conduct team to provide more focus to our consumer protection work;
- an innovations unit to give us capacity to do considered cost-benefit analysis work on some of the more novel financial services ideas which we are asked to license; and
- a risk unit to superintend the introduction of risk-based supervision and the wider Sentinel programme, discussed above.

In this process a number of staff changed roles and I would like to thank them for the forbearance they have shown in adapting to the changes. To help support staff as they adapt to changed or much evolved roles within the organisation, we have put in place a programme of training which covers financial analysis, business model and strategy analysis, governance, interviewing skills and risk-based supervision. Whilst this programme was not fully implemented during 2013, I was encouraged by the positive feedback received about the initial courses. The Commissioners and I are committed to providing our staff with high-quality training to help them adapt to the increasing expectations being placed on them and their international colleagues.

International Change

In the wake of the near global collapse of 2008, the international community embarked on a wave of financial regulation renewal to replace the international standards which had been found wanting with ones which should be more effective going forwards. Keeping up with this process has been hard work for both regulator and regulated firm. I am hopeful that, with the main international standards now agreed by the Financial Stability Committee, the Basel Committee, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions and the Financial Action Task Force, we can now focus – working in co-operation with the States of Guernsey – on implementing and embedding the renewed standards in the Bailiwick in a proportionate manner so as to preserve our international reputation and adapt to very changed global expectations in a measured and balanced manner. This will be a task, not just for 2014, but for 2015 and 2016 as well given the weight of material to be digested and the number of our laws which will need to be improved if we are to continue to be a highly respected international financial centre.

Arriving in Guernsey from the Eurocentric crisis in the Irish Republic, I was pleasantly surprised to find how successfully the Bailiwick had insulated itself from the crisis. Certainly growth was down and employment in financial services somewhat slack compared with the previous high but it had not had that cathartic experience which the UK, the Irish Republic and a number of other larger economies were forced to endure. Given this reality I have devoted quite a lot of time to explaining why abiding by the new international standards is not an optional extra but absolutely essential for anyone who wishes to continue to make a living in international financial services. I am pleased to say that many working for the States and in industry agree. I believe we are gradually building a new consensus and that the States, Commission and industry can work together to renew our sector laws and regulations over the next two to three years to meet the series of new international standards which all jurisdictions are now under pressure to apply.

My personal perspective on change tends towards conservative with a small "c". I generally neither like change nor welcome the prospect of it unless it can be proved to me that the change will be beneficial. Sadly, the "Great Recession" proved – beyond reasonable doubt – that the previous international system of supervision was badly flawed. Thus, international plans have been made to fix it. Not everyone will like all those plans and I appreciate that the implementation of some of the international changes may require revisions to the business models of many firms, including firms based in the Bailiwick. That said, we are a micro state in a fiercely competitive global market and we need to recognise that the world owes us neither a living nor a veto over reforms agreed by the great powers. We must continue to adapt to these new international regulatory realities if we are to have a good chance of a future as a prosperous international financial centre. Firms and jurisdictions which resist them are about as likely to succeed as someone seeking to swim from Guernsey to Alderney against the tidal race.

Looking ahead, the European and British political outlook appears hazy at best. The direction the European Union takes after the May 2014 European Parliamentary elections, the results of the referendum the Scottish nationalists have called in September 2014 in an attempt to dissolve the 1707 Act of Union, the lack of clarity with regard to the composition of the House of Commons after the 2015 General Election and whether that, in turn, may result in British withdrawal from the European Union, are all incredibly hard to call with any certainty. The outcome of all or any of these votes may have important implications for the Bailiwick. At the Commission, we will continue to engage internationally and endeavour to ensure that our Bailiwick continues to be seen as a stable, reputable and reliable place in which to transact financial services business by whoever triumphs in each of the votes above. What is certain is that the international outlook is uncertain and that we all need to work tirelessly to ensure the Bailiwick remains one of the best places in the world to do business.

Commission Progress in 2013 and Plans for 2014

In our international work, the Alternative Investment Fund Managers Directive ("AIFMD") Memorandums of Understanding ("MoUs") signed with 27 European Economic Area states were an undoubted highlight of 2013 which should hopefully allow our investment firms to continue to engage positively with clients in the European Union. Further to that, our MoU with the China Securities Regulatory Commission should help to open up new options for Bailiwick firms which wish to undertake investment business within the People's Republic.

Closer to home, we received good feedback on the workshops we held for firms on how to do anti-money laundering better and brought two long-running enforcement cases to satisfactory conclusions. The relatively large operational surplus for 2013 is largely due to the enforcement costs and fines we recovered at the conclusion of those cases. Excluding those recoveries we showed a very small operating surplus.

In terms of externally focused initiatives, in 2014 we intend to make significant progress on Anti-Money Laundering ("AML") Handbook reform, on revised pension regulations for the Bailiwick to make it easier for pension providers to offer residents in the Bailiwick lower-cost products, as well as working with the States and industry on other law reforms to update and upgrade the legal framework which we oversee for the Bailiwick. We will also, in conjunction with our partners in law enforcement, St. James Chambers (Law Officers of the Crown) and the States, be working with the Moneyval inspectors who will review the Bailiwick's financial crime controls in autumn 2014.

My colleagues provide further detail on these initiatives and our other important work later in this annual report. I would merely like to conclude my statement by thanking those in the States, industry and the Commission itself who have gone out of their way to make me feel welcome since I arrived a few short months ago. I appreciate that it takes several generations before one can be considered a proper Guernseyman but I'm delighted to have been given the opportunity to serve the Bailiwick as Director General of the Commission.

William Mason, Director General

INCOME AND EXPENDITURE ACCOUNT

For the year ended 31 December 2013

	2013	2012
	£000	£000
Income		
Fees receivable	12,678	12,532
Interest received	94	159
	12,772	12,691
Expenditure		
Salaries, pension costs, staff recruitment and training	9,222	8,768
Commissioners' fees	215	238
Legal and professional fees	631	1,520
Premises and equipment, including depreciation	1,407	1,333
Other operating expenses	637	738
Other finance costs	135	205
Commission's contribution to expenses of GTA University Centre	–	440
	12,247	13,242
Surplus/(deficit) of income less expenditure	525	(551)

BALANCE SHEET

As at 31 December 2013

	2013 £000	2012 £000
Fixed assets		
Tangible assets	2,942	2,438
Current assets		
Debtors	469	547
Cash at bank and in hand	646	223
Short-term investments	7,474	6,730
	8,589	7,500
Creditors	(2,490)	(1,790)
Net assets before post-retirement liability	9,041	8,148
Post-retirement liability	(9,389)	(6,774)
Net (liabilities)/assets	(348)	1,374
Reserves	(348)	1,374

INVESTMENT SUPERVISION AND POLICY

Supervision

During 2013 the Division's main regulatory activities continued to be undertaken by its 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 transgressions 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. The Division was restructured in early 2014 to reflect PRISM impact categories relating to supervised firms and products.

The desk-based monitoring function continued to see considerable activity over the course of 2013 as licensees and collective investment schemes responded to changing global economic conditions. Twenty visits to licensees were conducted during the year, including seven undertaken jointly with other Divisions. The visits undertaken by the Division covered not only the directly licensed firms but 74 administered licensees, 142 regulated collective investment schemes and 13 non-Guernsey schemes. Matters identified during these visits were reported to the licensee's senior management and were considered for possible further action.

Policy

EU-driven initiatives continued to take up a significant amount of resource over the year. This is not surprising considering the importance of Europe as a significant market for Bailiwick investment products and services and this focus is likely to continue. The Alternative Investment Fund Managers Directive ("AIFMD"), which seeks to regulate the alternative investment fund sector, including hedge funds, private equity funds and real estate funds, came into force in July 2013.

In July 2013 the Commission signed co-operation agreements with 27 of the 31 Member States regulatory authorities. These co-operation arrangements are a necessary step in helping to maintain marketing access for Bailiwick funds into those countries. Two sets of rules were made by the Commission. The AIFMD (Marketing) Rules 2013 require notification to the Commission of the marketing of Bailiwick investment funds into EU Member States, whilst the AIFMD Rules 2013, which came into effect on 2 January 2014, provide a form of equivalent rules for those firms who wish to opt in for commercial reasons prior to the implementation of a possible marketing passport for non-EU funds that may occur in 2015 or 2016.

The Markets in Financial Instruments Directive ("MIFID") originated in 2007 as part of the larger scheme to establish a single market in the EU. Its impact on Bailiwick investment business had been limited, but that is due to change as a result of proposals which culminate in MIFID II. The major issue likely to impact Bailiwick (and all relevant non-EU) firms is the requirement to establish a branch operation in the relevant Member State where a firm has retail clients situated and for the branch to be subject to certain provisions of the Directive. A dialogue between the Commission, Government and representatives of local regulated firms has commenced, on similar lines to that used regarding AIFMD, and it is expected that during 2014 consideration will be given towards the Bailiwick's response to the proposals.

Finally, consultation had been undertaken during the first half of 2012 in respect of proposals to replace the Collective Investment Schemes (Class B) Rules 1990 with a renewed version of the rules to reflect more up-to-date practices and experience gained over the past 20 years. Taking account of the progress made with AIFMD-related matters, the revised rules, now called The Authorised Collective Investment Schemes (Class B) Rules, 2013, were implemented and the previous Rules revoked. The new rules came into force on 2 January 2014.

Risk Outlook

Major stock markets saw significant volatility during the course of 2013, albeit their overall performance generally tracked upwards over the year. This led to mixed outcomes regarding listed investment valuations with both gains and losses. In the closed-ended investment fund arena, the private equity sector continued to experience liquidity issues and investor appetites for new offerings generally remained lower than they had been several years ago. Whilst confidence levels relating to investment funds began to improve over 2013, it cannot be said that it was sector-wide; rather it focused on individual firms and their underlying promoter groups and their offerings. Unless there are major changes to the international outlook this is likely to continue during 2014.

As a result of the international perspective, both in terms of global market performance and internationally driven regulatory initiatives, it is to be expected that new business flows will continue to remain well below the much higher levels seen between 2007 and 2009. The Division will continue to assess new business proposals on a basis consistent with that employed over the years and it is for regulated firms and advisers to demonstrate to the Commission that they have undertaken sufficient due diligence when taking on new business.

