

2016



Guernsey Financial
Services Commission

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2016

"Confidence in the Bailiwick: securing good regulatory outcomes with integrity, proportionality and professional excellence."



Guernsey Financial Services Commission

Chairman's Statement	2
Director General's Statement	4
Investment Supervision and Policy	8
Fiduciary Supervision Policy and Innovations	10
Insurance Supervision and Policy	12
Banking Supervision and Policy	14
Conduct Unit	15
Financial Crime Supervision and Policy	16
Enforcement	18
Senior Decision Makers	20
Chief Risk Officer's Report	22
Authorisations Unit	24
Financial Stability	26
Chief Operating Officer's Report	28
Independent Auditor's Report	30
Financial Statements	32
Commissioners	48
Senior Officers of the Commission	50
Statistical Data	52
Appendix	
Functions, Structure and Corporate Governance and other Control Systems of the Commission	62

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 and Resources Committee and submitted 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" or "the Board".

CHAIRMAN'S STATEMENT

Unrewarded Risk

This year, I am limiting my observations to one subject only; the role of boards in financial services and the activities of Non-Executive Directors (NEDs) in particular. Last year I wrote about the goals the Commission had set itself some five years ago, and to what extent they had been met.

I am happy to report that we have now also met our last incomplete goal, which was to resolve all the legacy enforcement cases. Let me first revisit some history. When I became Chairman, I inherited a number of significant enforcement cases, some with a high public profile, the resolution of which had been making slow progress for a number of reasons. Commissioners recognised the need to strengthen its enforcement capability and decided to set up a dedicated Enforcement Division. We were also very aware of the potential conflicts of interest, for locally based Commissioners in a jurisdiction the size of the Bailiwick, when sitting as a Commissioners' Decision Committee (CDC) to decide on the cases brought before us. A solution was found in the appointment of independent Queen's Counsel to hear and decide on cases brought to them by the Commission's Enforcement Division. Commissioners now rarely sit as a CDC and are no longer involved in most cases.

Disappointingly, the successful completion of the legacy cases has not resulted in a reduction of work for the Enforcement Division. There continues to be a steady flow of new cases requiring the attention of that Division.

Turning now to the role of boards and NEDs, in my address at the Commission's Industry Presentations in November 2016, I emphasised the need for local boards to enhance their approach to governance and for NEDs to play a more active role in the boards on which they sit. The way that Company Law and the regulation of companies has developed over the last twenty years has meant that the role of an NED has developed into that of an 'Independent' Director. The main difference between board Directors now is that some, the Executives, are full-time and the others are part-time.

Bailiwick Law identifies three main duties for board Directors and there is no distinction between the Executives and the non-Executives:

- Fiduciary
- Skill and Care
- Good Faith

In order to discharge their duties, Directors have rights which they need to exercise.

Politicians around the world have responded to high-profile cases of failures in corporate governance within companies by introducing more onerous forms of regulation and putting greater responsibilities on regulators.

Managing a company should be a positive and rewarding experience despite the greater responsibilities and higher expectations that have been placed upon Directors. Ensuring proper governance should improve the client experience and enhance the value of the company. Assessing and controlling risk is an essential part of that activity. It is well understood by the Commission that, in order to make money, a level of risk needs to be accepted. The role of the board is to decide where that level of risk lies and then to ensure it is effectively managed. Getting risk and reward out of "sync" potentially damages customers and the company and can lead to damage to the reputation of the Bailiwick as a good place to do business. That constitutes an unacceptable risk to the Commission.

There are over 2,200 entities regulated by the Commission with some 7,200 directorships of which c.4,500 of those involve NEDs. There will be considerable overlap in these NED numbers with people sitting on multiple boards.

NEDs have an increasingly difficult task in that they have to address complex issues with uncertain outcomes, including, for example, Brexit, low interest rates, European regulation and ever stronger competition driven by a lowering of entry barriers. The low interest environment, in particular, sets a challenge for

the financial services industry where there may be a temptation to run greater levels of risk to improve returns.

A relatively small jurisdiction with access only to a limited pool of qualified directors has its challenges. In addition, the (mainly) small size of the companies in the Bailiwick can restrict the option of having a meaningful Internal Audit Department which offers even more reason for the NEDs to discharge their duties diligently.

Being an NED is not a sinecure and should not be treated as such. The Bailiwick needs good quality, conscientious individuals to undertake the role of NED and expects them to do their job in an effective manner putting the well-being of their customers and the Bailiwick at the forefront of the decisions they take.

In closing, I would like to take this opportunity, on behalf of the Commission, to express our appreciation to Alex Rodger whose term of office as a Commissioner ended on 1 February 2017. Alex served as a Commissioner for nine years and during that time his responsibilities included chairing the Commission's Remuneration Committee and serving as a member of its Audit Committee. He was also appointed as Vice-Chairman in April 2015. Throughout his time as a Commissioner, Alex worked diligently on behalf of the Bailiwick and the Commission is grateful to him for his valuable contribution.

Cees Schrauwens
Chairman



DIRECTOR GENERAL'S STATEMENT

2016 was a year of relative stability for Guernsey. In an environment where many electorates, particularly the United Kingdom's electorate and the United States' electorate, voted for radical change, the electorate of Guernsey voted for relative stability with the former Treasury & Resources Minister being elected by our legislature (the States) as the new senior politician of the island after an election campaign in which domestic issues were more prominent than international ones.

Our stability has not meant that events outside Guernsey do not have a significant impact for the Bailiwick. Our financial services sector is international so the political economy of the wider world concerns it directly. The Commission has been active, in support of the States, and in conjunction with other countries' regulators, in helping ensure that Guernsey is appropriately positioned in the still partially unclear new international order. We have continued our work within the International Organisation of Securities Commissions, the Financial Action Task Force and the International Association of Insurance Supervisors to ensure that Guernsey's perspective as a small jurisdiction, which seeks to meet all relevant international standards, is understood. We are able to provide a valuable, sophisticated but small jurisdiction perspective, something which can sometimes be lost in organisations dominated by large countries who often act predominantly as home rather than host supervisors of financial services firms.

In terms of our other international activities, we have continued to provide leadership to the Group of International Insurance Centre Supervisors and to participate in the Group of International Financial Centre Supervisors whose Trustee and Company Service Provider standard is attracting interest as the new international standard for the supervision of fiduciary companies. We have also continued to provide Commonwealth Secretariat-funded technical assistance to the Cook Islands and Nevis, as well as hosting educational visits to Guernsey by the Reserve Bank of Malawi and the Central Bank of the Seychelles - activity which helps ensure that Guernsey is recognised as being a responsible global contributor. We also uphold our international obligations to provide support to regulators from other countries, with our support being widely appreciated by a number of agencies in 2016 stretching from the US in the West to New Zealand in the East.

Closer to home we have continued to provide support to the Channel Islands Brussels Office and to the States in its relationship with HM Government when financial services matters are under consideration. We have also maintained and developed our own relationships with the Bank of England, Financial Conduct Authority and the European Securities and Markets Authority

(ESMA) and the European Central Bank. In our work here as elsewhere internationally, we seek to ensure that Guernsey is well positioned with both the European Union and United Kingdom in an era marked by discontinuity. We were pleased, after further due diligence, to be recommended by ESMA once again for an EU alternative investment funds passport, a testament to the credibility of our funds regime. We cannot determine what the future looks like but we can help ensure that Guernsey is well prepared to face it.

Policy

Alongside the States and industry, we put a huge amount of effort into policy development in 2016. In terms of the policy initiatives which we took and brought to fruition within the year, we launched the Manager Led Product and the Private Investment Fund regimes, both major new products which we hope will help maintain the Bailiwick's reputation as an innovative jurisdiction for funds. Further, we announced a general review of the funds regime and will continue to work closely with industry on its development in 2017 to ensure that our existing strengths are maintained and new ones forged. We also launched a new set of Insurance-Linked Securities rules which set out clearly how such securities are appropriately regulated in Guernsey.

In terms of policy development which did not conclude within the year, we continue to work with the Law Officers of the Crown on the development of the different sets of legislation required to implement the Revision of Laws project approved by the States in the autumn of 2015. This is a major exercise which, whilst designed to simplify and update most of our major financial services laws, is itself very complex. In a similar vein, we continue to work with the States, Law Officers and industry on the redrafting of the financial crime regulations which will enable the renewal of our anti-money laundering handbook. We were able to make some modifications to the current handbook in 2016 to make clear that Bailiwick firms are allowed to use electronic authentication technology and plan to renew the handbook completely once the new financial crime regulations are drafted.

Newer policy initiatives which acquired shape in 2016 include a Lending, Credit and Finance discussion paper which was launched in the third quarter of the year and a Pensions discussion paper which was published in the fourth quarter. We will plan to consult on policy in both these areas in 2017 and we are conscious that a number of pensions sector practitioners are keen for an early resolution of the pensions regulation question given increasing international and UK expectations in this sector.

Other policy work has included our ongoing contribution to the financial crime-focused National Risk Assessment of the Bailiwick which is being supported by the International Monetary Fund, our participation in the new Guernsey Financial Stability Committee chaired by Peter Sedgewick on which the Commission's Chairman, Director of Financial Stability and I sit. In terms of making our policy accessible, our conduct team has undertaken outreach work with sixth formers on the island whilst our Chief Operations Officer has overseen the comprehensive rebuilding of our internet presence – improving both the content and the underlying technologies used to display the information, thereby ensuring that the Bailiwick's financial services regulations are easily accessible on most types of web browser, given the huge growth in the use of iPads and smart phones for business purposes.

Authorisations and Supervision

Whilst I'm not going to comment on the controversy about whether the health of the British economy in the second six months of the year was despite Brexit or because of Brexit, Guernsey's financial services sector, from the perspective of new authorisations, appears to have remained sound with funds and fiduciary applications up whilst insurance applications fell back from their 2015 levels. In total, the authorisations team processed 498 applications in 2016 compared with 476 in 2015. The authorisations team also processed 8,400 personal questionnaire submissions, this being the return which allows us to understand who is a director of which regulated entity. With regard to this volume of activity, the online personal questionnaire system is starting to prove its worth and we have worked throughout the year to improve its performance. This work has improved the accuracy of the submissions from users of the system thereby reducing the workload for both users and the Commission.

We have continued to develop our supervisory capabilities in 2016. We reformed, and introduced online, six returns, mostly focused on the investment sector. These give us an enhanced ability to use key risk indicator tools embedded within our PRISM supervision system to automatically detect anomalies in returns submitted - in a fashion which it would have been very difficult to do when we only received paper returns. This work is not yet complete and the benefits, in terms of the quality of supervision, will only be seen once the data starts to be submitted. Internally, we have also worked this year to improve the quality of management information on our supervisory activities. The improved management information is not an end in itself but is rather something which helps drive constructive discussions at different levels of the Commission about what we are doing and not doing, given our finite resources.

The thematic work which we have done will be covered in more depth in the divisional reports which follow my report but in summary we continue to find that thematic work provides a powerful way of understanding some of the Bailiwick's lower impact firms and the issues they experience. This year we have undertaken thematics looking at alternative custody arrangements; risk, compliance and audit frameworks for fund managers and fund administrators; bank regulatory returns; late accounts; client money; and the provision of financial crime training. We also published the results of the thematic we did in 2015 on assets under trust. I'd encourage all financial services participants to read the thematic results we publish on our website as they offer a good window into our thinking on some of the risks which your firms may face. In terms of helping firms understand and manage their risks better, we have also undertaken over twenty educational outreach sessions for the financial services sector. These can range from a business breakfast themed around an issue through to a formal lecture on a subject of note. Feedback we have had indicates that industry participants find these to be a helpful tool in their work to ensure that regulatory standards are met and we intend to continue conducting them in 2017.

In terms of our supervisory activity, we completed c.370 engagement tasks in 2016. These range from a formal meeting with the compliance officer of a firm through to comprehensive full risk assessments involving several days working in a firm's offices which will have been preceded by several weeks' preparatory activity. These activities led to more than two hundred formal risk mitigation programme actions being created in 2016 as firms worked with supervisors to correct excessive risks in their organisations which became apparent to our teams in the course of their duties.

This ongoing engagement with our firms - using our risk-based approach which reflects internationally accepted best practise for supervision - helps to add value to the Bailiwick by resolving risks and issues before they ever develop into crises. For those not directly involved in it, it is subterranean activity, out of sight and out of mind. As I have said in, I think, every annual report I have written, it is not foolproof and can never hope to be foolproof in a world of human frailty and finite resources. In a capitalist economy, firms will fail and have failed in 2016. Whilst I cannot comment at this juncture on any of those failures whilst our investigations into them continue, it is worth reiterating that we run a regime which expects directors of companies and trustees of trusts to do their job in an honourable, upright and competent fashion. That this is the case does not make us in any sense complacent about the quality of our supervision. Unfortunately,

Director General's Statement *(continued)*

on occasion directors and trustees are neither competent nor honest. When something goes wrong at a firm, we look at what has happened and ask ourselves whether we could reasonably have done something about it sooner. Some might characterise this as shutting the door after the horse has bolted and whilst it is true that one or two may well be over the hill, there are still more than 2,200 such "horses" in our stables and we will continue to work to make sure that our supervision of them is appropriate.

Enforcement

If we cannot prevent all failures, we can endeavour to hold those who failed, accountable for their actions when it was the result of misconduct as opposed to the mere miscarriage of honest endeavour. This is the work on which our Enforcement Division, and those that support it, have continued to engage with some success in 2016.