Supervision

As a result of the restructuring of the Commission in mid-2013, the Division now operates with two teams with licensee relationships allocated across those two teams. Applications for the registration of non-regulated financial services businesses ("NRFSB") are shared between the two teams.

Under the structure promoted by EY (formerly "Ernst and Young") in its Internal Evaluation Review ("IER") of the Commission, the Commission's centralised Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") team now undertakes AML/CFT visits to firms in the sector and reports the findings back to the Division. The good news was that there were several firms where there were no material findings, although some firms fell short of best practice, particularly in relation to governance. In a few cases we recommended the establishment of robust new business or client acceptance committees.

The Division conducted on-site visits to a cluster of pension providers. In general terms this highlighted some shortcomings in administration and some gaps in best practice controls, perhaps indicating the presence of inadequate procedures during the rapid expansion of previous years on the back of the growth of Qualifying Recognised Overseas Pension Schemes ("QROPSs").

In the non-regulated financial services business sector the Division has engaged with a number of enquirers relating to the provision of payment services and innovative financial services offerings.

The Division successfully undertook a sector-wide thematic review on data security. Some best practice recommendations emerged from this but generally there was a very positive response in that it raised awareness of several technical issues which licensees had not considered before. The electronic delivery of the questionnaires and responses was a first for the Division and the experience from the thematic review enabled us to employ the same delivery system at the due date for reporting the Annual Returns.

The introduction, in 2013, of the Guernsey Foundation Law made way for the use of Guernsey Foundations as a means of holding and transferring assets. We have seen the employment of this new product in several wealth-holding structures but its take-up has been modest. At the end of the first year, 13 Foundations had been registered in the Bailiwick; however, it is early days.

At the Commission's presentations to industry in December, the Division addressed three main areas under the heading "Managing Risks at the Frontier":

- an overview of sector developments with a call to become smarter on risk awareness, to articulate risk appetite better and to embed risk assessment with the business developers;
- a review of NRFSBs which led us to call for a more comprehensive risk assessment of the diverse risks associated with the businesses being conducted through these entities in the Bailiwick; and
- our review of pension business which led us to urge providers to improve governance culture, develop proper procedures around suitability of product and adequately resource their business.

Policy

During the year the Division met with fellow fiduciary supervisors in the Quatre Isles Group (comprising Guernsey, Jersey, the Isle of Man and Gibraltar) to share and explore topics of mutual interest and to discuss our input to the revised Statement of Best Practice for Trust and Corporate Service Providers which is being taken forward by the Group of International Finance Centre Supervisors ("GIFCS"). Guernsey chairs the working group on reviewing and refreshing the Statement of Best Practice and it was helpful to receive contributions ahead of the plenary meeting of GIFCS. This took place in November where drafting sessions continued and where we were able to benefit from input from supervisors from the Caribbean jurisdictions. One issue identified in that exercise is that our approach to the calculation of Financial Resources Requirements ("FRR") is less clear than in our peer jurisdictions. We have proposed that a technical working group should be set up with the Guernsey Association of Trustees to review the adequacy of this concept in the Bailiwick and this work should commence during 2014.

We are also consulting pension providers and other stakeholders on the adequacy of the Commission's rules on Retirement Annuity Trust Schemes ("RATS"). This was announced at the Commission's 2013 presentations to industry. The object of the exercise is to see whether the total cost to Guernsey residents of participating in such schemes could be reduced in order to encourage saving for retirement. An avenue that will be explored is whether Bailiwick residents could be allowed to make self-investment arrangements for their pension scheme and so avoid the burden of investment management fees.

Risk Outlook

During the year we continued to receive enquiries from potential new entrants to the sector.

Looking forward we would anticipate a more settled year as economic activity in the major economies begins to pick up, bringing with it the potential for greater business volumes in the Bailiwick's fiduciary sector, albeit perhaps with a time lag. What we will see are some changes of controllers of fiduciary firms – which requires regulatory approval from the Commission – as several transactions which were initiated in 2013 continue to run their course in 2014. Two of those transactions will see the growing presence of private equity firms in the ownership of the sector. That prospective investment is, itself, a positive message suggesting underlying optimism about the sector.

Supervision

In July 2013, the Banking and Insurance Divisions were merged into one. One reason for this was that each Division had shrunk as a result of process redesign, centralisation and a continuing fall in bank licences. The new Division has been able to deliver business efficiencies as well to begin the task of sharing approaches to supervision. The new Division continues to deliver subject matter expertise around areas distinct to banking and insurance.

In global terms, 2013 was another relatively tough year for insurers. Interest rates remained low and general insurance premiums tight. The cost of natural catastrophes is heading to be marginally above average. On the other hand, asset prices recovered, the Eurozone was relatively stable and the industry continued to develop new distribution channels. The most significant global trend from the point of view of the Bailiwick insurance industry was a material increase in alternative financing, especially for catastrophe risk.

2013 aggregate figures are provided in arrears and, as such, are unavailable at present; but 2012 gross assets stood at £22.90bn, net worth £9.34bn, and premiums £4.63bn. This represented little change from 2011. However, given that these numbers are significantly influenced by a few large firms, they do not give a good indication of the degree of activity amongst smaller international firms in the Bailiwick. Whereas in 2012, the number of international insurer licences increased in net terms by 50, growth in 2013 was more modest but still increased by 21 from 737 in 2012 to 758 in 2013. There was a tailing-off in the popularity of the NewBuy Scheme, as the UK Government introduced other incentives to UK house building. In addition, there was a rationalisation of a block of effectively dormant cells. Despite these negative factors, net licence numbers still increased due to an increase in catastrophe cell business and the continuing popularity of the Bailiwick for captive business.

In terms of licence types, the Protected Cell Company ("PCC") cell remained by far the most popular. Traditional company licences remained flat in net terms at 242 compared to 414 PCC cells. However Incorporated Cell Company ("ICC") cell numbers grew from 18 to 26.

As in previous years, in 2013 the domestic Bailiwick market remained stable in terms of licences. In 2013, there were eight licensed domestic insurers dealing with local requirements compared to the same number in 2012, and 20 authorised managers serving the captive market compared to 19 in 2012.

The Division continued, in 2013, to vet carefully all new licence applications, including preliminary meetings with prospective licensees. Formal applications in principle were processed generally within one month.

Over the course of 2013 the Division began a programme of business rationalisation aiming to secure internal efficiencies and this programme continues into 2014.

There were relatively few major supervisory issues affecting insurance firms. Where problems arose and, in so far as there was a common denominator, it was poor corporate governance.

There was only one supervisory college event which the home regulator called by conference call; the Commission participated fully in this call.

Policy

The Commission continued to be engaged in the international insurance arena. The Bailiwick has a seat on the Technical Committee of the International Association of Insurance Supervisors ("IAIS") and continues to lead on the IAIS update of its captive paper. In October 2013, the Bailiwick was elected to chair the Group of International Insurance Centre Supervisors.

In 2013, after extensive discussion with the industry and a local quantitative impact study, the Commission issued a major insurance consultation paper in order to ensure that the Bailiwick adheres to new international insurance standards. Broadly this paper differentiates capital requirements by types of issuer, as well as setting out appropriate supervisory standards around corporate governance, disclosure and group supervision. It adapts supervisory practice in order to ensure that supervisory resources are committed at an early stage where an insurance company's capital is under pressure. This paper will be taken forward in 2014.

Risk Outlook

The current boom in alternative financing will, in due course, tail off and the local industry needs to think of further business diversification. Fronting agents and re-insurance are used extensively in the Bailiwick and there is always the remote risk of a large non-Bailiwick insurer or re-insurer failing; vigilance around credit ratings is therefore paramount. There is some danger that adverse connotations will arise from the term "captive" as US life insurance firms use the term to describe intra-group extra-state attempts to engage in regulatory and tax arbitrage.

Supervision

The last two years have been mixed for banks in the developed world. Although funding has been accessible and provisioning levels have stabilised, the net interest rate margin has remained low. Regulatory and shareholder pressure has led to improved capital levels but this in turn has limited balance sheet size. Increasingly, banks have been subject to regulatory fines reflecting market misconduct, mistreatment of consumers or Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") and tax evasion issues. Growth in the developed world has remained limited, although there was some recovery in the UK and USA in the latter part of 2013.

Conditions in the Bailiwick remain correspondingly difficult. In recent years the retail model of up-streaming has been affected by regulatory concerns at both the home and host level and this, together with the impact of UK bank restructuring, has led to shrinkage of the retail sector in the Bailiwick. Expatriate deposits have been increasingly centralised for business reasons in other jurisdictions. The tight net interest margin has held back profits given that this is the largest single source of profit for the Bailiwick banking sector. Global deleverage has also taken its toll in the Bailiwick.

As a result of all the above factors, non-Swiss fiduciary deposits have fallen from £85bn in 2008 to £61bn in 2013, albeit broadly flat from 2012. Low interest rates have, in particular, reduced the attraction of Swiss fiduciary deposits. These have fallen in the Bailiwick from a peak of £71bn at end-2008 to £23bn at end 2013, down £3bn from 2012. Aggregate deposits and other assets stood at a peak of £179bn at end 2008 but fell to £107bn at end 2013, down £7bn from end 2012.

Bank licences have fallen from 48 in 2008 to 31 in 2013, with one small private bank leaving in 2013. Full-time staff numbers in the Bailiwick have fallen from 2,009 to 1,605 over the same period, compared to 1,692 in 2012.

The aggregate pre-tax profit for Bailiwick subsidiaries after provisions remained at much the same level in 2013 as in 2012; that is, 7% return on actual capital or 12% return on regulatory capital. Many subsidiaries have high capital ratios for large exposure reasons.

Individually, each bank has its own story to tell. In 2013, some banks took on staff due either to additional business arriving as a result of group activity or in anticipation of a pick-up in demand for wealth advice. Several banks continue to fulfil an essential supporting role to other group activities in the Channel Islands in the other financial sectors, or more widely across the world.

The minimum regulatory capital requirement in the Bailiwick is a risk asset ratio of 10% – otherwise expressed as an Internal Capital Guidance (ICG) ratio of 125%. All banks operate above this limit.

In 2013, the Division continued its programme of supervisory oversight. Its review of banks' subsidiary Individual Capital Adequacy Assessment Processes ("ICAAPs") is on an 18-month cycle such that 10 were completed in 2013. Apart from meetings to deal with particular issues as they arose, there were 12 routine prudential visits in 2013, including branches. The division attended three supervisory college meetings and one through a conference call and there was periodic bilateral contact with home regulators. The Division conducted three on-site credit reviews. There were several meetings with the Association of Guernsey Banks.