As the Director of Enforcement made clear on a number of occasions in 2016, not all cases referred to enforcement lead to sanctions being imposed. Some are referred back to supervision because, on further analysis, we do not consider that the regulatory failings which have occurred merit enforcement sanctions but rather are better dealt with by supervisors. Some are dropped because, on further investigation, the firm brings matters to our attention of which the supervisors who made the referral were not fully aware and this leads us to reconsider the merits of the case. Conversely some, following our initial investigation, appear to involve criminal activity to such a degree that we consider it more appropriate for the Bailiwick's Economic Crime Unit to have an opportunity to bring criminal charges in the first instance so we refer those to the criminal investigators prior to the Crown bringing the suspected malefactors to trial before the Royal Court.

In terms of the volume of enforcement cases, there were eleven in progress as of the last day of 2016. Sometimes, the total number of ongoing cases might rise as high as around a dozen; sometimes it might drop as low as seven or eight. I am putting these figures into the Commission's annual report because there have been a number of mischievous rumours circulating in 2016 relating to the scale of the Commission's enforcement activity. Throughout my tenure as Director General we have been very selective about the firms and individuals referred to enforcement. The Commission has no desire to take forward petty cases – life is far too short; we have no desire to spend our finite time on them and our resources are far too modest for that to be an appropriate approach given the levels of serious malfeasance with which we are dealing. Indeed, as I write, it is more the case that we are accumulating serious cases for further investigation as our finite, experienced

investigatory staff are almost fully consumed on a small number of complex investigations which we have prioritised because of their seriousness.

Our bench of Senior Decision Makers continued to prove its worth in 2016 as its members adjudicated a number of complex cases with their judgements being scrutinised by the Royal Court on more than one occasion over the last two years (I could not refer to some of the cases in the 2015 annual report because the appeals had been heard in camera and the results were not yet public). We were sorry to lose Andrew Stewart QC and Malcolm Davis-White QC over the course of 2016 but have been delighted to see them appointed to the judicial benches, respectively as Senator of the College of Justice in Scotland and Lord Commissioner of Justiciary, and as a specialist Circuit Judge in England - sitting in Chancery and mercantile cases. We were pleased to be able to appoint Kirsty Hood QC from the Scottish Bar to our panel in August.

In terms of cases whose outcomes we can discuss, we concluded three investigations with robust sanctions in 2016 as well as obtaining two administration/liquidation orders for failing firms from the Royal Court. The findings are set out in the public statements on our website. We will continue to work to ensure that our public statements allow those in industry to understand the detail of what went wrong at a firm as the feedback we have received is that the more detailed public statements have been much more helpful. In particular, the Commission was pleased to see the case concerning Marlborough Trust Company Limited, Marlborough Nominees Limited and four of its directors concluded with regulatory sanctions, after four years of intense effort. Those opposing the Commission in connection with the Marlborough case were well funded and fought hard using all means available to them to endeavour to stop the investigation ever reaching a conclusion which could enable sanctions to be bought against the directors. It required exceptional tenacity from all those involved at the Commission with the Marlborough case to persevere and bring this case to a successful conclusion with justice being done and being seen to be done. I and the Commissioners are proud of them for having done so and hope that the case will be seen by others as representative of the Commission's determination to deliver justice when faced with misleading behaviours and serious misconduct.

People

The Commission is only as good as its people. I am delighted to have such an accomplished set of directors. In 2016, I was pleased to see Tim Loveridge, after his hard work as Chief Transformation Officer and Chief Risk Officer of the Commission, appointed to

become Guernsey's next Director of Income Tax. I imagine that his achievements at the Commission will stand him in good stead as he now heads another arm of Guernsey's public service. We have also continued to liaise closely with the Guernsey International Business Association (GIBA) and I'd like to thank Patrick Firth for his constructive engagement during his two years as GIBA Chairman.

At director level, the Commissioners and I were pleased to appoint Andrew Sloan as Director of Financial Stability and Katherine Jane as Chief Risk Officer. Andrew moved to the Commission in 2014 having previously worked for both the States and the Guernsey International Business Association. His doctorate in economics equips him well for this role which we created in the light of the increasing international focus on linkages between micro-prudential and financial stability issues. He also has considerable expertise in European Union and pension policy-related matters which we find helpful. Katherine has a background in accountancy and consulting (most recently as a senior manager with Deloitte in London) as well as having gained a reputation as an accomplished regulator at the Financial Services Authority dealing with the consequences of the 2008 global financial crisis.

We have invested considerably in people development in 2016. In addition to the normal range of regulatory courses focused on technical and interpersonal skills, we also provided focused management development training for more than twenty managers and aspiring managers within the Commission. We also used the recent changes in employment law as an opportunity to comprehensively renew our staff handbook to reflect the decent and welcoming 21st century workplace which we aspire to be. We continued to apply our rigorous appraisal and moderation process to ensure that pay rises and bonuses awarded at the end of the year to some staff are merited rather than automatic. We think that this helps us ensure that we use our licensees' money wisely.

Finances

The Chief Operating Officer explains the financial results in detail in his section of the annual report. In summary, we continued to live within our means and ran a modest operational surplus of £632,030 which meant that for the fifth year in the row we were able to consult on a fee increase of 2% or less for the median financial services licensee. Unfortunately, we cannot do anything material about the discount rates used to determine the valuation of the Commission's share of the States of Guernsey's final salary pension scheme which we closed to new contributions in July 2014, having previously closed it to new entrants in 2008. Given the downwards trend in real interest rates which was sustained through much of 2016, the deficit has increased to £14.9 million

according to the widely criticised FRS 102 standard. The deficit is underwritten by the States of Guernsey and so the deterioration in our net asset position, whilst less than ideal, does not impact upon the ability of the Commission to continue to function as a going concern. Going forwards we will continue to endeavour to manage money carefully and live within our means once the impact of the historic pension deficit is discounted.

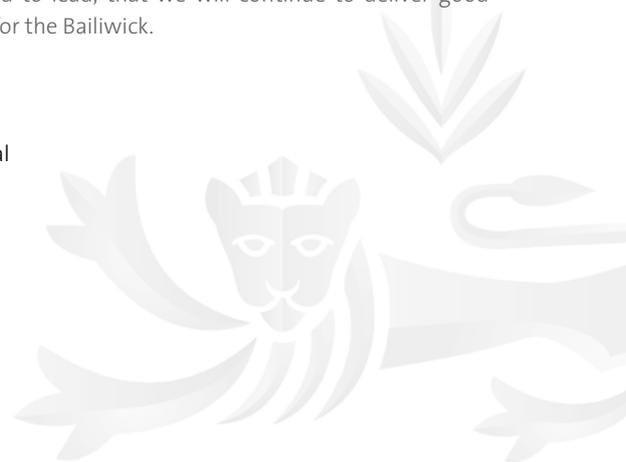
Looking Ahead

In 2017, we will continue to work to ensure that we:-

1. Execute high-quality risk-based prudential, financial crime, and conduct supervision with appropriate authorisation processes;
2. Deliver high-quality regulatory policy;
3. Deliver targeted, high-value risk-based enforcement;
4. Protect and enhance the Bailiwick's reputation and influence;
5. Manage finite resources effectively; and
6. Develop staff.

I cannot promise, given the international outlook, that we will necessarily be able to achieve all that we set out to do on behalf of the Bailiwick, however, a failure in that respect will not be because of any poverty of ambition on our part. We will continue to strive to do that which is good and right for the Bailiwick whilst being realistic about our limitations and cognisant of the need for focus. Because we will continue to strive and to push ourselves hard to serve the common good we may, on occasion, get things wrong or fail to get as far down a chosen track as we had wished. When that is the case we will seek to learn from our experiences and improve our practises or change track to get to the objective that we or other Bailiwick authorities seek. I am confident, given the skills, dedication and public service ethos of the men and women who I am proud to lead, that we will continue to deliver good quality results for the Bailiwick.

William Mason
Director General



Supervision

During 2016, our engagement with High, Medium High and Medium Low impact firms included undertaking full risk assessments on 12 firms with a further 77 engagement meetings held. Our engagement with Low impact firms was conducted through the notification regime and reacting as required to trigger events. During the course of this engagement across all impact levels we applied 55 Risk Mitigation Programme Actions with the most frequently cited risk being governance risk, followed by operational risk and conduct risk.

As reported last year, the Division undertook its first thematic review in October 2015. The findings of that review, on the Oversight of Alternative Custody Arrangements of open-ended authorised schemes, were published on our website in February 2016. In brief, the principal conclusion of the thematic review was that all firms indicated that they were undertaking some kind of oversight of service providers where modifications of the rules as they apply to custodians were in place, albeit to a varying degree. We continue to encourage firms to review their own practices in light of the findings and to consider whether their own risk management frameworks could be enhanced in line with the examples of good practice that we saw.

The experience of the first thematic informed our approach for future reviews and in the early autumn of 2016, the Division undertook its second, being a joint thematic review with the Financial Crime Supervision and Policy Division, entitled Risk, Compliance and Audit Frameworks for Fund Managers and

Fund Administrators. This thematic was conducted through a questionnaire, sent to 35 Low impact licensees, covering areas pertinent to our colleagues in the Financial Crime Supervision and Policy Division as well as conduct of business issues. In particular we sought to explore the cross-over topic of business risk assessments as well as more general business risks e.g. operational and business model risks, both of which feature in our engagement with higher impact rated licensees. The 2016 thematic, as with the thematic conducted in 2015, proved to be an effective means of proactive engagement with the Low impact licensees where we normally operate on a reactive basis. A sample of 10 firms from the 35 taking part in the thematic were visited in December by members of the Financial Crime Supervision and Policy Division with members of the Investment Supervision and Policy Division accompanying them on four of the visits. At the time of writing the findings from the thematic are under evaluation.

The topics of future thematic reviews were highlighted at the Industry Seminar presentation held in November 2016 and industry can expect to see a further thematic in quarter four of 2017.

Inevitably, supervision of our licensees will identify good practice but some poor behaviour will also come to the surface. The poorer behaviour may be of a level where it can be dealt with through risk mitigation programmes and the entities can be restored to a good state, however, in certain cases the poor behaviour is severe enough to warrant a referral to the Enforcement division. During 2016 the Division referred several entities to the Enforcement Division.

Policy

2016 was a busy year for the Division in respect of policy both on the domestic front and internationally.

Looking internationally: in early 2016, the Division responded to a further request for information and evidence from the European Securities and Markets Authority (ESMA) as part of the Alternative Investment Fund Managers Directive (AIFMD) equivalence process. The considerable effort expended by the Commission in developing its response paid off when, in the summer of 2016, ESMA once again recommended that there were no obstacles to Guernsey bring granted a passport under AIFMD.

The other main focus of our international policy work continued to be the European Union's (EU's) Market in Financial Instruments Directive II; however, given the EU's extension to the timetable for implementation to 3 January 2018, there is currently more of a requirement for a watching brief than for any particular policy change.

Finally, our active involvement on the International Organisation of Securities Commissions (IOSCO) Committee 4, included work to introduce an Enhanced Multilateral Memorandum of Understanding.

Domestically, there were two strands to our policy work: the first was the introduction of two new products. The second strand was reviewing existing rules with the intention of updating them where necessary in line with applicable international standards, for example Client Asset Rules. This piece of policy work continues into 2017.

The first of the two new products to be introduced during 2016 was the Manager Led Product. The Manager Led Product is intended for use by Alternative Investment Fund Managers who wish to domicile in Guernsey: taking advantage of the National Private Placement Regime market into EU Member States. The Manager Led Product, in recognising international moves to

regulate at the manager level, departed from Guernsey's existing regime of placing rules on any vehicle core to the fund structure, e.g. a general partner or limited partnership. Thus the burden of rules falls solely on the Alternative Investment Fund Managers.

The second product introduced was the Private Investment Fund. Whilst both products were developed through close consultation with industry, in the case of the Private Investment Fund, it was industry which provided the impetus for its introduction. The Private Investment Fund is a regulated product with a strong emphasis on corporate governance, including managing conflicts of interest. Its design is sufficiently flexible to be utilised both by family offices and private equity hedge fund managers.

Risk Outlook

Low interest rates continue to present a challenge to all forms of the wealth management industry and raises the possibility of a pricing bubble in asset classes. Indeed, at the time of writing, the US markets are experiencing increased volatility. Regardless, the old maxim must surely apply that higher return can only be achieved by taking on greater risk. The Commission bears this in mind in its supervision and in particular encourages firms involved in the retail space to ensure that this trade-off is understood.

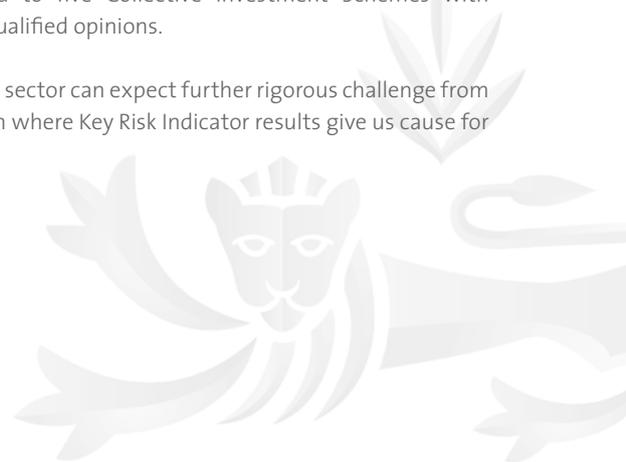
The Commission is considering the possible effects of a return to more orthodox monetary policy. This return, widely anticipated, appears to be crystallising with, in March 2017, the US Federal Open Market Committee (FOMC) raising the federal-funds rate to between 0.75% and 1%, and announcing the likelihood of two further jumps in 2017.