In 2013, there was no one overriding supervisory issue. Instead the Commission continued to discuss with banks a range of issues such as up-streaming limits, structural internal changes, operational problems and dividend payments.

Policy

As a response to the global financial crisis, the Bank for International Settlements ("BIS") has put in train a series of policy changes – known as Basel III. The Division is participating in a common Crown Dependency response to these proposals with sister regulators in Jersey and the Isle of Man. In the Bailiwick this has taken the form of the issuance to local banks of two discussion papers in 2013. The first considers the nature of capital in line with Basel III – though this hardly affects the Bailiwick's banks as the quality and quantity of capital in Bailiwick banks are already generally high. The second is around the potential treatment of domestically significant international banks. Other discussion papers are likely to follow and all should, in due course, be wrapped up into one consultation paper.

The paper on domestically significant international banks also touches on the issue of resolution. This is at a preliminary stage of consideration and will depend on how the "Vickers" debate affects the Bailiwick. The Commission is working closely with sister regulators and the Bailiwick's government to provide advice in this area.

The Division issued one consultative paper in 2013, namely on large exposures. The current large exposure policy dates from 1994 and is in need of revision. It was also necessary to consider the policy in the light of the global financial crisis and the EU's 2009 large exposures directive, with a 2013 BIS paper also being relevant. The consultative paper marginally hardens policy for third-party and sovereign large exposures and, significantly, augments limits on bank exposures. This follows the failure of many banks during the global financial crisis and is in line with international regulatory policy. The paper also offers new guidance on connected parties. The new large exposure policy will be introduced in 2014.

Risk Outlook

Banks in the Bailiwick continue to face the risk of a local adverse finding connected with AML/CFT and/or tax evasion; the maintenance of high standards in this area is therefore crucial. A newer risk that is emerging is around mis-selling claims by corporates and wealthy individuals; this points to the need for extra care around the selling process. Finally, banks need to take care around the long-term operational risks potentially associated with short-term cost cutting.

CONDUCT UNIT

In July 2013, a Conduct Unit was created to concentrate on the treatment of predominantly local consumers. The Unit consists mostly of people with experience in the oversight of insurance intermediaries. One person undertook a three-month secondment with the UK Financial Conduct Authority to gain practical experience of its approach to consumer protection.

The Unit's immediate focus has been the second iteration of a series of 12 thematic on-site visits looking at sales practices around long-term insurance policies. As a result of this, most firms have been asked to undertake remedial actions.

Allied to this thematic, the Unit has also taken responsibility for the delivery of the Guernsey Financial Advice Standards ("GFAS"), which was an initiative launched by Government. In 2013, in a consultative paper, the Unit set out its proposals to raise educational requirements and disclosure standards in the Bailiwick. This will also involve significant rewriting of local rules and regulations. GFAS comes into effect on 1 January 2015.

The Unit has also been active in forging links with other interested bodies, including the new Channel Islands Ombudsman, the Citizens Advice Bureau and Government departments. In 2014, the unit plans to develop a Commission internet page directing the public to key information sites as well as setting out easy-to-understand outlines of consumer regulation. The Unit's agenda will further develop over 2014 as it takes into account stakeholder feedback.

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General

A dedicated Enforcement Division was created by the Commission in the summer of 2013 with the objective of developing a centre of excellence within the Commission to investigate a range of enforcement matters, particularly those involving significant breaches of regulatory requirements and poor conduct. This marks a change of approach by the Commission to enforcement activity.

The Division commenced its work in earnest at the beginning of September. The Division has a good balance of enforcement and supervisory knowledge.

A review of the policies and procedures for enforcement was commenced during the fourth quarter of 2013 and it is anticipated that this important work will be completed by the end of the second quarter of 2014. Part of this process was to rewrite the guidance on the decision-making process and then to publish these guidelines, via the Commission's website, on the change to the decision-making process. This has been extended from the previous guidance and the revised document presents, in more depth, the process which the Commission will follow when engaging with a licensee or individual regarding enforcement matters. It also sets out the staged approach that will be taken, either by a Supervision and Policy Division or the Enforcement Division, when matters are dealt with under the legal powers that are available to the Commission.

One major change is that cases that have, until now, been heard by a Decisions Committee (a panel of Commissioners) will in future normally be heard before a senior lawyer who will be appointed as a judicial officer of the Commission. The Commission is establishing a panel of such lawyers to hear future cases.

Cases

The Division has been busy from inception, having also taken on a number of outstanding cases. It is anticipated that these legacy cases will be brought to a conclusion during 2014.

Two of the legacy cases were brought to a conclusion towards the end of 2013, with fines totalling £160,000 being imposed. In one of these cases a prohibition was also placed on an individual. In both cases public statements were published on the website in order to show the findings of the investigation. At the conclusion of enforcement cases found in favour of the Commission, it will be practice for this to occur. However, it has to be highlighted that in both of these cases the relevant parties engaged with the Commission at the end of the investigation in an effort to bring matters to a conclusion, with relevant discounts being applied due to this fact.

This revised and proportionate approach (towards early settlement) was highlighted at the industry presentations in December and is contained in the new guidance on the decision-making process which is available on the Commission's website. The Commission intends to encourage this approach where it is appropriate to do so, although this will remain at the discretion of the Commission.

Whistleblowing Line

In September 2013, in line with similar actions taken by regulatory bodies in other jurisdictions, the Commission introduced a whistleblowing line as a method for receiving information about regulatory misconduct. Calls to the whistleblowing line are neither electronically recorded nor traced by the Commission and callers can remain anonymous if they choose to do so (Tel: 01481 748094).

Whistleblowing lines have proved successful in other jurisdictions and have assisted in providing information which has led to bad practices being identified and addressed. It is clearly in the interests of customers, and those firms who are carrying on their business properly within the Bailiwick, that the Commission is able to identify those which are failing to comply with the regulatory requirements.

The line is manned by staff from the Commission's Intelligence Team who review the information supplied and consider if a referral to the Commission's Supervision and Policy Divisions is required. A referral may lead to action by the Enforcement Division.

FINANCIAL CRIME TEAM

General

The Anti-Money Laundering ("AML") Unit was established in November 2012 as part of the implementation of the recommendations made in the Independent Evaluation Review ("IER") undertaken in 2011 by EY (formerly "Ernst and Young"). In July 2013 the team became one of the components of the Financial Crime and Authorisations Division ("FC&A") and is now known as the Financial Crime Team.

Role

When it was first formed in 2012, the AML Unit's primary responsibilities were the undertaking of on-site visits in order to verify compliance with the regulatory requirements and effective management of money laundering and terrorist financing risks. The Financial Crime Team was also responsible at that time for industry enquiries and in identifying appropriate and effective means by which to address Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") non-compliance.

Following the creation of the FC&A division in July 2013, the Financial Crime team's responsibilities were expanded to include the broader area of financial crime and related policy activities, which were formerly undertaken by the Policy and International Affairs Division. This expansion of duties also encompassed responsibilities for the issuance of Guidance, Notes, Instructions and the management of the two AML/CFT Handbooks as well as continuing to perform on-site visits covering AML/CFT and the broader subject of financial crime.

The Financial Crime Team conducted a total of 52 visits during 2013 across the various financial and non-financial sectors (e.g. accounting firms, estate agents) of the Bailiwick.

In 2013, the Commission commenced its assessment of how best to implement the 2012 Financial Action Task Force ("FATF") recommendations. A working group was formed comprised of compliance personnel from various industry sectors to review the existing Handbooks and their provisions, and to identify possible areas of revision in consideration of the 2012 Recommendations. The Commission has begun to take steps to embed the principles underlying those FATF recommendations in its financial crime supervisory activities so as to ensure that these are taken into account in a proactive and effective manner whilst our Handbook is being developed.

AUTHORISATIONS TEAM

General

The Authorisations Unit was established in October 2012 as part of the implementation of the recommendations made in the IER undertaken in 2011 by EY. It is one of the components of the FC&A division formed in July 2013 to give increased focus to the Commission's AML and authorisations activity.

Role

The role of the authorisations team is to act as a first line of defence against unsuitable firms and individuals being licensed or registered to conduct financial services business in the Bailiwick.

The Authorisations team provides a centralised function for the Commission through the intake and processing of Personal Questionnaires ("PQs") and Personal Declarations ("PDs"). This approach is designed to allow for efficient and cost-effective processing of these forms. The team's activities also include the undertaking of due diligence in relation to the subjects of the PQs and PDs along with other persons, both natural and legal, relating to certain regulatory applications.

The team has also been working in conjunction with the Chief Transformation Officer's team on the development of a portal which will facilitate the online filing of PQs and eliminate the need for paper PQs. This new service should be available in the summer of 2014.

In addition, since May 2013, the Authorisations team has been responsible for the processing of "Fast-Track Funds", comprising applications relating to the authorisation of Qualified Investor Funds, Registered Collective Investment Schemes and Non-Guernsey Schemes. The Authorisations team works collaboratively with the other Supervision and Policy Divisions to ensure that all assessments are undertaken in an effective manner.

During 2014 the Authorisations team will be assuming other authorisations functions which will benefit from a centralisation of knowledge and processes.

During the calendar year 2013, the Authorisations team processed the following:

- PQs received in 2013 – 865
- PDs received in 2013 – 2,597
- "Fast-Track Fund" applications since May 2013 – 101

The Authorisations team is represented at meetings with industry by the Head of the FC&A Division or the Assistant Director of the team. In December 2013, the Head of the Division gave a presentation to the Non-Executive Directors Forum which covered the functions of the team and its processing activity during the year. The Authorisations team seeks actively to engage with individuals and industry as a whole so that the activities which it undertakes are understood and applications can be processed in a timely manner.

Introduction

The Finance and Operations Division ("F&O") is central to the smooth operation of the Commission and its overarching aim is to support the Supervision and Policy Divisions, the Executive Office and the Central Units in the execution of their primary roles.

F&O provides financial and management information, communications and information systems, human resources and facilities management to the Commission. The Division includes the new Data Management Unit, which commenced operation in May 2013 with the aim of delivering economies through the centralisation of common functions in one location.

The Division also works closely with the Project Management teams which are delivering further organisational change under the overarching Sentinel programme and in support of PRISM.

During 2013, the Commission put considerable time and effort into re-analysing and developing its approach to identifying key organisational objectives. Previously, the setting of key objectives had been undertaken at divisional level and it was decided that a more comprehensive, dynamic and flexible method was required to focus the Commission's activities in an efficient, cost-effective and timely manner.

Therefore, with the 2013 key objectives (set in March 2012) having been realised, in September 2013 the Commission introduced a balanced scorecard for the first time. Further details follow.

Financial Information

The financial statements are shown on pages 32 to 43.

The overall surplus for the year 2013 was £525,347, compared to a deficit in 2012 of £550,746. Costs for 2013 were 8% lower than in 2012, or 4% lower excluding the contribution to the GTA University Centre, which ceased on 31 December 2012. This reduction comprised a blend of recurring costs, such as legal costs associated with enforcement, and non-recurring costs, such as the conclusion of the Independent Evaluation Review ("IER").

The 2013 result reflects a significant decrease in net enforcement costs associated with investigative and enforcement activity. This is due firstly to the establishment of the Enforcement Division, which had the effect of bringing costs in-house, and secondly due to the successful recovery of some enforcement costs.

During 2013, the Commission started to implement its Sentinel programme, with the majority of the current and future costs being capital in nature. In 2013, Sentinel activities focused on its IT solution for a structured approach to risk-based supervision (PRISM). It will be adopted across all Supervision and Policy Divisions during 2014. Work was also conducted on the Commission's portal, which should have an initial roll-out to industry in the first half of 2014, although the second phase – full computerisation of all standard Commission returns – is likely to last well into 2015.

Income and expenditure by sector are set out in table 2 on page 55.

Pensions

The Commission's staff are members of one of two Pension Schemes: a Defined Benefit Scheme (which is part of the States of Guernsey's Superannuation Fund and which has been closed to new entrants since 1 January 2008) and a Defined Contribution Scheme, which the Commission adopted for staff joining from 1 January 2008.

Defined Benefit Pension Scheme under Financial Reporting Standard 17 ("FRS 17")

The basis of preparing FRS 17 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.

The deficit at 31 December 2013 reported under FRS 17 is £9,389,067, an increase of £2,614,776, reflecting an inflation assumption that has increased by 0.5% and a discount rate that has decreased by 0.2%, together with an actual investment return that was higher 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 accrued benefits, irrespective of the planned closure to future service accrual.

The scheme's actuary carried out a full actuarial valuation of the scheme as at 31 December 2013, though the results are not yet available. The Commission requested the actuary to prepare an estimated funding valuation as at 31 December 2012 which shows a shortfall of £56,000, a figure considerably lower than that disclosed by the FRS 17 calculation of £9,389,067.

There are extensive disclosures required under FRS 17 which are intended to be an aid in comparing pension costs and liabilities between companies. FRS 17 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 deficit in the pension scheme as at 31 December 2013 reflects assumptions based on conditions that existed at that date, including the assumption that the scheme would continue as an active scheme, whereas (and as described overleaf) the Commission is closing the scheme to new accruals with effect from 1 July 2014, marking an end to current service costs relating to the provision of a defined benefit pension. The effect of the closure to future service accrual will be reported in the financial results for 2014.

Closure of the Defined Benefit Pension Scheme

The terms of the States' Public Sector Pension Scheme ("PSPS"), which is a defined benefit pension scheme, have been under review by a working party established by the States of Guernsey, with proposed changes to those terms being discussed with representatives of members of the whole scheme before any changes are effected.

During the second half of 2013, the Commission consulted staff who were members of the PSPS defined benefit scheme with a view to the possible closure of that Scheme to new contributions. This action was prompted by the need to stabilise the Commission's cost base and the requirement to manage the risks inherent in defined benefit schemes, principally the uncertainties surrounding life expectancy. The outcome was a decision taken in December 2013 to close the scheme to future service accrual from 1 July 2014 and to offer those members defined contribution-type alternatives. The Commission's portion of the States' PSPS defined benefit scheme will therefore comprise, from that date, deferred members and members with pensions in payment, but no active members. The Commission forecasts not only a significant saving in current pension service costs from 1 July 2014, but also a reduction over time in its exposure to the financial volatility associated with the PSPS defined benefit scheme.

The pension scheme deficit will continue to be recognised in the balance sheet in accordance with FRS 17 (and, from 2015, in accordance with FRS 102, which is the Revised Financial Reporting Standard that the Commission plans to adopt from 1 January 2015). The Commission will continue to meet the States of Guernsey's requirements in keeping the PSPS defined benefit scheme funded for the benefit of all Commission members. The States of Guernsey has previously undertaken 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 Fund would then be met by the States of Guernsey from general revenue.

Staff Remuneration

Salary and related costs for the year were £9,356,663 (which is the combined total of £9,221,754, and the pension-related charge of £134,909 disclosed as other finance costs) in the year, compared to the 2012 equivalent of £8,972,850. An analysis of these figures is provided in table 4 on page 55. Pension costs, including other finance costs, increased by £12,000 in 2013.

Analyses of staff by salary band and movements in staff numbers are shown in tables 5 and 6 on page 56.

A breakdown of Commissioners' fees is shown in table 8 on page 57.

Fees

Fee rates for 2013 were generally increased by 2%. For 2014, other than in respect of anomalies, a general increase of 0.3% was applied (0% for the investment sector).

The fees regulations for the banking, fiduciary, insurance and the non-regulated financial service business sectors were revised with effect from 1 January 2014.

A list of the current regulations prescribing fees payable is:

- The Financial Services Commission (Fees) Regulations, 2013;
- The Financial Services Commission (Fees) (Amendment) Regulations, 2013;
- The Protected Cell Companies and Incorporated Cell Companies (Fees for Insurers) Regulations, 2013;
- The Registration of Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) (Fees) Regulations, 2013;
- The Amalgamation and Migration of Companies (Fees Payable to the Guernsey Financial Services Commission) Regulations, 2013;
- The Criminal Justice (Proceeds of Crime) (Legal Professionals, Accountants and Estate Agents) (Bailiwick of Guernsey) (Amendment) (No.3) Regulations 2013.

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

GTA University Centre

The Commission discontinued its financial support of the GTA at the end of 2012 on the basis that the provision of funding for an external training institution was not a core function of a financial services regulator, particularly as that funding could not be ring-fenced for finance sector training. Those funds have been used towards investment in the Sentinel programme, to offset increased regulation and enforcement expenditure and to ameliorate the need for higher rates of fee increases.

Retained Reserves

As a result of the FRS 17 calculations and increased pension deficit for 2013, described above, the retained reserves are now £(348,163). However, the Commission maintains substantial cash balances to cover its liabilities and unforeseeable expenditure, such as enforcement, so its liquidity risk is low. The Commission maintains a policy of keeping liquid funds in excess of £3 million to enable the efficient and uninterrupted financing of its activities.

Given the decision to close the defined benefit pension scheme to future accrual, savings are anticipated which are expected to return the reserves to a positive figure. Unlike a conventional company the Commission is not insolvent as a result of having negative reserves as its pension liabilities are underwritten by the States of Guernsey. The Commission will seek to run operating surpluses in the medium term to rebuild its net assets to a positive level, although both enforcement costs and FRS 17 / FRS 102 pension numbers are very volatile from year to year.

Review of Key Objectives - Introduction of a Balanced Scorecard

The essence of a balanced scorecard is that key objectives are identified and articulated at an overall organisational level before being carefully weighted (balanced) to ensure work is appropriately prioritised. The conceptual links between a balanced scorecard and our drive towards risk/impact-based supervision (such as we are implementing using PRISM) are self-evident.

The scorecard is a proven tool to identify, effectively monitor and achieve objectives across the Commission that will enable us to become better at what we do in a holistic and balanced way. The objectives that were established during late 2013 are forward-looking and dynamic, based upon exercising good, effective and proportionate regulation. They are detailed below:

- Execute high-quality supervision and risk-aware authorisation processes;
- Deliver high-quality regulatory policy;
- Deliver targeted, high-value enforcement;
- Maintain and enhance international reputation and influence;
- Manage costs rigorously, delivering best value; and
- Develop staff.

Once high-level organisational objectives are agreed, supporting and specific tasks must then be identified across all of the Supervision and Policy Divisions, Executive Office and the Central Units. In this way, every task, however small, is capable of being linked directly to an organisational objective and hence it can be established how the activity contributes to achieving the Commission's overarching mission, summarised as "Winning for the Bailiwick".

A balanced scorecard is a unique tool for each organisation. The Commission has taken significant steps in introducing this approach as a way to focus activity, in a balanced manner, on high-level priorities. The adoption of the scorecard is beginning to permeate the daily life of all of our staff and we are developing a cultural foundation upon which to build. The overarching purpose remains for every functional area, as well as each individual, to have clearly articulated priorities, objectives and targets which are aligned to the high-level priorities established by the Commission.

Throughout 2014 the approach outlined above will continue to be developed and tailored to suit our organisation and it will be the role of the Chief Operating Officer to drive and monitor this.

Human Resources

2013 was a year of internal reorganisation and restructuring within the Commission. Our staff have shown great resilience and flexibility and are now well placed to continue to develop their skills and experience further. An in-house and external training programme supports and underpins the development of our staff.

Facilities Management

The Commission enhanced its business continuity arrangements and in particular its computer server resilience through lessons learned during the power outage which affected parts of St. Peter Port in October 2013. It also maintains a dedicated area at a service provider's premises in order to ensure it is able to recover swiftly from adverse incidents.

Communications and Information Systems

Information systems lie at the core of efficient and effective operational performance across the Commission. The IT elements of the PRISM solution for risk-based supervision were successfully launched in autumn 2013. Also launched were enhancements to the central regulatory database for the development of the Authorisations Unit and for the establishment of the Data Management Unit.

Data Management Unit

The Data Management Unit supports all the Supervision and Policy Divisions, the Executive Office and the Central Units in handling incoming physical mail, annual returns, annual accounts and statistical returns for the banking and insurance, investment and fiduciary sectors.