Clean audited annual accounts of Collective Investment Schemes submitted to the Commission on time are a key facet of good corporate governance.

Emma Bailey
Director

The use of Key Risk Indicators in our supervisory work over the period has proven fruitful in identifying licensees and funds where the good corporate governance expected is not evident. This led the Commission to introduce a new policy on the late submission of Collective Investment Scheme accounts, and accounts with qualified, disclaimed or adverse audit opinions. This new policy means the Commission will issue a notice of conditions as soon as we become aware that the Collective Investment Scheme has passed its accounts submission date. During the year, conditions were applied to four Collective Investment Schemes for late submission and to five Collective Investment Schemes with disclaimed or qualified opinions.

The investment sector can expect further rigorous challenge from the Commission where Key Risk Indicator results give us cause for enquiry.



Supervision

2016 was a year of relative stability for the fiduciary sector in the Bailiwick. The Fiduciary Supervision Policy and Innovations Division (the Division) supervised 154 full fiduciary licensees, 34 personal fiduciary licensees and 41 Non-Regulated Financial Services Businesses (“NRFBSBs”). Government statistics for 2016 highlight that there were 32,291 people employed in Guernsey, of whom 10% continue to work in the fiduciary sector.

During 2016, the Division conducted 27 visits to licensees (8 Full Risk Assessments, 11 Engagement visits and 8 thematic visits). These PRISM visits enabled the Division to target its limited resources on licensees’ business models, understand their core issues/risks and work together to mitigate potential risks, for example cyber crime, which played a more prominent role in onsite visits this year. Themes identified during our 2016 visits remained similar to those highlighted in our 2015 Annual Report. Risk Mitigation Programmes (where required) continue for local fiduciary licensees to centre around governance risk, conduct risk, operational risk, insurance risk and/or financial crime risk. This approach will continue to be a theme in 2017 and beyond.

Our 2016 thematic review, entitled “Client Money”, which followed on logically from the 2015 thematic review of “Fiduciary Decision-Making in Respect of Assets Under Trust”, sought to explore a key area of responsibility for trustees. This topic also enabled us to focus on crystallised risks recently experienced in the sector whilst enabling us to assess the need for client asset rules to ensure that the jurisdiction complies with international standards. We are also working with colleagues in the Investment

Supervision and Policy Division to ensure consistency with regard to the introduction of enhanced client asset rules and we intend to issue a Consultation Paper in 2017. For the Client Money Thematic, we issued a questionnaire to all full fiduciary licensees and undertook an analysis of the responses. This analysis, together with the findings from the eight thematic site visits, resulted in a report, published on our website, which we commend to all of our licensees as it offers a useful perspective on some of the risks which local fiduciary firms face.

In 2016, we worked with colleagues in the Financial Crime and Enforcement Divisions to take robust action against those few fiduciaries guilty of serious breaches of the law. Nevertheless, in our experience, the vast majority of our licensees continue to operate reputable businesses which epitomise why Guernsey remains a leading international centre of expertise for Trust and Corporate Service Provider (TCSP) business.

We repeated our quarterly fiduciary ‘drop-in’ breakfasts and extended invites to the Personal Fiduciary Licensees for the first time during 2016. These sessions are informal in nature, with no prescribed agenda, and proved to be successful in developing working relationships, sharing fiduciary trends and understanding the challenges our local firms face. We intend to continue these events in 2017. Members of the Division also delivered presentations to a variety of industry groups including the Guernsey Association of Trustees (GAT), the Society of Trust and Estate Practitioners (STEP) and the Institute of Chartered Secretaries and Administrators (ICSA) on a range of topics.

Policy

Support of innovation remained high on our agenda during 2016. Considerable effort was focused by the Division on progressing the Lending, Credit and Finance Project which has two principal objectives. Firstly, to introduce consumer lending and credit protection and secondly to provide clarity on the regulatory requirements for innovative financial lending services. The project also contemplates the repeal of the existing Registration of Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) Law, 2008. The project has sought to engage an extensive range of stakeholders. We were pleased by the significant number of responses to the Discussion Paper in the third quarter of 2016. Work in this area continues apace and it is envisaged that a Consultation Paper will be issued in the first half of 2017.

The Division and the wider Commission continue to play an active role in the international arena for the fiduciary sector, in particular with regard to key work streams under the Group of International Finance Centre Supervisors (GIFCS). Leading a working group on the GIFCS' Standard on the Regulation of Trust and Corporate

Service Providers ("the Standard"), the Division helped shape a template to assist global GIFCS members in assessing their own arrangements for meeting the Standard. The Commission continues to work to ensure that Guernsey is compliant with the Standard to uphold our reputation and reinforce our position as a leading trust jurisdiction and is currently developing Client Asset Rules in this regard.

During 2016 the Division maintained dialogue with industry representatives, including Personal Fiduciary Licensees, on the subject of statutory exemptions and acting as a director and with respect to statutory exemptions for Private Trust Companies. A number of issues and solutions were identified. Whilst some of the issues are expected to be resolved through the Revision of Laws project, the Division has been working closely with industry bodies to understand issues for practitioners. Whilst there is ongoing work in this area, constructive discussions have been held and the Commission has recently published updated guidance and FAQs on its website.

Risk Outlook

At present, the sector remains stable both in terms of the number of full fiduciary licensees (153 in 2015 and 154 in 2016) and in the value of assets held by local firms.

New business continues to be developed internationally, including from China, the Middle East and Asia. Where new business is developed from higher risk jurisdictions we continue to expect firms to apply a risk-based approach and ensure appropriate and robust AML/CFT arrangements are maintained and implemented.

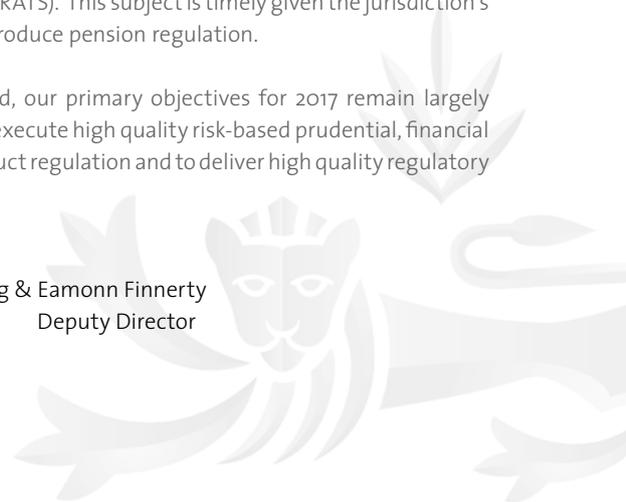
The Division's supervisory activities have resulted in risk mitigation actions which continue to be focused on governance risk, conduct risk, operational risk, insurance risk and financial crime risk. Going forward one of the main challenges for the sector continues to be environmental risk. The global tax narrative and increased focus on offshore structures continue to pose a challenge to our licensees. Further, cyber security threats globally increased significantly during 2016 and the Bailiwick was not immune to such attacks with licensees having been subjected to attacks in all sectors. Vigilance around staff training and updating or replacing legacy systems that are no longer supported by software providers will form part of

the strategy to mitigate the growing cyber security threat. When conducting onsite visits supervisors will consider whether or not the firms have adequate policies and procedures in place to ensure that the threat from cyber crime is reduced.

The Division announced to industry that the annual thematic topic for 2017 will focus on the area of Pensions and Retirement Annuity Trusts (RATS). This subject is timely given the jurisdiction's intention to introduce pension regulation.

Looking forward, our primary objectives for 2017 remain largely unchanged: to execute high quality risk-based prudential, financial crime and conduct regulation and to deliver high quality regulatory policy.

Gillian Browning & Eamonn Finnerty
Director Deputy Director



Supervision

Since 2008, policy makers have considered, in depth, the degree to which the global insurance industry poses a threat to global financial stability. A notable example of this was in 2016 when the International Monetary Fund (IMF) argued that regulators should supplement their traditional firm-specific approach to regulation with a wider macro-economic approach. The IMF urged consideration, for example, of such issues as a higher risk appetite in the search for yield, correlated sectoral exposures, closer links to the capital markets, cross-border regulatory arbitrage, the impact of fair value accounting, derivative usage and so on.

Although important for the Island, the Guernsey insurance industry is too small to have much of an impact on global or even regional financial stability; not least as a large proportion of business is made up of self-insuring captives. Nevertheless, the Commission takes care to follow the advice of, for example, the IMF, by considering the global picture in its everyday supervision. For example, whether the Insurance-Linked Securities (ILS) sector is under-priced and how therefore it should be supervised; or whether Guernsey insurers are taking on more credit and duration risk to improve yields; or whether sovereign risk is a concern, not least given regional debt levels. Whatever the answer to these questions, their consideration enhances the quality of Guernsey's everyday supervision as well as ensuring that the jurisdiction is aligned with the wider, global picture, and thus meets its international obligations.

Turning more specifically to the Bailiwick, 2016 aggregate figures are unavailable, given that many firms have an end-December year-end and do not report till the end of the first quarter of 2017. However, in 2015, gross assets stood at £23.9bn (£23.7bn in 2014), net worth at £11.5bn (£11.6bn in 2014), and premiums at £5.5bn (£4.9bn in 2014). Given that these figures can be unduly influenced by a few of the larger firms (and in 2015 some larger deals), all that can be safely said is that the local industry has remained stable in recent years with some signs of modest real growth, not least after nominal numbers are inflation-adjusted.

International insurer licences increased from 804 in 2015 to 835 in 2016; largely due to new Protected Cell Company (PCC) cells. This increase primarily reflected a re-structuring of current business.

Otherwise, in 2016 the market remained unchanged with 8 licenced domestic insurers dealing with local requirements and 19 authorised managers dealing with international business.

Recurring themes in insurance supervision in 2016, were key man risk, group outsourcing and the impact of technology on business models.

Policy

In January 2017, the Commission issued Special Purpose Insurer Rules to provide additional clarity to this sector, in the particular context of catastrophic re-insurance. The Commission also revised its insurance fee structure to reduce ILS fees.

In 2016, the Commission continued to contribute to the International Association of Insurance Supervisors (IAIS) through membership of IAIS's Executive Committee, its Financial Stability and Technical Committee and the Reinsurance Task Force. The Commission continued to chair the Group of International Insurance Centre Supervisors (GIICS) and supported its mid-level

training event in London. The Commission, funded by the Commonwealth Secretariat, also completed its work for the Cook Islands around captive regulation and the risk-based approach. The Commission continued to self-assess itself against the Insurance Core Principles, on a timeline set by IAIS.

Risk Outlook

As in 2016, in 2017 Guernsey insurers need to be aware of three immediate and continuing risks. First is the need to ensure that retail investors are not included in funding of the ILS sector in Guernsey, given the risks involved. Second, is the need to control asset quality despite the search for yield. And third, is the need to respect the increasing regulatory and societal focus on conduct of business issues.

Jeremy Quick
Director

A final and emergent risk, although present for some time, is the threat from cyber crime. This is especially the case where insurers retain sensitive personal details of their clients.



Supervision

Global growth for 2016 was projected at 1.6% for the developed world by the International Monetary Fund (IMF) in January 2017; although a strong outturn in the fourth quarter in both the UK and USA had not been factored into that projection. Growth in the developing world was estimated at 4.1%; with Asia performing well. In aggregate, the IMF project 2016 global growth at 3.1%.

As at end-September 2016 (latest figures), total liabilities of Guernsey banks stood at £115bn compared to £105bn a year earlier. Third party deposits, that is deposits other than from banks, as at end September 2016, stood at £44bn compared to £39bn a year previously. The general increase in liabilities and deposits is largely to be explained by the sudden depreciation in sterling following the referendum in the UK on membership of the European Union, given that a significant proportion of banking business in Guernsey is transacted in US dollars and euros.

Four licences were surrendered in 2016 bringing the number of banks in Guernsey to 25 at end-year. Of the four banking licences surrendered, three came from groups that still retain one or more banking licences in Guernsey. There was a minimal impact on local employment as the number of full time equivalent staff was more or less static at 1,498 in September 2016 compared to 1,488 in September 2015.

During 2016, there were no recurring supervisory issues with Guernsey banks although AML/CFT issues periodically appeared. The biggest recurrent regulatory challenge that Guernsey banks face is outsourcing key activities without a loss of control.

The Commission undertook a desk-based thematic examination of regulatory returns. It concluded that some improvements for certain banks around the pre-submission process were advisable.

Policy

As part of its continuing implementation of Basel III, in 2016 the Commission completed its implementation process (including an impact study) for the Liquidity Coverage Ratio and the Net Stable Funding Ratio. These requirements will come into effect in 2017.

Since 2016, Guernsey banks have been able to participate in the Single European Payments Area (SEPA). So far, three banks have taken advantage of this.

The Commission has continued to support the Guernsey government in 2016 as it considers the issue of bank resolution.

In the course of 2016, the Commission has been active internationally; attending several regulatory colleges and meetings of the Group of International Finance Centre Supervisors (GIFCS).

In terms of international co-operation, the Commission visited Nevis to provide advice on Basel II implementation, funded by the Commonwealth Secretariat and hosted a delegation from the Central Bank of the Seychelles on banking regulation in general. Several bilateral visits were made to sister regulators.

Risk Outlook

In global terms, the IMF forecasts stronger global growth in 2017 than in 2016. However, for Guernsey banks, the biggest risks come from a continuing slide towards autarchic sentiments around the world that will continue to constrict the cross-border financial and

non-financial flows upon which Guernsey banks depend and a decline in the central London residential and commercial property market where Guernsey banks have, in aggregate, their largest sectoral exposure.

Jeremy Quick
Director

CONDUCT UNIT

In 2015, the International Association of Insurance Supervisors (IAIS) published a paper on conduct of business and in 2016 followed this with another paper on intermediaries. Each of these supports a related specific insurance core principle. This increasing international focus on conduct reflects the fact that conduct is becoming more important, including for traditional prudential supervisors, in terms of everyday supervision. Guernsey is no exception to this trend. For example, the Commission has a dedicated Conduct Unit, supports financial literacy, engages in onsite thematic reviews, and so on. Having said this, Guernsey, like other small jurisdictions, faces particular challenges in conduct regulation. Key amongst these is the fact that many of the insurers providing local services are situated, and regulated, outside the jurisdiction. As global regulators begin to combine issuer and intermediate regulation into one stream, for regimes like Guernsey, this leads to a challenge of cross-border co-operation so as to ensure that overseas insurers are effectively aligned with Guernsey intermediaries.

There were 34 licensed insurance intermediaries at the end of 2016 dealing with local and specialised requirements covering both life and general insurance. This is consistent with the end of the previous year; with 1 new authorisation and 1 surrender.

As part of its commitment to intermediaries, the Commission hosted a one day seminar on the UK Insurance Act 2015, accessing several off-island speakers. Feedback on this seminar was positive.

The Commission began its revision of the Code for Authorised Insurance Representatives (AIRs) so as to make it more accessible and compatible with business practices – to be implemented in 2017. The new draft Code is designed to strengthen the quality of general insurance advice in the Bailiwick. The revision followed a thematic where the Commission expressed concern over the

practice of opting out rather than opting in to certain general insurance products, as also highlighted by the UK Financial Conduct Authority (FCA).

The Commission withdrew the Guernsey Insurance Certificate, as demand for the examination had fallen to a very low level and as it had, in part, been made redundant by the increased availability of relevant Guernsey-specific educational reference material.

The Conduct Unit continued to play a role in improving local financial awareness. An example of this was the hosting, for local sixth formers, of a seminar on the local financial industry. The Conduct Unit also continued to liaise with the new Channel Islands Financial Ombudsman as the latter got into its stride.

The Conduct Unit was active internally in supporting the production of the Commission's Discussion Paper on consumer loan regulation; as well as in determining the Commission's approach to robo-advisers. It also hosted a visit from the Reserve Bank of Malawi which focused on conduct regulation. This is the third recent Commission contact with the Reserve Bank with previous sessions covering the risk-based approach and insurance regulation.

In terms of everyday supervision, the Conduct Unit continued to concentrate on long-term insurance advice together with the proactive supervision of retail bank branches.

Risk Outlook

In 2017, firms should be aware that the Commission intends to undertake a third thematic on long-term life intermediaries. General insurance intermediaries should, in due course, undertake a gap analysis around the new Code for AIRs and take remedial action where necessary. As always, firms should pay particular attention to the need to treat customers fairly, which includes,

amongst other matters, being transparent about charges, clear in the coverage of each policy and balanced when dealing with complaints.

Jeremy Quick
Director

Supervision

In quarter one of 2016, the Financial Crime Supervision and Policy Division applied for the first time the methodology it developed for assessing financial crime risk across the finance sector using data submitted in 2015 from the annual Financial Crime Risk Return.

The Division was pleased to note a 98% return rate from industry for this first set of data, a return rate which was repeated for the second set of annual data representing the period July 2015 to June 2016 which was received in the fourth quarter of 2016. This second set of data now means that the Division can begin to examine year-on-year changes in key risk indicators on a firm and sector basis to improve its understanding of financial crime risks on an individual and sector basis and across the industry as a whole.

This ability to apply a consistent method of assessment of risk is important for determining not only our programme of supervisory engagements with firms, but also for the generic data it provides on a sector and industry-wide basis for policy work on matters such as the National Risk Assessment.

Globally, many financial supervisors are now starting to request financial crime data from their firms. The Division was therefore pleased to receive an approach from a major onshore financial services regulator who wanted to learn about our experience in introducing an industry-wide return and on the development of a methodology for assessing inherent financial crime risk.

During 2016, we carried out onsite visits to 46 firms, 10 of which were carried out under our 2016 joint thematic review with the Investment Supervision and Policy Division. The thematic commenced in the third quarter and examined audit, compliance and risk management frameworks in the investment fund administration sector. In respect of financial crime issues within this exercise, we were seeking to understand how fund administrators address risks associated with bribery, corruption, tax evasion, fraud and international sanctions posed by investors and within collective investment funds themselves. This work was carried out alongside assessing the general measures firms employ to monitor the effectiveness of their compliance monitoring programmes and their controls for undertaking investor customer due diligence, monitoring and reporting suspicions, including how firms ensure that suspicions are being reported in a timely manner. We intend to publish the findings from this thematic in 2017.

In June 2016, the report from the Division's thematic review of the provision of financial crime training was published. This exercise involved 62 firms employing 2,238 employees. Its key finding related to a disconnect between the money laundering, terrorist financing and more general financial crime risks - which firms identified as the greatest threat to their businesses - and the content of the training provided to their boards of directors and staff. The Division found that nearly three-quarters of firms surveyed identified fraud as one of their top three risks but only six of those firms specifically covered fraud in the regular training provided to staff.

Findings from the Division's onsite visits continued to show that most firms inspected had strong control environments enabling them to manage effectively laundering and terrorist financing risks. We found, however, a few firms where there were significant systemic failings. During the year, several firms were referred to the Enforcement Division for further investigation.

Several other firms were intensively supervised during 2016 with measures including licence/registration conditions or independent reviews implemented as part of risk mitigation programmes to remedy financial crime deficiencies.

Policy

The two projects which dominated the Division's policy work in 2016 were the commencement of the Bailiwick's National Risk Assessment ("NRA") and the continued development of the AML/CFT Handbook. As with Moneyval's evaluation of the Bailiwick's AML/CFT regime which scrutinised the work of all the Bailiwick's AML/CFT agencies, these two projects are also multi-agency exercises.

By the end of 2016, the Bailiwick was about a third of the way through the NRA. This government-led project, which is utilising a model framework from the IMF, to assess the money laundering and terrorist financing risks the Bailiwick faces, is also drawing upon the knowledge and experience of a cross-section of firms representing the broad composition of the Bailiwick's financial and professional services sectors.

Much of the work has involved the completion of perception surveys and collection of statistics for which the Division was able to draw upon data from the financial crime returns regarding the number of high-risk and politically exposed customer relationships there are on a sector basis. One workshop involving the AML/CFT agencies was held at the end of November to consider the money laundering and terrorist financing threats to the Bailiwick and the Bailiwick's vulnerabilities and a further workshop, which will also involve representatives from the private sector, is scheduled for mid 2017.

As a precursor to the NRA, earlier in the year the Division took part alongside the other Bailiwick's agencies, in Financial Action Task Force (FATF) and Moneyval surveys on terrorist financing.

The development of the AML/CFT Handbook has remained a longstanding project and with the publication of Moneyval's report of its assessment of the Bailiwick's AML/CFT regime in January 2016, considerable progress has been made to advance revisions to the legal framework. The Division has been working with the Policy and Resources Committee, which is responsible for the Proceeds of Crime Regulations, the Law Officers of the Crown and the Alderney Gambling Control Commission, whose supervision of the egambling entities includes ensuring compliance with a similar AML/CFT regime based upon the FATF Recommendations. The revisions, which will be subject to consultation, will bring the AML/CFT regime which firms must apply, up to the FATF's latest standards and incorporate Moneyval's recommendations, including the recommendation that the categories of customers to which enhanced measures should be applied should be expanded. In this respect the Division has reviewed other comparable jurisdictions, including Jersey. We intend that the revised regime will come into effect in the second half of 2017.

The publication of the Moneyval report also afforded an opportunity for the Commission, alongside the Guernsey Border Agency and the Policy and Resources Committee, to provide feedback to industry on the report. The Division also provided supervisory feedback on the robustness of firms' sanction-screening controls at a Guernsey Border Agency seminar on terrorist financing which was held in October.

Risk Outlook

Moneyval's findings from its evaluation of the Bailiwick, that firms were highly knowledgeable in respect of their AML/CFT obligations and had comprehensive customer take-on policies, procedures and controls, mirrored the Division's experience as a supervisor that the finance sector is good at identifying and verifying beneficial ownership. Clearly, this is important for ensuring that the beneficial ownership records, which will be held by the Bailiwick through the Register of Beneficial Ownership which is due to be established by mid-2017, are accurate and up to

date. Those records will also need to be underpinned by effective and robust due diligence measures which drill down on beneficial ownership. This will be essential to continue to mitigate the range of financial crime risks faced by all firms, ranging from bribery and corruption to tax evasion and terrorist financing and sanctions risk.

Fiona Crocker
Director

General

2016 was another busy year for the Enforcement Division both in the number of cases requiring an investigation and, for the first time since its inception, conducting more outreach to industry by way of case typology presentations.

During 2016, the Division brought to a conclusion the two remaining cases linked to the Arch Cru investigation, however, there are further major cases being investigated which are complex and stretch across several jurisdictions. We also continue to receive referrals from the supervisory divisions involving cases where licensees have serious AML/CFT failings or where serious corporate governance failings have been identified. Such cases bring into question whether the senior management and the boards concerned are meeting the minimum criteria for licensing.

It is, however, within the fund sector where the Division has been most active in the last twelve months with some concerning instances being uncovered of significant failings in corporate governance and the management of conflicts of interest as well as extremely poor management of clients' investments. During the year, the Division had to deploy significant resources in order to deal with several cases involving investment funds where retail clients were potentially at risk. Where, during the course of our investigations, we identify material which leads us to believe that criminal activities may have occurred, we will refer those matters to the Economic Crime Division with whom we share a close and constructive working relationship.

With regard to those cases where there was a cross-jurisdictional interest then, as with other global regulatory enforcement bodies, the Commission has the ability to exchange information with, and make requests of, other regulators in relation to specific investigations. Such requests are made under the Multilateral Memoranda of Understanding of bodies such as the International Organisation of Securities Commissions (IOSCO), which enables regulators to exchange material and to assist each other in ongoing investigations.

Once again this year (as in 2015), we have found it necessary to make applications to the courts for administrators or liquidators to be appointed for licensed entities. We have resorted to this action in those cases where we believe there are either solvency issues that require urgent resolution and / or there is a real threat to investors' funds. The Commission only takes such action where the circumstances are considered to be serious and where we consider alternative courses of action – such as the licensee making the application itself - unappealing. These cases can be both time consuming and expensive for the Commission, hence applications will usually be made for costs to be awarded. This ensures that, wherever possible, such expenditure will not ordinarily fall on those licensees who operate profitably, professionally and within the ambit of the law.

Outreach to Industry

In February this year, the Enforcement Division, in conjunction with the Financial Crime Supervision and Policy Division, was invited by the Guernsey Association of Compliance Officers to provide a case study presentation to its members. This was an interactive session which enabled those attending to get involved. Later in the year, we were invited by the Institute of Directors and the Guernsey International Business Association to provide a similar presentation to their members.

It was pleasing to note similar answers being provided by both the Compliance Officers and the Directors at the two separate events showing that, on the whole, proper consideration is being given to the key regulatory expectations of our licensees.

This was the first time the Commission has delivered such a targeted presentation to industry on the subjects of enforcement and financial crime and from the feedback we received it is clear that those who attended found the presentations to be both informative and helpful. We hope that the presentations also provided an insight into the types of cases that are being investigated and the reasons why sanctions were brought against the firms and individuals.

It is envisaged that the Enforcement Division will undertake further outreach activities for industry during 2017.

Cases reported

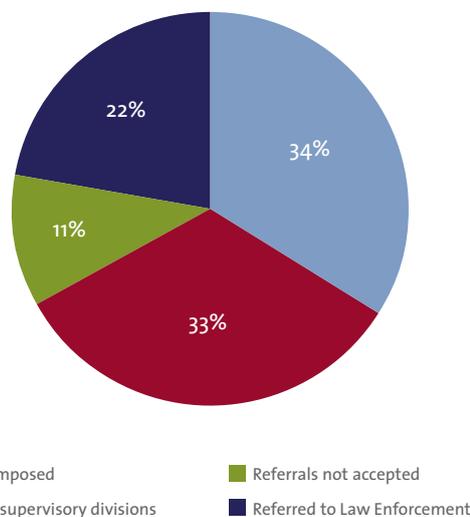
The theme for the 2016 Industry Presentations was around corporate culture. From the public statements that have been published on the Commission's website over the last two years or so, it is clear that the culture within some of those firms who have faced sanctions, was one of profit regardless of societal cost.

In the early part of the year, the Division reported on a fiduciary that was not fulfilling the regulatory requirements with regard to AML/CFT requirements and failing to keep up with client file reviews. There were also other issues which were considered to be serious regarding the licensee which led to sanctions being brought.

During the year, the two remaining legacy cases were finally brought to a conclusion both of which had links to the Arch Cru collapse. These cases were extremely time-consuming to progress. We faced challenge at various intervals with attempts being made to break the process rather than address the substantive issues. However, the Commission's decision in 2014 to establish a panel of Senior Decision Makers (SDMs) comprising eminent QCs from the UK who determine the serious enforcement cases, has been shown by these cases (and others) to have been the right thing to do. In particular, the SDMs' experience in dealing with complex legal arguments and writing up detailed findings with precise reasoning has ensured that the Commission has been well placed to deal with subsequent appeals where, despite some penalties being remitted for adjustment, both the process and the substance of the SDMs' decisions have withstood the scrutiny of the courts.