As the Sentinel programme moves forward, the Data Management Unit will find itself not only more enlaced with daily activity, but also outward facing, as certain online submissions will come directly to it. It is acquiring more tasks as its capability develops, such as providing anonymised statistics from Bailiwick financial institutions to the International Monetary Fund ("IMF") for its Coordinated Portfolio Investment Survey ("CPIS") annually. Also during the year it has moved the Commission much closer to electronic records retention instead of relying on physical document archives.

Independent Auditor's Report to 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 2013 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 Commission, in accordance with our Terms of Engagement as detailed in our letter dated 28 November 2013. Our audit work has been undertaken so that we might state to the Commission those matters we are required to state 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 for our audit work, for this report, or for the opinions we have formed.

Statement of the Commission's Responsibilities

The Commission is 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 Commission is 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 Commission is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Commission and to enable it to ensure that the financial statements have been prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. It is 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 the Commission and Auditor

As explained more fully above, the Commission is 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 Financial Reporting Council's ("FRC'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 Commission; 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. 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 2013 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.

BDO Limited
Chartered Accountants
Guernsey
12 May 2014

INCOME AND EXPENDITURE ACCOUNT

For the year ended 31 December 2013

	Note	2013	2012
		£	£
Income	2		
Fees receivable	1(b)	12,517,683	12,532,222
Financial penalties imposed	1(c)	160,000	–
Interest receivable and similar income	1(d)	94,491	159,456
		12,772,174	12,691,678
Expenditure			
Salaries, pension costs, staff recruitment and training		9,221,754	8,767,951
Commissioners' fees		214,583	237,891
Legal and professional fees		631,116	1,519,846
Premises and equipment, including depreciation	1(f), 1(h), 4, 10	1,406,684	1,333,318
Other operating expenses		629,031	729,769
Other finance costs	1(i), 7(b)	134,909	204,899
Auditor's remuneration		8,750	8,750
		12,246,827	12,802,424
Commission's contribution to expenses of GTA University Centre	9	–	440,000
		12,246,827	13,242,424
Surplus/(deficit) for the year		£525,347	£(550,746)

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

The notes on pages 36 to 43 form an integral part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2013

	Note	2013	2012
		£	£
Surplus/(deficit) for the year		525,347	(550,746)
Actuarial (loss)/gain	7(e), (k)	(2,247,755)	1,274,589
Total recognised (loss)/gain for the year		£(1,722,408)	£723,843

The notes on pages 36 to 43 form an integral part of these financial statements.

BALANCE SHEET
As at 31 December 2013

	Note	2013	2012
		£	£
Fixed assets			
Tangible assets	4	2,941,650	2,438,323
Current assets			
Debtors	5	468,629	547,259
Short-term investments	1(g), 13	7,474,029	6,730,106
Deposits with States Treasury	13	21,650	21,519
Cash at bank and in hand	13	624,396	201,124
		8,588,704	7,500,008
Creditors – amounts falling due within one year	6a	(2,385,750)	(1,718,945)
Net current assets		6,202,954	5,781,063
Creditors – amounts falling due after one year	6b	(103,700)	(70,850)
Net assets before post-retirement liability		9,040,904	8,148,536
Post-retirement liability	7(a), (k)	(9,389,067)	(6,774,291)
Net (liabilities)/assets		£(348,163)	£1,374,245
Reserves	8	£(348,163)	£1,374,245

The financial statements on pages 32 to 43 were approved by the Commissioners and signed on their behalf on 12 May 2014 by:

C Schrauwers
Chairman

S Farnon
Vice-Chairman

W Mason
Director General

The notes on pages 36 to 43 form an integral part of these financial statements.

CASH FLOW STATEMENT
For the year ended 31 December 2013

	Note	2013	2012
		£	£
Reconciliation of surplus/(deficit) of income less expenditure for the year to net cash inflow from operating activities			
Surplus/(deficit)		525,347	(550,746)
Other finance costs	7(b)	134,909	204,899
Current pension service cost	7(c)	682,690	798,833
Contributions made to pension scheme	7(d)	(450,578)	(532,031)
Depreciation on tangible fixed assets	4	478,113	404,825
Interest receivable		(94,491)	(159,456)
Decrease/(increase) in debtors		78,630	(47,331)
Increase /(decrease) in creditors		699,655	(617,958)
Net cash inflow/(outflow) from operating activities		£2,054,275	£(498,965)
Return on investments and capital expenditure			
Returns on investments and servicing of finance – interest		94,491	159,456
Capital expenditure	4	(981,440)	(320,172)
Management of liquid resources	1(g), 13	(743,923)	(882,110)
Net cash outflow from investments and capital expenditure		£(1,630,872)	£(1,042,826)
Increase/(decrease) in cash in the year		£423,403	£(1,541,791)
Reconciliation of net cash flow to movements in net funds			
Increase/(decrease) in cash in the year	13	423,403	(1,541,791)
Net funds at 1 January	13	6,952,749	7,612,430
Cash outflow from increase in liquid resources	13	743,923	882,110
Net funds at 31 December	13	£8,120,075	£6,952,749

The notes on pages 36 to 43 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2013

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 United Kingdom. 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) Financial penalties imposed

The Commission imposed financial penalties during the year under Section 11D(1) of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

(d) Interest

Bank and States Treasury deposit interest is accounted for on an accruals basis. Interest income received on a portfolio of certificates of deposit is also included, and accounted for on an accruals basis.

(e) 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.

(f) 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	over the shorter of 10 years and the estimated useful economic life of the assets
Computer equipment:	
Hardware	33⅓% straight-line
Software	over the shorter of 10 years and the estimated useful economic life of the assets

(g) Short-term investments

Short-term investments, represented by a portfolio of certificates of deposit and managed by an investment manager, are actively traded and thus included as current assets irrespective of the maturity date of individual certificates.

(h) 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.

(i) 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.

1. Accounting policies (continued)

(i) Pensions (continued)

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 2013	1,272,523	438,711	600,452	1,760,135	4,071,821
Additions	7,849	5,680	67,016	900,895	981,440
Disposals	–	(5,822)	(105,996)	(166,420)	(278,238)
At 31 December 2013	1,280,372	438,569	561,472	2,494,610	4,775,023
Depreciation					
At 1 January 2013	126,494	181,408	475,586	850,010	1,633,498
Charge for the year	55,961	74,736	74,491	272,925	478,113
On disposals	–	(5,822)	(105,996)	(166,420)	(278,238)
At 31 December 2013	182,455	250,322	444,081	956,515	1,833,373
Net book value at 31 December 2012	£1,146,029	£257,303	£124,866	£910,125	£2,438,323
Net book value at 31 December 2013	£1,097,917	£188,247	£117,391	£1,538,095	£2,941,650

5. Debtors

	2013	2012
	£	£
Other debtors	18,903	140,125
Prepayments	449,726	407,134
	£468,629	£547,259

6a. Creditors – amounts falling due within one year

	2013	2012
	£	£
Expense creditors and accruals	1,148,378	846,378
Fees received in advance	1,237,372	872,567
	£2,385,750	£1,718,945

6b. Creditors – amounts falling due after one year

	2013	2012
	£	£
Expense accruals	103,700	70,850
	£103,700	£70,850

7. Superannuation

(i) FRS 17 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 was last calculated at 31 December 2012, resulting in a funding deficit of £56,000. The scheme's actuary is carrying out a full actuarial valuation as at 31 December 2013, though the results are not yet available.

The valuation used for FRS 17 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.

(This scheme will close to future service with effect from 1 July 2014, although the pension scheme deficit will continue to be recognised in the balance sheet in accordance with FRS 17 – see Post-Balance Sheet event, detailed at Note 14).

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

	2013	2012
	£	£
Fair value of scheme assets	17,123,000	15,277,000
Present value of funded obligations	(26,512,067)	(22,051,291)
Net pension liability	£(9,389,067)	£(6,774,291)

The asset and liability values on the FRS 17 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:

	2013 £	2012 £
Interest on obligation	1,029,669	982,298
Expected return on scheme assets	(894,760)	(777,399)
Other finance costs	134,909	204,899
Current service cost	682,690	798,833
Expense recognised in income and expenditure account	£817,599	£1,003,732
Actual return on scheme assets	£1,845,929	£1,303,183

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

	2013 £	2012 £
Opening defined benefit obligation	(22,051,291)	(21,033,140)
Current service cost	(682,690)	(798,833)
Interest on obligation	(1,029,669)	(982,298)
Contributions by members	(234,184)	(255,208)
Actuarial (losses)/gains on obligations	(3,068,403)	748,805
Net benefits paid, including pensions, lump sums, refunds of member contributions and transfer values	554,170	269,383
Closing defined benefit obligation	(£26,512,067)	(£22,051,291)

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

	2013 £	2012 £
Opening fair value of scheme assets	15,277,000	13,455,961
Expected return on scheme assets	894,760	777,399
Actuarial gains on scheme assets	820,648	525,784
Contributions by employer	450,578	532,031
Contributions by members	234,184	255,208
Net benefits paid, including pensions, lump sums, refunds of member contributions and transfer values	(554,170)	(269,383)
Closing fair value of scheme assets	£17,123,000	£15,277,000

7. Superannuation (continued)

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

		2013	2012
		£	£
Opening amount of losses recognised in STRGL		(6,437,719)	(7,712,308)
Actuarial (losses)/gains on obligations for the year	7(c)	(3,068,403)	748,805
Actuarial gains on scheme assets for the year	7(d)	820,648	525,784
Total actuarial (losses)/gains for the year		(2,247,755)	1,274,589
Cumulative amount of losses recognised in STRGL		(£8,685,474)	(£6,437,719)

(f) The employer expects to contribute £388,982 to the scheme in the year ended 31 December 2014. 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% of salary 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 FRS 17 and representing the cost to the Commission of the benefits accrued to active members of the scheme during the financial year ended 31 December 2013, 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:

	2013	2012
	%	%
Equities	71	69
Gilts	3	5
Corporate bonds	13	15
Property	9	7
Other assets	4	4

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):

	2013	2012
	%	%
Discount rate as at 31 December	4.5	4.7
Expected return on fund assets at 31 December	6.6	5.8
Rate of increase in pensionable salaries	4.5	4.0
Rate of increase in deferred pensions	3.7	3.2
Rate of increase in pensions in payment	3.7	3.2

The FRS 17 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:

	2013	2012	2011	2010	2009
	£	£	£	£	£
Defined benefit obligation	26,512,067	22,051,291	21,033,140	19,356,128	16,837,302
Fair value of scheme assets	17,123,000	15,277,000	13,455,961	14,811,865	12,344,058
Deficit in the scheme	(9,389,067)	(6,774,291)	(7,577,179)	(4,544,263)	(4,493,244)
Actuarial gains/(losses) on scheme assets	820,648	525,784	(1,582,355)	793,060	940,303
Actuarial (losses)/gains on defined benefit obligation	(3,068,403)	748,805	(1,853,787)	(564,879)	(2,793,117)
Actuarial (losses)/gains recognised in STRGL	(2,247,755)	1,274,589	(3,436,142)	228,181	(1,852,814)

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.