2017 is set to be another busy year with cases that have been investigated in 2015 and 2016 starting to come to a conclusion. In general terms, the Enforcement Division has between 8 to 14 live cases at any one time, generally at differing stages.

The chart below depicts the outcomes of cases that have been concluded during 2016 and shows quite clearly that not all matters that are referred to the Division lead to sanctions being imposed.



There were a couple of instances where fines remained unpaid by firms and individuals. The Commission commenced proceedings in one of these matters in 2016 and further applications are expected to be made to the Courts in 2017 for the payment of fines, where we adjudge such action appropriate, given the solvency of the individual or firm concerned.

Simon Gaudion
Director

Whistleblowing Line

Calls to the whistleblowing line during 2016 included the expression of concerns about the conduct of certain senior staff at licensees and other general reports of poor business practices. The reports were reviewed by the Intelligence Unit and relevant information passed to the supervisory division for further consideration where appropriate.

The whistleblowing line is 01481 748094. There is also now an email address available: whistleblower@gfsc.gg

SENIOR DECISION MAKERS

The Panel of Queen's Counsel set up in 2014 to act as Senior Decision Makers in contested enforcement proceedings brought by the Commission against firms and individuals, has now benefited from further experience in discharging that independent and quasi-judicial role.

During the course of 2016, three cases were pending before Members of the Panel and one of those three was completed during the year. In addition, there were in 2016 further (appellate) proceedings in relation to two of the three cases decided by Members in 2014 and 2015. There were remittals in each of those two cases, which were disposed of in the course of 2016. Thus five Members of the Panel were actively engaged in casework over the course of the year.

All the present Members of the Panel have now had one case to deal with, except for the most recently appointed Member.

At the end of 2016, the Senior Decision Makers were: -

- Glen Davis QC
- Dr Kirsty Hood QC
- Richard Millett QC
- Terence Mowschenson QC
- Leigh-Ann Mulcahy QC, and
- Nicholas Peacock QC.

Andrew Stewart QC of the Scottish Bar resigned from the Panel on his appointment as a Judge of the Court of Session with the judicial title of Lord Ericht. After advertisement and interview, the Commission appointed Dr Kirsty Hood QC in his place. Malcolm Davis-White QC also resigned following his appointment as a Specialist Civil Circuit Judge exercising Chancery and Mercantile jurisdiction in the North Eastern Circuit in England. Leigh-Ann Mulcahy QC was appointed in January 2016 to sit (part-time) as a Deputy High Court Judge in England and Wales.

The only determination made in the course of 2016 led to a public statement which appears on the Commission's website. It is dated 21 November 2016, and relates to Marlborough Trust Company Limited, Marlborough Nominees Limited and four individuals related to those companies.

The two determinations by Senior Decision Makers mentioned in my report in the 2015 Annual Report were each appealed to the Royal Court, and each resulted in a partial remittal to the Decision Maker. Following the decision relating to Guernsey Insurance Brokers Ltd of December 2014 and two individuals related to it, one of the individuals appealed on the basis that the penalty in his case was too high. On appeal from the Royal Court, the Court of Appeal (Appeal No 498) concurred with the Deputy Bailiff's decision in the Royal Court that the amount of that penalty fell to be remitted to the Senior Decision Maker and it provided interpretation of the Deputy Bailiff's Judgment on factors to be taken into account when setting penalties which the Commission found helpful. The outcome of the remittal was an amended public statement which appears on the Commission's website.

Bordeaux Services (Guernsey) Ltd and three individuals related to it also appealed to the Royal Court from the decision of August 2015 in their case. The Deputy Bailiff's Judgment of 11 May 2016 made some adjustments to the outcome, including remittals as to the amount of one penalty and the length of one prohibition order. The outcome of the remittal was an amended public statement which also appears on the Commission's website.

At the year end, two other contested cases were pending before Senior Decision Makers. One of the two appears to be of unusual size and complexity.

The annual training day was held for the Panel in September 2016, to consider the early experience gained by individual Members of the Panel and the implications for them of the decisions of the Royal Court and Court of Appeal. A further training day is scheduled for September 2017.

Michael Blair QC
President of the Panel of Senior Decision Makers

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CHIEF RISK OFFICER'S REPORT

As noted in the Director General's statement in 2015, the Commission implemented the second major part of the PRISM supervisory system therefore meaning that 2016 was our first full year in which all aspects of PRISM were used by all our supervisory teams. This meant that, during 2016, the Risk team, who had been responsible for the successful implementation of PRISM, could shift into the more traditional roles of providing challenge, assurance and development of risk-based supervision within the Commission, as should be seen in the Risk function at any authorised firms. During this period we also saw a number of changes in the personnel of the Risk team, including me joining the team and the Commission as Chief Risk Officer.

From my past history and experience as both a supervisor and consultant, I know that PRISM, as a system and methodology for risk-based supervision, is not a panacea for all. Also, as I noted at our 2016 Industry Presentations, even if we had an individual supervisor for every firm, this would be no guarantee that all firm

failures could be prevented. Risk-based supervision is necessary to ensure that we execute high-quality prudential, financial crime and conduct supervision using the resources we have available. Nevertheless, we would be resting on our laurels if we assumed that because PRISM has been implemented, everything is working as efficiently and effectively as it could, or that there are not further risks on the horizon that the Commission should be aware of, and prepared for. My challenge in 2017 and going forwards therefore is to lead the Risk team at the Commission in providing assurance on the efficiency and effectiveness of our supervisory approach and to be one of several voices providing insights into the potential risks that the financial services industry and the Commission face.

Supervisory Actions

Whilst PRISM has been fully implemented, we continue to roll out risk-based supervision to authorised firms within the Bailiwick. During 2016, our supervisors visited c.40 firms on risk assessment visits, each of which was followed by a Risk Governance Panel which is the Commission's method of internal challenge to ensure consistency and fairness across all supervisory divisions. From these visits, and other supervision interactions, just over 150 Risk Mitigation Programme ('RMP') issues were identified by supervisors resulting in over 200 actions being set for both the firms and the Commission. Actions are created where the weakness identified in the systems and controls at a firm for a specific issue results in probability of a risk crystallising, such as financial crime, being above the Commission's risk appetite.

Whilst the actions created by supervisors in 2016 aimed to mitigate a wide range of risk types, a significant number of actions were targeted at financial crime risks, operational risks, governance and conduct risks. The completion of these actions will continue to be monitored by our supervisors until we are satisfied that the risk has been mitigated such that the probability of the risk crystallising is below the Commission's risk appetite. As we continue to visit firms for the first time using the PRISM methodology in 2017, I expect that we will identify further RMP

issues and actions across a number of risk types including the ones mentioned above. Firms and their directors should continue to ensure they are satisfied that their own systems and controls in each of these risk areas are sufficiently robust to mitigate the level of risk that they face, especially if a firm operates a high-risk or innovative business model.

Firm Risk Assessment visits and interviews with senior individuals at firms are the most obvious aspects of our proactive supervision of entities authorised in the Bailiwick, however, we also receive a range of additional information on the firms we supervise from a number of sources such as online returns, firm notifications, social media and the whistleblowing hotline. Alerts will also be created within PRISM to trigger supervisory consideration of a specific issue or event. Supervision will create a record of such alerts within PRISM and will record the action the Commission has, or if appropriate has not, taken as a result of this additional information using a triage within the system. Over the course of 2016, our supervisors dealt with over 13,000 alerts across approximately 2,000 firms, with over 1,200 triages being recorded. These alerts and triages cover a wide range of events from breaches of legislation or rules to reporting errors or the need to follow up an RMP action that had been set.

Whilst multiple alerts may be recorded against one firm, with 2,150 entities authorised in the Bailiwick, it shows the breadth of information the Commission receives and the amount that our supervisors deal with during the course of a year. We will continue to investigate methods to enable us to improve our use of information and identify those firms which may pose a risk to the Bailiwick and its financial services industry. In addition, the

information we receive along with the RMP issues and actions which were created in 2016, demonstrates that the majority of actions taken by the Commission to help address issues it has identified were done in cooperation with the firms we supervise. It is only in extreme or egregious cases, that a referral to our Enforcement Division is considered.

2017

The Risk team will remain as a mainly internal facing function of the Commission, though we will continue to participate in industry events and deliver educational initiatives where we believe the subject of risk, the role of risk and risk-based supervision on the island can be better communicated and understood. We will continue to be responsible for assuring that PRISM remains effective in mitigating the risks of the firms authorised by the Commission through the operation of Risk Governance Panels, regular management information and specific assurance reviews on our supervisory approach.

As noted within the comments of the supervisory directors, there are a number of new policy initiatives which will be implemented in 2017. The Risk team will continue to be responsible for ensuring we are prepared for these changes when they occur and in providing guidance to our supervisory colleagues on how to assess new risks or requirements at the firms they visit.

Throughout 2017, the Risk team will also be considering how, as a Commission, we can best use the information we receive to help identify future risk trends within our firms and the wider industry, along with assessing new risk areas that may arise. We aim to continue to ensure that the Commission carries out effective and efficient high-quality prudential, financial crime and conduct supervision.

Katherine Jane
Chief Risk Officer



AUTHORISATIONS UNIT

2016 has been the first full year of operation for our completely centralised Authorisations Unit since its initial inception. There is now a complement of twelve staff in the Authorisations Unit and the process of streamlining working practices and cross-training continues. The responsibilities of authorisations comprise three main areas: (i) the assessment, review and final decision-making on all applications which are submitted to the Commission; (ii) the assessment and review of all personal questionnaires, appointments and resignations; and (iii) the running of the online services help desk.

The establishment of a centralised area responsible for the consideration of all applications has facilitated a consistency in approach and decision-making which was more difficult to achieve when assessments were undertaken independently within each of the supervisory divisions. Communication between the Authorisations Unit and each of the supervisory divisions remains a priority and weekly reporting is provided regarding submissions to the Commission. In addition, to aid the quality and timeliness of decision-making and information sharing across the Commission, regular meetings have been set up between the Authorisations Unit and all supervisory divisions to discuss ongoing and potentially complex, innovative or higher risk applications.

Overall, the volume of applications submitted to the Commission increased by 5% during 2016, with a total of 498 received during the year compared to 476 during 2015. The two sectors which saw the most growth were Investment and Fiduciary. The majority of the increase in investment applications can be accounted for by a rise in the number of open-ended fund classes launched. In the Fiduciary sector, there have been a number of high-profile consolidations which have resulted in 16 amalgamation applications during the year, compared to none during 2015.

Generally, a peak in both applications and surrenders has been noted towards the end of the year which is matched by a corresponding decline during the summer months. Whilst we will endeavour to meet deadlines, it is always helpful if complete applications are submitted as early as possible to help achieve this.

The Authorisations Unit adopts a consistent, robust and rigorous approach to the assessment of all applications; the applicant must demonstrate how they are going to meet the relevant regulatory requirements or they will not receive approval. Throughout the year, this stance has resulted in a small number of applications not proceeding to the approval stage due to either material weaknesses in the application or business model. Nevertheless, over 96% of applications submitted were approved showing how well the majority of firms demonstrate that regulatory requirements would be met.

Over half of the non-approved applications were withdrawn by the applicants when it became clear to them that there were weaknesses in their proposed business model, systems or controls which required additional work. During the year, the Authorisations Unit conducted a review of outstanding 'in principle' approvals which had not been progressed, in some cases for over two years. On the back of this review we have implemented a working practice that, if a substantive response to all our queries is not received within three months or an 'in principle' approval is not taken up within this period, the application is archived, and reactivation requires a new submission with an attendant application fee. Lapsed applications such as these accounted for just under 2% of the non-approved applications. There was only one instance of the Commission issuing a minded to refuse letter during 2016.

During 2016, a total of 8,400 submissions were made through the online Personal Questionnaire (PQ) portal, which represented an increase of 21% from 2015. The rise is due both to more people using the portal and firms being able to ensure more easily that all individuals' records are kept up to date. Since its launch in October 2015, there have been approximately 7,500 submissions made via the online submissions portal; 6,300 returns and 1,200 notifications. The returns submitted are used to drive Key Risk Indicators within PRISM which feed into the reactive supervision carried out by the regulatory divisions. We noted that calls and emails to the help desk increased when new forms were launched during the year (such as the investment compliance and statistical

return launched in October) or when a number of return dates coincided. Whilst we are happy to provide this service we hope that, as industry becomes increasingly familiar with the online submission process, the number of calls and emails to the help desk will decline.

Whilst the Authorisations Unit is essentially a reactive team, we expect that with the launch of new initiatives such as the Manager Led Product, Private Investment Fund and Special Purpose Insurer Rules, we may continue to see an increase in the number of applications submitted to the Commission.

In 2016, we achieved the 90% service level standard for the three-day turn around on fast track funds. The few instances where this service level could not be achieved were when the submission required significant clarifications from the applicant or referral to the Investment Supervision and Policy Division because of the innovative or unusual features of the application. Therefore, in order to ensure that the Authorisations Unit can continue to provide a timely and efficient service, we intend to hold a series of meetings and presentations with industry and relevant stakeholders during 2017. At these engagements, the Commission's expectations regarding the quality of application submissions will be outlined because a high-quality, clear and comprehensive submission assists our review and accelerates the decision-making process. At the same time we will be looking to identify opportunities for how we can work better with industry in the application process, for example with complex or innovative applications.

Katherine Jane
Chief Risk Officer



General

When I was appointed Director of Financial Stability, a friend of mine, a Managing Director at a respectable large Asian financial group, suggested, somewhat mischievously, that it was economics as a three wheeler. Beyond the joshing, however, his was a serious point: that in financial services and markets, stability and growth are two sides of a policy trade-off and there are many of the view that global regulatory policy makers have, in most recent years, over-emphasised stability at the expense of growth.

2016 saw continuing global political push back against the regulatory response to the global financial crisis culminating with the election of a US President vowing to repeal or at least reform the Dodd-Frank Act. Notwithstanding, the mandate and influence of financial stability departments and bodies continues to grow. In the UK in particular, with interest rates stationary for so long, it is arguably the Financial Policy Committee and not the Monetary Policy Committee, that in recent years has been the key policy-making body of the Bank of England.

The focus of my own initial work programme for 2016 was rather more grounded: providing ongoing assessment of systemic risks that may directly or indirectly impact us in the Bailiwick and

commencing a review of monitoring processes and our macro-prudential policies and procedures, in particular benchmarking against current international policy standards.

During the course of the year, the institutional arrangements for monitoring of risks in Guernsey were supplemented by the introduction of the Financial Stability Committee by the States of Guernsey; a non-statutory body, independently Chaired, whose membership includes representatives of the Commission including our Chairman, Director General and myself. The Committee's overarching mandate is to "provide advice to the States on co-ordination of strategies and policies to enhance Guernsey's capability to identify, understand, monitor and address systemic risks". The creation of the Committee was a result of a recommendation of the International Monetary Fund (IMF) following its last Financial Sector Assessment Programme visit. The Committee met once in 2016 and the Commission will work to help it undertake its mandate.

Policy

2016 saw political push back against post-financial crisis international banking policy (Basel III/IV) in both the US and EU. International insurance regulators continued to make slow progress developing a global capital standard. Yet 2016 also saw the Financial Stability Board (FSB) continue its drive to push through financial stability driven policy development in the asset management sector. Stepping back from its original attempt to designate the largest global asset managers as systemically important, it published fourteen separate policy proposals to address concerns about structural vulnerabilities from asset management activities that could potentially present financial stability risks. Of more immediate significance was the signposting that the FSB might consider there to be principles that ought to be applied to pension (and sovereign wealth) fund supervision.

2016 was the year the Commission commenced a fundamental review of the Bailiwick's pensions regulatory framework with the publication of a discussion paper in the fourth quarter. This was driven by a need to modernise and future proof our regime to improve consumer protection and meet international expectations as well as prepare the ground for the States of Guernsey's secondary pensions scheme. We will continue our development of pensions regulation in conjunction with the States and industry in 2017.

Risk outlook

There are few significant financial stability risks generated domestically but the Commission remains vigilant to those which develop globally. Sources of global risks to the financial stability of the global economy remain depressingly constant: excessive debt, the low interest rate environment and Chinese imbalances remain, in my view, the three largest sources of risk to global financial stability. Geopolitically, the United States' trade policy has become, overnight, a source of potential instability and Brexit, a financial stability non-event in 2016, presents some uncertainty for the wider European economy at the two-year horizon. As ever, Greece and Italy pose real risks more near-term than that. Storm clouds on the horizon are an ever-present threat but the more probable, benign and, it has to be said, hoped-for, outcome is to be writing the exact same sentiment again in 12 months' time.

Dr Andrew Sloan
Director



Introduction

Across the financial and operational areas of the Commission, the aim throughout 2016 was to ensure that our supervisors continued to have the environment and tools to carry out their work in a cost efficient and effective way.

Mindful of this commitment, the Commission continues to manage its costs carefully, as evidenced by the decision we took in 2016 to once again limit increases in 2017 fees to a gross blended rate of 2% (other than in respect of anomalies). This is the fifth year in succession where general fee increases have been limited to 2% or less.

The ongoing development of our staff continues to be amongst our top operational priorities and our performance-based remuneration system ensures that staff who perform to the required high standards are rewarded. In addition to our normal recruiting activity, our successful Graduate Development Programme has entered its fourth year and several graduates have now left the programme and are operating at Senior Analyst and Analyst level.

Finally, our Balanced Scorecard approach, which in 2016 was in the fourth year of its application, continues to frame our strategic and operational aims and to be a focus for the clear articulation, delivery and measurement of all our activity.

Financial Information

I am pleased to report that the Commission returned an operating surplus for the fourth year in succession. This year our surplus of £632,030 was less than in 2015 because of a large increase in bad debt provisions with depreciation costs and salary costs rising modestly. The £326,000 increase in provisions arises largely because of doubts we have, taking into account the principle of prudence, as to whether all the outstanding monies owed to us by firms and individuals following enforcement action will be paid. We will use legal remedies to ensure that fines are paid where we believe the individual or firm in question has the funds but there are a number of cases where we believe it is prudent to make provision. The c. £232,000 increase in staff costs comes about in part because we had fewer unfilled vacancies through 2016 than was the case in 2015 and in part because of the 1.5% average pay rise which some staff received in January 2016. The £133,000 increase in depreciation costs is due to the capital expenditure on new regulatory technology (PRISM, Online Services) which we undertook between 2013 and 2016.

Our main fee income was, in real terms, broadly stable moving from £12,773,000 in 2015 to £12,935,000 in 2016. Better investment returns led to our interest income increasing marginally despite the interest rate environment whilst our investment portfolio which made a very small loss in 2015, recorded an unrealised gain of just over £200,000 in 2016. The major volatility in income in 2016, relative to 2015, arose because of a £278,000 increase in fines levied, but levying a fine is quite different from collecting it (please see above) and thus it would be inaccurate to regard this

as genuine income given the level of provisions we have to take against it on the basis of prudent accounting.

In summary, from an operational perspective, we have had a strong year with both investment in regulatory technology and strong cost controls delivering a solid operating surplus.

Unfortunately, the FRS 102 calculations on the Commission's share of the States of Guernsey's final salary pension scheme, shows a shortfall of £14.9 million which means that the Commission's reserves position is now a negative £2.3 million compared to a positive £2.8 million in 2015.

Whilst the Commission takes both the FRS 102 standards and our responsibility to monitor the scheme seriously, it is worth noting the questionable assumptions of the FRS 102 standards are now under considerable scrutiny as can be seen in the progress of the Pension Schemes Bill (currently at the Report stage in the House of Commons) and as specifically highlighted by Lord Flight during the Bill's 2nd Reading debate in the House of Lords in November 2016.

This year, for example, our actual returns on invested pension assets were 14% compared with the 2.75% assumption we are obliged to use for FRS 102 calculations based on the current low yields on double AA-rated corporate bonds. Whilst 2016 may have been an unusually good year for investment returns, it does not seem quite balanced for the discount rate on our pension liabilities to be negative 0.65%, as implied by the FRS 102 calculations.

Human Resources

The Commission is proud of its skilled, professional and motivated staff. We have a balanced age and experience profile with no particular vulnerabilities apparent. Key person risk is mitigated wherever possible, noting that our organisation remains small, given the broad scope of its responsibilities, with a Full-Time Equivalent establishment in 2016 of 113.4.

Staff turnover for 2016 was the lowest since 2013 at 16.5% (2015: 18% and 2014: 21%). Whilst this fall is pleasing, the loss of good and experienced staff to industry continues to be higher than management would prefer (although a testament to the skills and professionalism of the Commission's staff who prove attractive to industry's risk and compliance departments).

For example, in addition to our core regulatory and operational training programmes, 32 members of staff have studied towards a professional qualification in 2016 through bodies such as the Chartered Institute of Securities and Investments, the International Compliance Association, the Institute of Leadership

and Management, the Chartered Financial Analyst Institute and the Chartered Institute of Personnel and Development. Furthermore, our new Middle-Management Training Programme has been extended to over 22 members of staff, with 7 continuing to undertake an extended Institute of Leadership and Management professional qualification.

Salary costs, including pension costs, recruitment and training for the year were £8,700,000 (2015: £8,468,000) and a full analysis of these costs, together with an analysis of staff salary bands and movements in staff numbers (both full-time equivalent and headcount) are shown in tables 3, 4 and 5 on page 59.

Four graduates were recruited in 2016 onto our Graduate Development Programme and we plan further graduate recruitment in 2017. In addition to our Graduate Programme, the Commission welcomes applications from other skilled people, including those returning to the paid workforce having completed family or other career-based commitments.

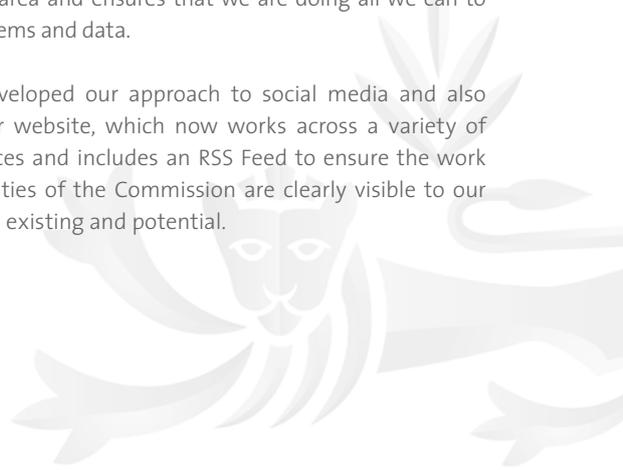
Communication and Information Systems

2016 was the first full-year in which the Commission delivered its full Online Services package. This meant that all the common regulatory applications, notifications and returns, as well as personal questionnaires, were submitted electronically to the Commission. The commitment to deliver, maintain and enhance this service in a secure and efficient manner has been a focus for the year and will continue to be so in the future. We continue to work with local and international suppliers, but also have taken steps to enhance our own in-house IT development team which allows us to be flexible and responsive to the needs of our users. This means that, externally, we can address ideas from our licensees (and potential licensees) to enhance our services whilst also working with our regulatory divisions to fine-tune reports and returns to make them progressively more succinct and productive.

Stephen Cole
Chief Operating Officer

Whilst we continue to engage with industry to develop and enhance our Online Services, internal management of our information and data has also been a significant focus as we continue to improve our data protection controls and policies. For example we undergo a rigorous yearly cyber audit which looks at all aspects of this developing risk area and ensures that we are doing all we can to protect our systems and data.

In 2016, we developed our approach to social media and also modernised our website, which now works across a variety of hand-held devices and includes an RSS Feed to ensure the work and responsibilities of the Commission are clearly visible to our licensees – both existing and potential.



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 2016 which comprise the Statement of Comprehensive Income, the Statement of Reserves, the Balance Sheet, the Statement of Cash Flows and the related notes 1 to 15. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards ("United Kingdom Generally Accepted Accounting Practice").

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 is undertaken so that we might state to the Commission, those matters we are required to state to it 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 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 2016 and of its result for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been properly prepared in accordance with the requirements of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

BDO Limited
Chartered Accountants
Place du Pré
Rue du Pré
St Peter Port
Guernsey

2 June 2017



FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

	Note	2016	2015
		£	£
Income			
Fees receivable		12,934,718	12,733,382
Financial penalties imposed	13	573,375	295,000
Interest receivable and similar income		116,240	83,967
Net change in investments measured at fair value through profit or loss	11	208,250	-
		13,832,583	13,112,349
Expenses			
Salaries, pension costs, staff recruitment and training		8,700,111	8,468,484
Other pension costs	7(b)	333,818	359,077
Commissioners' fees		235,433	203,417
Legal and professional fees		478,505	462,595
Premises and equipment, including depreciation and dilapidations		1,793,084	1,634,724
Other operating expenses		1,279,431	996,933
Bad debt provision expense	13	371,421	45,000
Net change in investments measured at fair value through profit or loss	11	-	17,277
Auditor's remuneration		8,750	8,750
		13,200,553	12,196,257
Surplus for the financial year		632,030	916,092
Other comprehensive income			
Re-measurement of net defined benefit liability	7(c)	(5,794,164)	1,552,680
Total comprehensive (loss)/income for the year		(5,162,134)	2,468,772

The notes on pages 36 to 47 form an integral part of these financial statements

STATEMENT OF RESERVES

For the year ended 31 December 2016

Note	2016	2015
	£	£
Opening reserves	2,867,261	398,489
Total comprehensive (loss)/income for the year	(5,162,134)	2,468,772
Balance at 31 December 2016	(2,294,873)	2,867,261

Reserves are stated after deducting the accumulated pension liability of £14,916,656 (2015: £8,784,674) which equates to the post-employment benefit liability under FRS 102 (see note 7).