(ii) FRS 17 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 2013 was £301,376 (2012: £271,539). Contributions of £4,665 were outstanding as at 31 December 2013 (2012: £2,266). No contributions were prepaid as at 31 December 2013 or 2012. Employer contributions are calculated at 12% of pensionable salary and mandatory employee contributions are at a rate of 5% of pensionable salary.

8. Reconciliation of movements in reserves

		2013	2012
		£	£
Reserves brought forward		1,374,245	650,402
Surplus/ (deficit) of income less expenditure for the year		525,347	(550,746)
Actuarial (loss)/ gain on post-retirement liability	7(e)	(2,247,755)	1,274,589
Reserves carried forward		£(348,163)	£1,374,245

Reserves are stated after deducting the accumulated pension liability of £9,389,067 (2012: £6,774,291) which equates to the post-retirement liability under FRS 17 (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 2012 to the company in order to meet approximately 50% of its budgeted net operating expenditure, with £450,000 in 2012 being provided by the States via the Commerce and Employment Department. 2012 was the final year of the grant provided by the Commission.

10. Lease commitments

The Commission leased office accommodation at Glategny Court throughout the year. The lease for Glategny Court expires on 16 September 2034 and the rental payable in the next year under the terms of the lease amounts to £655,188.

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. 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.

13. Analysis of changes in net funds

	At 1 January 2013	Cash flow	At 31 December 2013
	£	£	£
Deposits with States Treasury	21,519	131	21,650
Cash at bank and in hand	201,124	423,272	624,396
Total cash balance	222,643	423,403	646,046
Short-term investments	6,730,106	743,923	7,474,029
Total funds	£6,952,749	£1,167,326	£8,120,075

The certificates of deposit are managed as liquid investments and have maturity dates typically between three months and one year after the balance sheet date.

14. Post-Balance Sheet Event

The FRS 17 disclosures in Note 7 set out the results for the Guernsey Financial Services Commission Actuarial Account of the States of Guernsey Superannuation Fund ("the Actuarial Account") as at 31 December 2013, assuming the benefits provided by the Actuarial Account remain unchanged.

On 21 February 2014, each active member of the Actuarial Account agreed to cease future service accrual with effect from 1 July 2014. This represents an irrevocable commitment from the GFSC and each member and represents a curtailment event in accordance with FRS 17.

Furthermore, each member has been given a number of options with respect to their accrued benefits within the Actuarial Account. Depending upon the option selected by each member, this may represent a settlement event in accordance with FRS 17.

The impact of the curtailment and settlement events will be reflected in the FRS 17 disclosures produced for the year ended 31 December 2014.

SENIOR OFFICERS OF THE COMMISSION

COMMISSIONERS

William Mason
Director General

Philip Nicol-Gent
General Counsel

Fionnuala Carvill
Commission Secretary and
Head of Innovation Unit

INNOVATION UNIT

Stephen Cole
Chief Operating Officer

Tim Loveridge
Chief Transformation Officer

Kevin Bown
Deputy Director
Intelligence Services

Richard Walker
Special Advisor for
Policy and International Affairs

Philip Marr
Director
Fiduciary Supervision and Policy Division

Jeremy Quick
Director
Banking and Insurance
Supervision and Policy Division

CONDUCT UNIT

Carl Rosumek
Director
Investment Supervision and
Policy Division

Samantha Sheen
Head of Financial Crime
and Authorisations Division

Simon Gaudion
Director
Enforcement Division

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COMMISSIONERS

Drs. Cees Schrauwers
Chairman of the Commission

Drs. Schrauwers is a Dutch citizen and has more than 35 years' financial services experience. He has served as Managing Director of Aviva International, CGU Insurance and Commercial Union, covering both the general insurance and life sectors. He was instrumental in the mergers with General Accident and Norwich Union which resulted in the creation of Aviva plc. Following the mergers he was appointed Managing Director of Aviva International, gaining valuable experience in dealing with regulators across the globe, including North America. Prior to this, he was a Partner with Coopers & Lybrand in charge of insurance consultancy. In the past he has served as Chairman of Drive Assist Holdings Limited, senior non-executive director of Brit Insurance Holdings Plc and Brit Syndicates Limited, non-executive director of Canopius Holdings UK Limited and Canopius Managing Agents Limited and as a director of Munich Re (UK) Plc. He was appointed as a Commissioner in 2008 and Chairman in 2012 and is the senior non-executive director of Record Plc since November 2007. In May 2012 he was appointed as an Independent Director at Scottish Widows Group. He was educated at the Vrije Universiteit Amsterdam and the Nautical College Den Helder. He lives with his wife 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.

The Lord Flight MA (Cantab) MBA FRSA
Commissioner

Howard 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, Aurora Investment Trust plc 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 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 Global 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 USA, the 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.

Simon Howitt
Commissioner

Advocate Howitt was appointed as a Commissioner in June 2013. He has 25 years' experience as an advocate and is currently a partner at Babbé. He is a member of the Council of the Chamber of Commerce and served as its President between 2001 and 2003. Advocate Howitt has served on a number of States Committees including being a non-States member of the Legislation Select Committee since 2004, the share transfer duty working party and the Inheritance Law Review Committee.

STATISTICAL DATA - UNAUDITED DATA

Investment Supervision and Policy

Figure 1. **Net asset values of schemes under management at the year end**

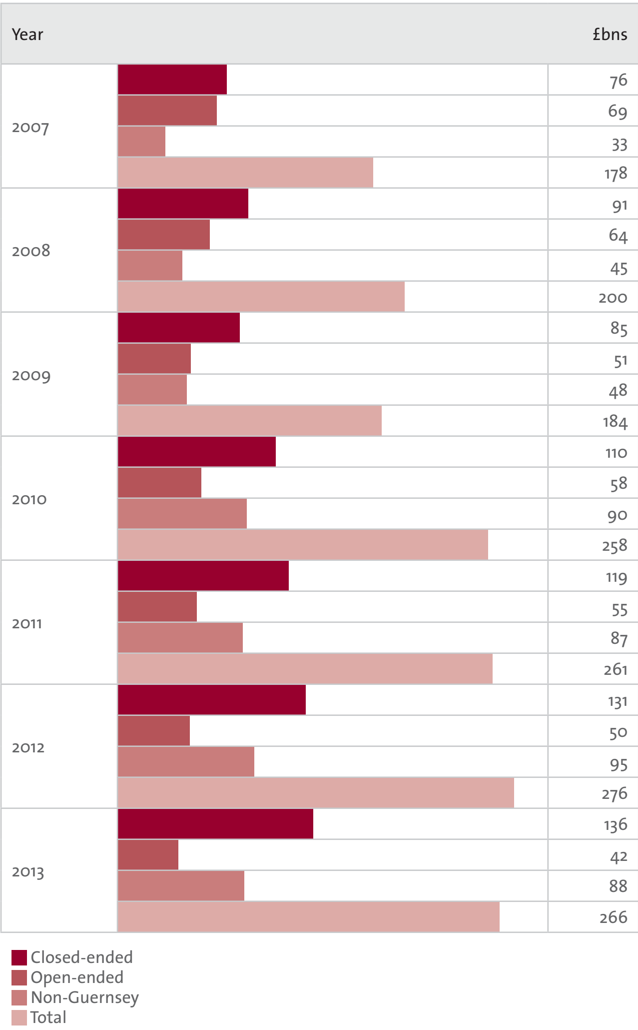


Figure 2. **Total number of investment funds at the year end**

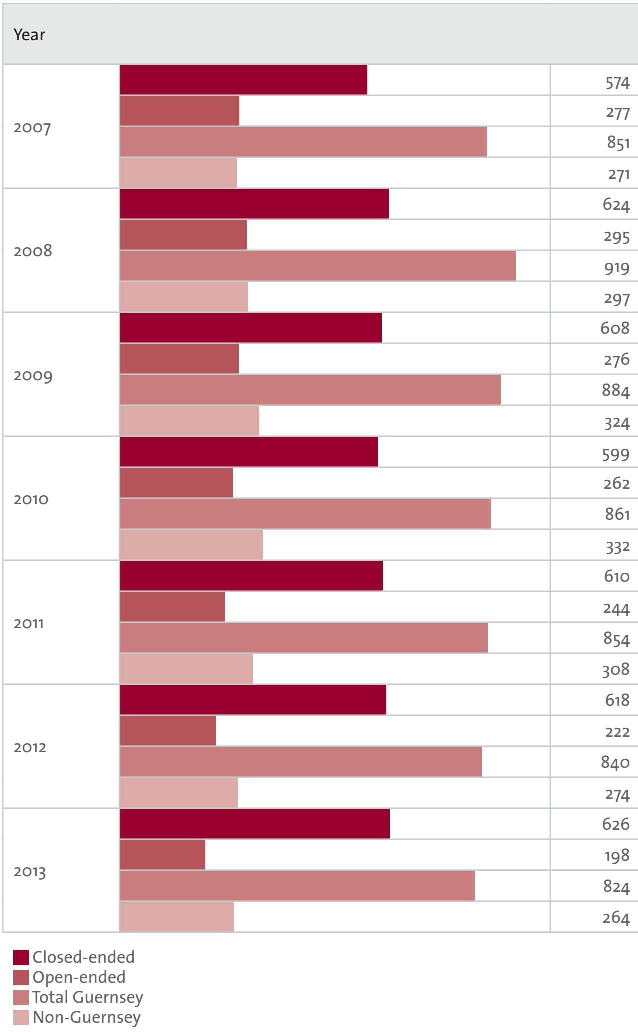


Figure 3. **Total number of licensees at the year end**

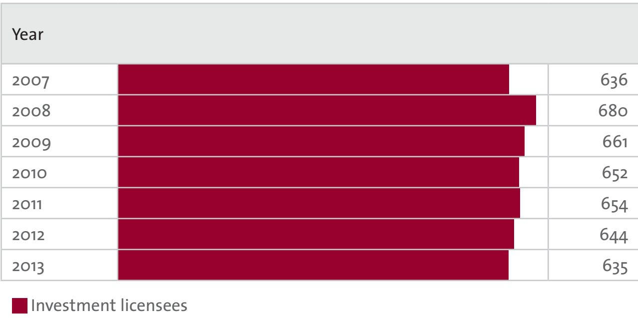
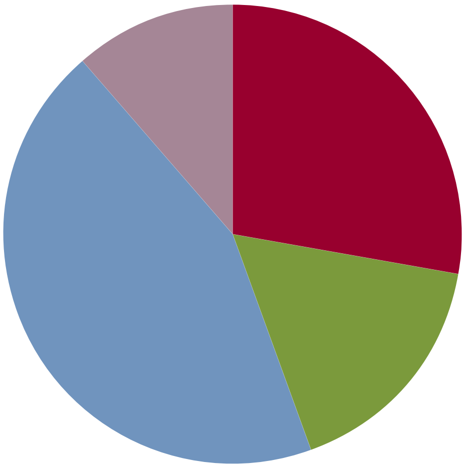


Table 1. **Movements within period**

Type	Total as at 31 December 2012	Approved in year	Lost in year	Total as at 31 December 2013
Total of open-ended schemes	222	16	40	198
of which Authorised	214	10	38	186
of which Registered	8	6	2	12
of which Qualifying Investor Funds	43	6	8	41
Total of closed-ended schemes	618	56	48	626
of which Authorised	463	17	34	446
of which Registered	155	39	14	180
of which QIF's	141	15	6	150
Total of licensees	644	52	61	635
Total of non-Guernsey schemes	274	31	41	264
of which QIF's	50	1	4	47

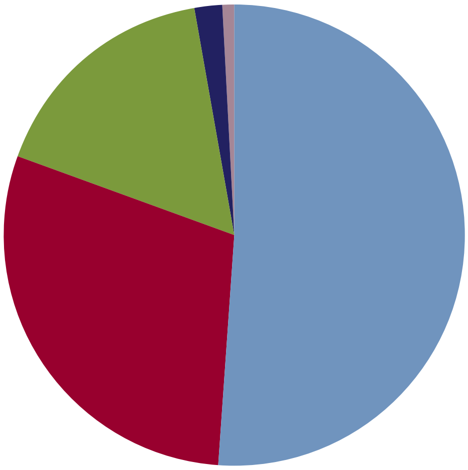
Figure 4. **Ownership of lead licensees at 30 June 2013***



	2013	2012
International financial group	42	41
Lawyers and accountants	25	26
Privately owned - local	66	66
Privately owned - overseas	17	18

*Based on 150 persons holding a full fiduciary licence as at 30 June 2013.

Figure 5. **Number of licensees per number of total staff carrying out regulated fiduciary activities***



	2013	2012
Up to 10 staff	77	74
11-25 staff	44	44
26-50 staff	25	24
51-75 staff	3	7
76-100 staff	1	2

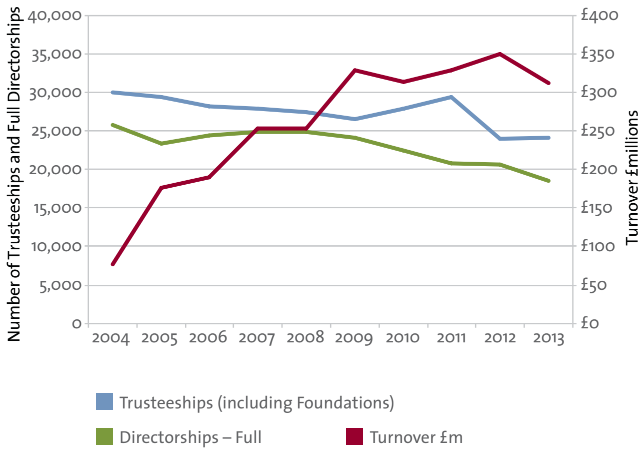
*Based on 150 persons holding a full fiduciary licence as at 30 June 2013.

Figure 6. **Number of licensees in each turnover band based on fiduciary turnover for accounting periods falling in the year ended 30 June 2013***

Turnover band	2010	2011	2012	2013
<£249,999.99	35	35	36	46
£250,000 to £999,999.99	24	27	28	30
£1,000,000 to £1,999,999.99	19	20	18	19
£2,000,000 to £3,999,999.99	24	26	25	25
£4,000,000 or over	25	27	32	30

*Based on licensees that have submitted audited financial statements. Financial statements may not have fallen due for recently licensed companies.

Figure 7. **Number of Director and trustee appointments for full fiduciaries at the year end; aggregate turnover of full fiduciary licensees***



*Please note turnover records aggregate annual chargeable fees. It does not represent assets under trusteeship.

Figure 8. **December 2013: Last 12 months: total number of licences by type of licence**

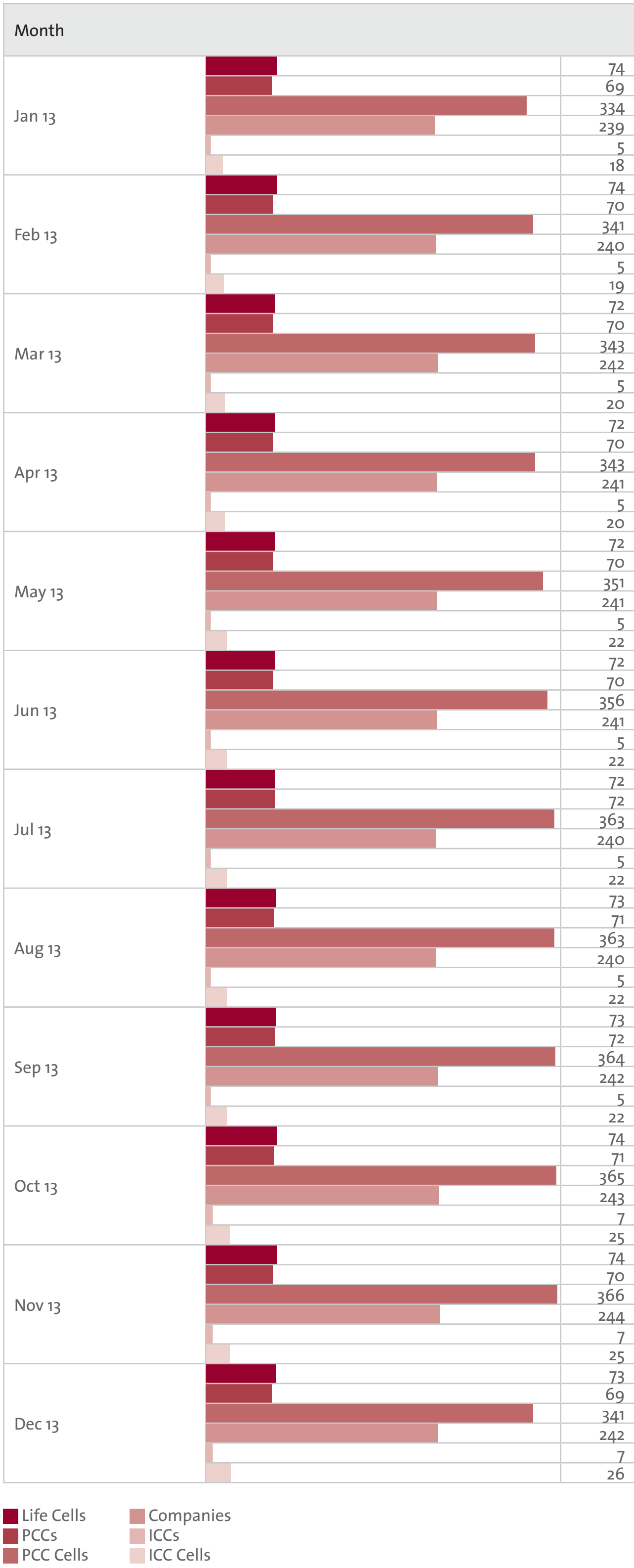


Figure 9. **International insurers – net worth**

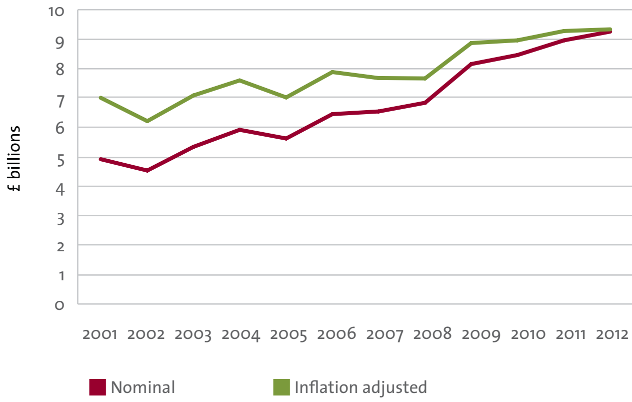


Figure 10. **International insurers – gross assets**

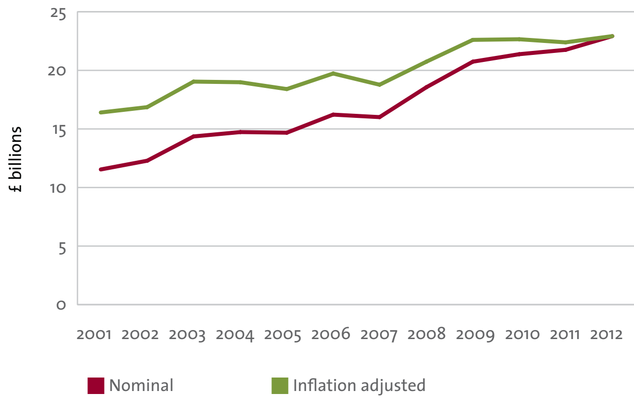


Figure 11. **International insurers – gross premium**

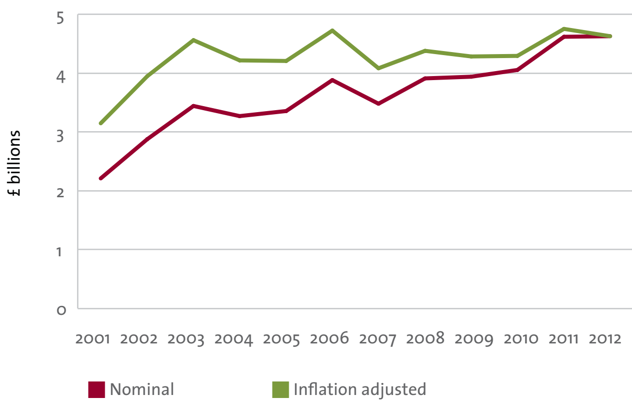
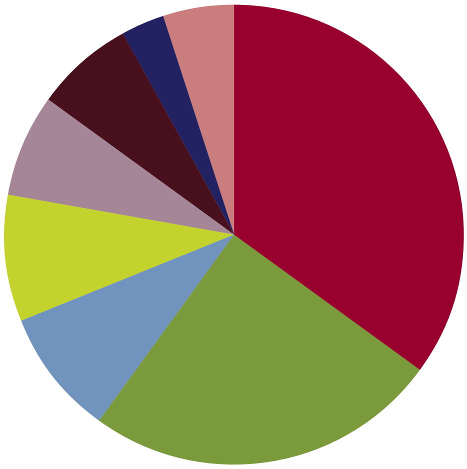