The notes on pages 36 to 47 form an integral part of these financial statements



BALANCE SHEET

As at 31 December 2016

	Note	2016	2015
		£	£
Fixed assets			
Tangible assets	4	3,303,982	3,733,271
Current assets			
Debtors and prepayments	5	679,690	674,889
Short-term deposits	10	6,110,473	4,500,000
Investments	11	3,190,973	2,982,723
Cash at bank and in hand	10	659,059	1,010,212
		10,640,195	9,167,824
Current liabilities			
Creditors – amounts falling due within one year	6	(1,124,298)	(1,077,084)
Net current assets		9,515,897	8,090,740
Non-current liabilities			
Provisions for liabilities	14	(198,096)	(172,076)
Net assets before post-employment benefit liability		12,621,783	11,651,935
Post-employment benefit liability	7(a)	(14,916,656)	(8,784,674)
Net (liabilities)/assets		(2,294,873)	2,867,261
Total reserves		(2,294,873)	2,867,261

The Financial Statements on pages 32 to 47 have been approved by the Commissioners and signed on their behalf on 2 June 2017 by:-

C Schrauwers
Chairman

R Moore
Vice-Chairman

W Mason
Director General

The notes on pages 36 to 47 form an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

	Note	2016	2015
		£	£
Cash flows from operating activities			
Surplus for the financial year		632,030	916,092
Adjustments for:			
Defined benefit pension scheme:			
Pension scheme administration costs	7(e)	4,000	3,926
Other pension costs	7(b)	333,818	359,077
Depreciation of tangible fixed assets	4	781,034	647,053
Loss on disposal of tangible fixed assets	4	2,678	1,080
Interest receivable		(116,240)	(83,967)
Unrealised (gain)/loss on investment portfolio	11	(208,250)	17,277
(Increase)/decrease in debtors and prepayments		(4,801)	1,083
Increase/(decrease) in creditors		47,214	(1,003,339)
Increase in provisions for liabilities		26,020	34,324
Net cash generated from operating activities		1,497,503	892,606
Cash flows from investing activities			
Purchases of tangible fixed assets	4	(354,423)	(1,054,388)
Interest received		116,240	83,967
Purchase of current asset investments		-	(3,000,000)
(Purchase)/sale of short-term deposits	10	(1,610,473)	2,640,274
Net cash from investing activities		(1,848,656)	(1,330,147)
Net decrease in cash at bank and in hand	10	(351,153)	(437,541)
Cash at bank and in hand at the beginning of the year		1,010,212	1,447,753
Cash at bank and in hand at end of the year		659,059	1,010,212

The notes on pages 36 to 47 form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2016

The Guernsey Financial Services Commission (“the Commission”) is a Public Benefit Entity whose primary objective is to regulate the finance industry in the Bailiwick of Guernsey. The reserves support the primary objectives of the Commission.

I. Accounting policies

The financial statements of the Commission have been prepared in accordance with FRS 102, the financial reporting standard applicable in the United Kingdom and the Republic of Ireland.

i. Presentation and functional currency

The financial statements are presented in pounds sterling. The Commission’s functional currency is also pounds sterling.

ii. Legal status

The Commission is a body corporate established under the Financial Services Commission (Bailiwick of Guernsey) Law, 1987. The Commission’s operations are conducted from offices at Glatigny Court in Guernsey. The Commission has placed a member of staff in the Guernsey Finance office in Hong Kong.

iii. Preparation

The preparation of financial statements in compliance with FRS 102 requires the use of certain critical accounting estimates. These financial statements have been prepared on a going concern basis. 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.

iv. Going concern

The Commission continues to meet its day-to-day working capital requirements through its bank balances and short-term deposits. The net liabilities effectively result from the increased defined benefit pension scheme deficit, calculated according to FRS 102 accounting standards. The States has confirmed that in the final resort the claims of the Commission’s pensioners and employees would be met from the States Superannuation Fund and any shortfall in that Fund would then be met by the States from General Revenue. The Commissioners are therefore content that the Commission has adequate resources to operate effectively in the foreseeable future and continues to adopt the going concern basis in preparing its financial statements.

The following significant accounting policies have been consistently applied:

(a) Fees receivable

Fees are a combination of annual licence fees, application fees and late filing fees. Fees payable by licensees and registrants are enshrined in law and set out on the Commission’s website, split by sector. Fees receivable are accounted for on an accruals basis. Income received prior to the 1 January invoice date for annual fees are treated as fees received in advance, as part of creditors. A breakdown is shown in note 6.

(b) 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. Financial penalties are recognised as income receivable when the decision is made and the public statement is placed on the Commission’s website. When the circumstances of a debtor give rise to concerns over settlement, and/or payment is not made within 7 days of the financial penalty being imposed, consideration is given to raising a provision.

(c) Interest receivable

Bank interest is accounted for on an accruals basis. Interest income received from fixed and notice deposits and certificates of deposit are also accounted for on an accruals basis.

(d) Investigation and litigation

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

(e) Tangible fixed assets and depreciation

Tangible fixed assets are stated at historical cost less accumulated depreciation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to bringing the asset to the location and condition for it to be capable of operating in the manner intended by management. Depreciation on tangible fixed assets is calculated, using the straight-line method to allocate the cost of assets, less their residual value, over 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	25% straight-line
Furniture and fittings	over the shorter of 10 years and the estimated useful economic life of the assets
Computer equipment:	
Hardware	33 1/3 % straight-line
Software	over the shorter of 10 years and the estimated useful economic life of the assets

(f) Financial instruments (financial assets and financial liabilities)

i. Recognition

All financial assets and financial liabilities are recognised when the Commission becomes party to the contractual provisions of the instrument. The financial assets and financial liabilities comprise the following basic financial instruments: cash at bank; short-term deposits, including fixed maturity deposits and accounts where notice of withdrawal is required; certificates of deposit; current asset investments in a portfolio of equities, bonds and funds; other debtors and expense creditors.

ii. Initial measurement and subsequent measurement

All financial assets and liabilities are initially measured at transaction price. Financial assets subsequently measured at fair value through profit or loss comprise the current asset investments in a portfolio of equities, bonds and funds. Financial assets subsequently measured at amortised cost comprise cash at bank, certificates of deposit, short-term deposits and other debtors. Financial liabilities measured at amortised cost comprise expense creditors.

iii. De-recognition

Financial assets are de-recognised when the contractual rights to the cash flows from the financial asset are settled. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

(g) Cash at bank and in hand

Cash at bank and in hand includes cash and deposits held at call with banks, with a maturity date of less than three months.

(h) Short-term deposits

Fixed and notice deposits, with original maturities of between three and twelve months, are included as current assets. Other short-term deposits, represented by a portfolio of certificates of deposit are managed by an investment manager.

(i) Investments

A portfolio comprising equities, bonds and funds, held in listed companies, which are traded on a regular basis, is managed by an investment manager. Investments are accounted for at fair value and gains or losses on fair value are included in the Statement of Comprehensive Income.

(j) Leases

Rental payments made in relation to office accommodation are treated as operating leases and are charged to the Statement of Comprehensive Income on a straight-line basis over the lease term. Provisions are maintained for dilapidations, including redecoration, to cover future liabilities under the terms of the lease.

(k) Employee benefits

i. Short term benefits

A liability is recognised to the extent of any unused holiday pay entitlement which has accrued at the balance sheet date and carried forward to future periods. This is measured at the undiscounted salary cost of the future holiday entitlement and accrued at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS (continued)

ii. Defined benefit scheme

Employees of the Commission who joined before 1 January 2008 were 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.

This defined benefit scheme closed to future service accrual on 30 June 2014.

The liability recognised in the balance sheet in respect of the defined benefit scheme is the present value of the defined benefit obligation at the end of the reporting period less the fair value of the scheme assets at the reporting date. The defined benefit obligation is calculated using the projected unit credit method. Annually the Commission engages independent actuaries to calculate the obligation. The present value is determined by discounting the estimated future payments using market yields on high-quality corporate bonds that are denominated in sterling and that have terms approximating the estimated period of the future payments (‘discount rate’).

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of scheme assets. This cost is recognised in the Statement of Comprehensive Income as ‘Other pension costs’.

Actuarial gains and losses arising from experience adjustments and changes to actuarial assumptions are charged or credited to other comprehensive income, within the Statement of Comprehensive Income. These amounts together with the return on plan assets, less amounts included in net interest, are disclosed as ‘Re-measurement of net defined benefit liability’.

Following closure of this defined benefit scheme to future service accrual, employees had the option to transfer out their pension or become deferred members of the scheme.

iii. Defined contribution schemes

Employees who joined the Commission after 31 December 2007 up until 30 June 2014 were generally eligible to be members of the Island Trust Plan (the DC Plan). With effect from 1 July 2014, members of the DC Plan, deferred members of the defined benefit scheme and new employees were offered a choice of pension offerings. The options consist of the Island Trust DC Plan, a multi-member Group RATs scheme or a personal approved pension plan. Contributions by employees are no longer a mandatory requirement.

The contributions are recognised as an expense when they are due.

2. Judgements in applying significant accounting policies and key sources of estimation uncertainty

i. Tangible fixed assets (see note 4)

Tangible fixed assets are depreciated over their useful lives taking into account residual values, where appropriate. The actual lives of the assets and residual values are assessed annually and may vary depending on a number of factors. In re-assessing asset lives and residual value, factors such as technical innovation, product life cycles and the remaining life of the asset are taken into account.

ii. Defined benefit pension scheme

Note 7 outlines in significant detail the nature of the pension and sets out the actuarial assumptions used to support the fair value of scheme assets and the present value of funded obligations.

iii. Lease classification (see note 8)

The Commission established a lease with the landlord of its Gategny Court office accommodation in September 2010. This is classed as a non-cancellable operating lease.

iv. Investments (see note 11)

The most critical estimates, assumptions and judgements relate to the determination of the carrying value of investments measured at fair value through profit or loss. In determining this amount, the Commission has applied the concept that fair value is the amount for which an asset can be exchanged between knowledgeable willing parties in an arm's length transaction. Investments, comprising equities, bonds and funds, are valued at the reporting date at the quoted bid price.

v. Bad debt provision (see note 13)

The recoverability of debts is assessed and where appropriate a provision is raised. Such debtors comprise entities or individuals who, given their circumstances, are unlikely to be able to settle the debt, in part or in full. Primarily, but not exclusively, the debt arises as a result of the imposition of a financial penalty under Section 11D (1) of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

The debts, for which a provision has been raised, are reviewed regularly to ensure that all avenues are explored to obtain recovery.

vi. Dilapidations (see note 14)

Provisions are maintained for dilapidations, including redecoration, to cover future liabilities under the terms of the Glatigny Court lease. A professional review of the future dilapidations liability provided an initial estimate of the level of provision to be applied on an annual incremental basis. The original amount is increased annually at the Guernsey rate of inflation.

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 2016	1,280,372	427,239	709,842	3,933,495	6,350,948
Additions	80,566	6,995	73,882	192,980	354,423
Disposals	-	(9,180)	(32,754)	-	(41,934)
At 31 December 2016	1,360,938	425,054	750,970	4,126,475	6,663,437
Depreciation					
At 1 January 2016	294,014	317,758	563,267	1,442,638	2,617,677
Charge for the year	56,924	29,499	110,905	583,706	781,034
On disposals	-	(6,502)	(32,754)	-	(39,256)
At 31 December 2016	350,938	340,755	641,418	2,026,344	3,359,455
Net book value at 31 December 2015	986,358	109,481	146,575	2,490,857	3,733,271
Net book value at 31 December 2016	1,010,000	84,299	109,552	2,100,131	3,303,982

NOTES TO THE FINANCIAL STATEMENTS (continued)

5. Debtors and prepayments

	2016	2015
	£	£
Prepayments	564,132	627,851
Provision for bad debts (see note 13)	(253,909)	(245,000)
Other debtors	369,467	292,038
	679,690	674,889

Included in the total are prepayments of £116,774 (2015: £118,653) which relate to periods longer than 12 months.

6. Creditors - amounts falling due within one year

	2016	2015
	£	£
Expense creditors and accruals	674,793	559,023
Fees received in advance	449,505	518,061
	1,124,298	1,077,084

7. Post-employment benefits

(i) FRS 102 (Section 28) Disclosure for the Guernsey Financial Services Commission ("GFSC") Actuarial Account of the States of Guernsey Superannuation Fund

Nature of the GFSC Actuarial Account

The GFSC Actuarial Account operated by the Commission is a funded defined benefit arrangement which provides retirement benefits based on final pensionable pay. The GFSC Actuarial Account ("the scheme") forms part of the States of Guernsey Superannuation Fund. The scheme closed to future accrual of benefits with effect from 30 June 2014. All remaining active members were treated as having left pensionable service with effect from that date. The employer contributions were determined on the basis of independent actuarial advice and were 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.

7. Post-employment benefits (continued)

The most recent formal actuarial valuation of the scheme was carried out at 31 December 2013 by the scheme's actuary, which resulted in a funding surplus of £315,000. The States of Guernsey ("the States") confirmed the advice of the actuary that given the funding surplus in the Commission's Actuarial Account additional contributions would not be required pending the result of the next triennial valuation in 2016, expected in the late Summer of 2017. It was recommended that the surplus was partly utilised to pay the expenses of administration in the Actuarial Account over the period until the next actuarial valuation.

The calculations for the FRS 102 disclosures have been carried out by running full actuarial calculations as at 31 December 2016.

Funding policy

Following the cessation of accrual of benefits with effect from 30 June 2014, regular contributions to the scheme are no longer required. However, additional contributions would be made by the Commission to cover any shortfalls that arise following each valuation. The funding method employed to calculate the value of previously accrued benefits is the projected unit credit method. The States determine the level of contributions payable following advice from the Fund's actuary.

Actuarial account amendments

The scheme closed to future accrual of benefits with effect from 30 June 2014. This gave rise to a curtailment gain on 30 June 2014. This comprises a gain from the loss of linkage of benefits to final salary, with partially offsetting losses due to the reduction in the assumed retirement age when members become deferred pensioners.