Figure 12. **Bank liabilities at the year end**

Year		Value
2005	Swiss fiduciary deposits	32,194
	Other liabilities	55,288
2006	Swiss fiduciary deposits	36,397
	Other liabilities	64,187
2007	Swiss fiduciary deposits	49,283
	Other liabilities	82,617
2008	Swiss fiduciary deposits	71,851
	Other liabilities	107,266
2009	Swiss fiduciary deposits	41,784
	Other liabilities	94,028
2010	Swiss fiduciary deposits	37,414
	Other liabilities	96,714
2011	Swiss fiduciary deposits	37,665
	Other liabilities	95,921
2012	Swiss fiduciary deposits	26,555
	Other liabilities	87,493
2013	Swiss fiduciary deposits	23,054
	Other liabilities	84,091

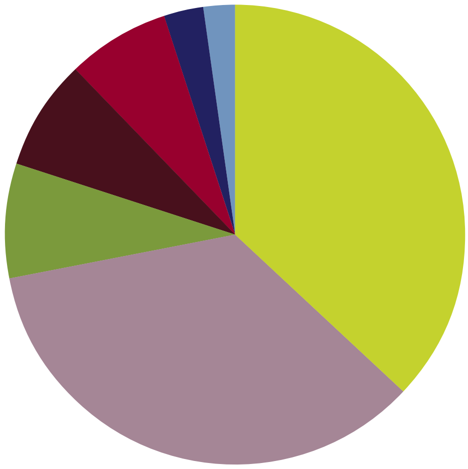
Swiss fiduciary deposits
Other liabilities

Figure 13. **Geographical analysis of assets as at 31 December 2013**



United Kingdom	35
United States	25
Other European Union	9
Switzerland	9
Guernsey	7
Jersey	7
Caribbean	3
Ireland	0
Other	5

Figure 14. **Geographical analysis of deposits as at 31 December 2013**



Switzerland	37
Guernsey	35
United States	8
Jersey	8
United Kingdom	7
Caribbean	3
Ireland	0
Other European Union	2

Finance and Operations

Table 2. **Income and expenditure by sector**

	Banking		Fiduciary		Insurance		Investment		Non-regulated financial services businesses and prescribed businesses		Total	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Number of regulated and registered entities	31	32	191	185	825	804	1,723	1,758	157	162	2,927	2,941
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Fee income	1,674	1,714	2,496	2,397	3,031	3,041	5,290	5,216	187	164	12,678	12,532
Interest income	12	24	19	29	22	37	41	70	0	0	94	160
Costs, including enforcement cost/recovery	(1,934)	(1,954)	(2,432)	(2,328)	(2,741)	(2,877)	(4,775)	(5,364)	(365)	(280)	(12,247)	(12,803)
Surplus/(deficit)	(248)	(216)	83	98	312	201	556	(78)	(178)	(116)	525	(111)
Contribution of costs to GTA University Centre											–	(440)
Surplus/(deficit), net of GTA contribution											525	(551)

Table 3. **Expenses by functional area**

	2013
	£'000
Enforcement	819
Authorisations and Data Management Unit	726
Risk and Transformation	722
Supervisory and Policy divisions (incl. anti-money laundering)	6,363
Other operational	1,294
Overheads, incl. premises, IT expenses and depreciation	2,323
Total	**12,247**

N.B. Comparative data not available for 2012 as a number of these are newly established areas.

Table 4. **Salaries and related costs**

	2013	2012
	£'000	£'000
Salaries	6,980	6,584
Consultants/ secondees	91	170
Pension costs	1,192	1,110
Social insurance, permanent health and medical insurance	701	637
Recruitment and training	258	267
Total	**9,222**	**8,768**

Table 5. Number of staff by salary band

Annual salary	2013	2012
£0- £39,999 p.a.	36	36
£40,000 - £79,999 p.a.	52	52
£80,000 - £119,999 p.a.	10	10
£120,000 p.a. and above	9	9
Total number of staff	107	107
Full-time equivalent	102.1	102.7
Comprising:		
Full-time staff	91	89
Part-time staff	16	18
	107	107
Vacancies at year end	2	2

Table 6. Movement in number of staff

	2013
Employed at start of year	107
Recruited into new positions	3
Positions removed	(3)
Existing vacancies filled	0
Employed at end of year	107

Table 7. Legal and professional fees

	2013	2012
	£'000	£'000
Legal fees – enforcement	165	542
Legal fees – advisory	129	56
Professional fees	208	168
Consultancy fees – Independent Evaluation Review and implementation of recommendations	35	563
Consultancy fees – Sentinel programme	63	168
Internal audit	31	23
	631	1,520

Table 8. **Commissioners' fees**

		2013	2012
		£	£
Peter Harwood	Retired as Chairman 31 January 2012	–	2,917
Cees Schrauwers		61,000	59,000
Susie Farnon		25,000	38,000
David Mallett	Retired as Deputy Chairman 31 January 2012	–	6,500
Alex Rodger		25,000	25,000
The Lord Flight		32,500	30,000
Richard Hobbs		38,000	42,500
Robert Moore		25,000	22,756
Paul Meader	Appointed 1 February 2012, resigned 28 February 2012	–	1,923
Simon Howitt	Appointed 3 June 2013	18,083	–

N.B. The Policy Council, in anticipation of the increasing input required from Commissioners, wrote to the Chairman of the Commission in January 2012 varying the fee arrangement for Commissioners. The arrangement allowed for per diem remuneration of £1,000 for Commissioners for work above the normal time commitment expected from them.

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 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 Commission remains committed to maintaining regular, constructive dialogue with the States. During 2013 the Commission continued to engage with the Policy Council, principally through the Fiscal and Economic Policy Group ("FEPG"), with meetings held in order to facilitate an open exchange of views on matters of importance to the States and the Commission. This is one of the key mechanisms through which the Commission is held to account by the States. The Commission also engages with the Commerce and Employment Department in relation to financial services legislation. The Department is an important stakeholder and the Commission values its relationship with the Department's political board. A presentation on the Commission's 2012 annual report was held for States Members in July. Outside of these formal meetings and presentations, the Commissioners and Director General maintain regular contact with Ministers.

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 seven Commissioners: Drs. Cees Schrauwers, Susie Farnon, The Lord Flight, Alex Rodger, Richard Hobbs, Bob Moore and Simon Howitt. A brief résumé for each Commissioner is provided on pages 46 and 47 of this report. All of the Commissioners are non-executive – four reside in Guernsey, with the remainder living in the UK.

There were 17 meetings of the Commissioners in 2013, with Simon Howitt being eligible to attend 12 of these, his appointment being from June 2013. The attendance was as follows: Cees Schrauwers 16, Susie Farnon 16, Howard Flight 16, Alex Rodger 17, Richard Hobbs 17, Bob Moore 16 and Simon Howitt 12. Prior to each meeting, Commissioners are provided, save in exceptional circumstances, 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 individually. 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.

Functions, Structure and Corporate Governance and other Control Systems of the Commission *(continued)*

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). Although not required to comply with the UK Corporate Governance Code, the Commission has regard to the guidance contained therein and complies wherever valid to do so.

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

In 2013 the Commission's Audit and Risk Committee, which comprised Alex Rodger and Richard Hobbs and was chaired by Susie Farnon, covered oversight of the management of risk, reviewed corporate governance and the systems of internal control and reported routinely to meetings of the Commissioners as a whole. Meetings were usually attended by the Director General, the Chief Operations Officer and the Commission Secretary (who is the Committee's secretary). The Committee met five times in 2013.

The attendance of the individual members at these meetings was as follows: Susie Farnon 5, Alex Rodger 4, Richard Hobbs 5. From February 2014, the Committee has become an Audit Committee rather than an Audit and Risk Committee, although it will continue to have oversight for non-regulatory risk. This change has been executed to comply with evolving thinking on audit and risk governance which suggests that audit and risk committees should not be combined. Regulatory risk will be reviewed routinely by the Commissioners as a whole as risk-based supervision, as covered in the Director General's Statement, is implemented Commission-wide.

Remuneration Committee

The Remuneration Committee, which comprised Bob Moore and Richard Hobbs and was chaired by Alex Rodger, is mandated to advise and assist the Commission in fulfilling appropriate governance in respect of remuneration policies, practices and structure. Meetings were attended by the Director General, the Chief Operating Officer and the Assistant Director of Human Resources. The Committee met twice in 2013 with all members attending both meetings.

Review systems

The Commission has retained specialist internal and external expertise to monitor the Commission's non-regulatory internal audit standards to ensure that the Commission is up to date with current expectations. During 2013, the Commission appointed an external party to undertake audits of the enforcement and anti-money laundering and countering the financing of terrorism activities of the Commission. The newly formed Enforcement Division and the Financial Crime and Authorisations Division have, respectively, taken forward the outcomes of those audits. In 2013, the corporate governance standards of the Commission were 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 against international regulatory and supervisory standards in 2010 under its Financial Stability Assessment Programme. The Commission and the other authorities in Guernsey were found by the IMF to have a high level of compliance with these standards.

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CONTACT US

info@gfsc.gg
www.gfsc.gg
+44 (0)1481 712706