Employee benefit obligations

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

	2016	2015
	£	£
Fair value of scheme assets	20,328,639	18,275,005
Present value of funded obligations	(35,245,295)	(27,059,679)
Net under-funding in scheme	(14,916,656)	(8,784,674)

The asset and liability values on the FRS 102 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.

b) The amounts recognised in the Statement of Comprehensive Income are as follows:

	2016	2015
	£	£
Net interest on net defined liability	333,818	359,077
Net expense recognised in the Statement of Comprehensive Income	333,818	359,077

NOTES TO THE FINANCIAL STATEMENTS (continued)

7. Post-employment benefits (continued)

c) The amounts recognised as re-measurements in other comprehensive income are as follows:

	2016	2015
	£	£
Return on assets (not included in interest)	1,889,321	(159,778)
Actuarial (losses)/gains on obligation	(7,683,485)	1,712,458
Total re-measurements recognised	(5,794,164)	1,552,680
Cumulative amount of re-measurements recognised in other comprehensive income	(4,856,166)	937,998
Actual return on scheme assets	2,573,961	487,881

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

	2016	2015
	£	£
Opening defined benefit obligation	(27,059,679)	(28,164,351)
Interest on obligation	(1,018,458)	(1,006,736)
Experience gains	629,591	450,784
(Losses)/Gain from changes in assumptions	(8,313,076)	1,261,674
Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values	516,327	398,950
Closing defined benefit obligation	(35,245,295)	(27,059,679)

The weighted average duration of the liabilities of the scheme was 22 years as at 31 December 2016.

7. Post-employment benefits (continued)

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

	2016	2015
	£	£
Opening fair value of scheme assets	18,275,005	18,190,000
Interest on scheme assets	684,640	647,659
Return on assets (not included in interest)	1,889,321	(159,778)
Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values	(516,327)	(398,950)
Administration expenses	(4,000)	(3,926)
Closing fair value of scheme assets	20,328,639	18,275,005

Following the closure of the scheme to future service accrual, no contributions, by either the Commission or members of the scheme, were made in the year ended 31 December 2016.

f) The major categories of fund assets as a percentage of the total Fund assets are as follows:

	2016	2015
	%	%
Equities	75	76
Gilts	-	2
Corporate bonds	14	10
Property	7	7
Other assets	4	5

All of the Fund's assets have a quoted market price in an active market. The Fund holds no financial instruments issued by the Commission, nor does it hold any property or other assets used by the Commission. This allocation is at the discretion of the States.

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 reporting year end.

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 that Fund would then be met by the States from General Revenue.

NOTES TO THE FINANCIAL STATEMENTS (continued)

7. Post-employment benefits (continued)

g) Principal actuarial assumptions used for the FRS 102 disclosures are as follows

	31 December 2016	31 December 2015
	%	%
Discount rate at end of the year	2.75	3.8
Discount rate at start of the year	3.8	3.6
Inflation	3.4	3.2
Rate of increase in deferred pensions	3.4	3.2
Rate of increase in pensions in payment	3.4	3.2

h) 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 87 if they are male and until 88 if female. For members currently aged 50, the assumptions are that if they attain age 60 they will live on average until age 88 if they are male and until 89 if female.

ii) Disclosure for defined contribution scheme

The amount recognised in the profit and loss account as an expense in relation to the Commission's defined contribution scheme, for the year ended 31 December 2016, was £114,509 (2015: £160,564). No contributions were outstanding as at 31 December 2016 or 2015. Employer contributions are calculated at 12% of pensionable salary and mandatory employee contributions were at a rate of 5% of pensionable salary up until 30 June 2014. Subsequent to this date, employee contributions are entirely voluntary.

iii) Disclosure for the Multi-member RATs scheme ("GFSC Group Pension Scheme")

The net expense of employer contributions to the GFSC Group Pension Scheme for the year ended 31 December 2016 was £332,818 (2015: £291,770). No contributions were outstanding as at 31 December 2016 or 2015 and no contributions were prepaid as at 31 December 2016 or 2015. Employer contributions are calculated at 12% of pensionable salary and employee contributions are entirely voluntary.

8. Operating lease commitments

The Commission had minimum lease payments under non-cancellable operating leases as set out below:

	£
Lease payments up to 1 year after balance sheet date	655,188
Lease payments between 1 and 5 years after balance sheet date	2,620,750
Lease payments more than 5 years after balance sheet date	8,325,369
Total future minimum lease payments	11,601,307

The Commission leased office accommodation at Gategny Court during the year. The lease for Gategny Court is non-cancellable and expires on 16 September 2034.

9. Controlling party

In the opinion of the Commissioners there is no controlling party of the Commission, as defined by FRS 102 (Section 33.5), 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.

10. Cash at bank and in hand and short-term deposits

	At 1 January 2016	Cash flow	At 31 December 2016
	£	£	£
Deposits with States Treasury	23,261	(23,261)	-
Cash at bank and in hand	986,951	(327,892)	659,059
Total cash at bank and in hand	1,010,212	(351,153)	659,059
Certificates of deposit	-	1,259,418	1,259,418
Fixed deposits and notice accounts	4,500,000	351,055	4,851,055
Total short-term deposits	4,500,000	1,610,473	6,110,473

Certificates of Deposit are managed as liquid investments and have maturity dates typically between three months and one year after the balance sheet date. The fixed deposits have original maturity dates ranging between three months and one year, whilst other deposits require notice of withdrawal of a maximum of three months.

II. Current asset investments

	2016	2015
	£	£
Opening fair value	2,982,723	-
Purchases	-	3,000,000
Net movement in fair value through profit or loss	208,250	(17,277)
Market value	3,190,973	2,982,723

All current asset investments are shares held in listed companies which are traded on a regular basis. The total unrealised gain recognised on these investments in the year was £208,250. The portfolio was first established in February 2015.

NOTES TO THE FINANCIAL STATEMENTS (continued)

12. Financial instruments

The Commission's financial instruments may be analysed as follows:

	2016	2015
	£	£
Financial assets		
Financial assets measured at fair value through profit or loss	3,190,973	2,982,723
Financial assets measured at amortised cost	7,428,216	6,185,101
Financial liabilities		
Financial liabilities measured at amortised cost	1,322,394	1,249,790

Financial assets measured at fair value through profit or loss comprise a portfolio of equities, bonds and funds, which are valued at the reporting date at the quoted bid price.

Financial assets measured at amortised cost comprise cash at bank and in hand, certificates of deposit, short-term deposits, and other debtors.

Financial liabilities measured at amortised cost comprise expense creditors.

13. Financial penalties and provisions for bad debts

During the year the Commission imposed financial penalties under section 11D (1) of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended, amounting to £573,375 (2015: £295,000). The amounts written off and provided for by the Commission during the year amounted to £371,421 (2015: £45,000). The total of provisions relating to financial penalties as at 31 December 2016 were £195,417 (2015: £45,000). Provisions relating to other fees outstanding at 31 December 2016 total £58,492 (2015: nil). 2016 debts totalling £117,512 (2015: nil) written off during the year are also reflected under bad debt expense.

14. Provision for liabilities

A provision is maintained for dilapidations, including redecoration, to cover future liabilities under the terms of the Glatigny Court operating lease. Over the course of the 24 year lease the dilapidation provision is planned to increase to £700,000, subject to annual inflationary increases. Provision for redecoration of the office is also included which needs to be undertaken on a 5 yearly cycle.

	2016	2015
	£	£
Provision brought forward from previous year	172,076	137,752
Dilapidations charged to Statement of Comprehensive Income	26,020	34,324
Total provision at year end	198,096	172,076

15. Related party

Key management personnel compensation

Key management comprises the Commissioners and members of the Executive Committee. The compensation paid to key management for employee services in 2016, including pension and social insurance, amounted to £1,920,944 (2015: £1,823,023).

Related-party transactions

The States appointed Wendy Dorey as a Commissioner on 1 November 2015. During the year, the Commission engaged her husband to provide professional services in respect of a thematic review. These were contracted on an arm's length basis and are not considered to be significant in the context of the business of the parties.



COMMISSIONERS

Drs. Cees Schrauwers **Chairman of the Commission**

Drs. Schrauwers is a Dutch citizen with more than thirty five years' experience in financial services. 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 its insurance consultancy practice. He has served as Chairman of Drive Assist Holdings Limited, Senior Independent Director of Brit Insurance Holdings Plc. and Brit Syndicates Limited, Non-Executive Director of Canopus Holdings UK Limited and Canopus Managing Agents Limited, Director of Munich Re (UK) Plc and as Senior Independent Director of Record Plc for nine years. He is currently Chairman and Commissioner of the Guernsey Financial Services Commission. Cees was appointed as a Commissioner in 2008 and Chairman in 2012 and is also Chairman of EC3/Legal LLP. He was educated at the Vrije Universiteit Amsterdam and the Nautical College Den Helder. He lives with his wife near London.

Alex Rodger MCIBS **Vice-Chairman of the Commission**

Alex Rodger was appointed as a Commissioner in February 2008. He spent over forty 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.

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 Chief Secretary to the Treasury and a member of the Shadow Cabinet. 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 forty 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.

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 fifteen years has been a consultant advising a wide range of clients in financial services on regulatory, risk and governance issues. He was previously Chairman of Faber Global Ltd, a wholesale insurance broker. He is currently Non-Executive Chairman 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 thirty years in the financial services industry in Guernsey and internationally. From 1979 to 1997, he held positions in international banking and international private banking with the Lloyds Bank/Lloyds TSB Group in South America, the United States, the United Kingdom 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 twenty-nine years' experience as an advocate and is a consultant at Babbé having previously been a Partner. 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 and its successor, the Legislation Review Panel, since 2004, the share transfer duty working party and the Inheritance Law Review Committee. Advocate Howitt is currently the Deputy Bâtonnier of the Guernsey Bar.

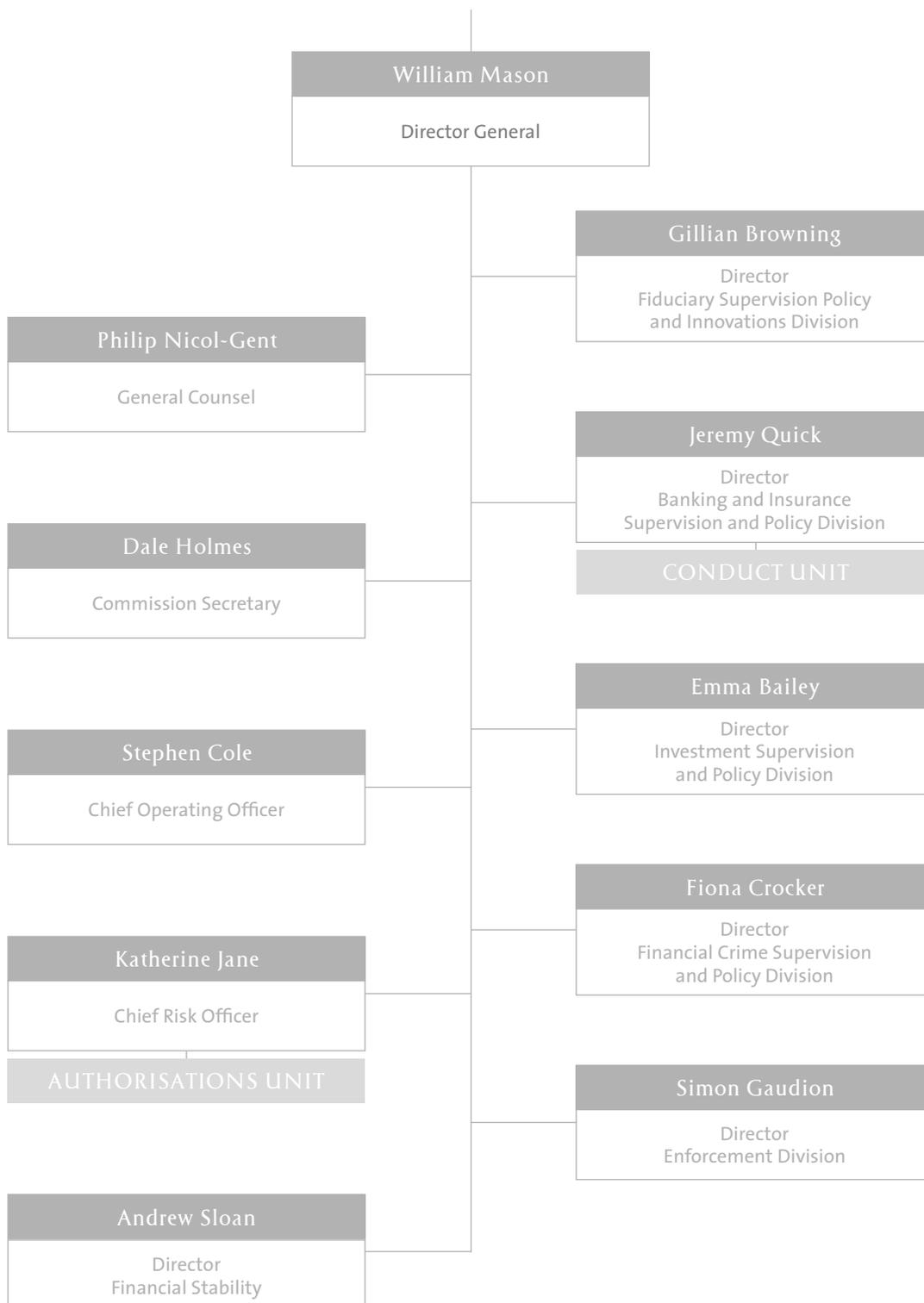
Wendy Dorey
Commissioner

Wendy Dorey was appointed as a Commissioner in November 2015. She has spent nearly twenty years in the financial services industry in the UK, France and Guernsey. Prior to moving to Guernsey in 2010 as Director of Dorey Financial Modelling, she occupied senior posts in financial marketing, distribution and business planning and strategy with Robert Fleming, Friends Ivory & Sime and M&G Asset Management in London. During that period she was also responsible for internal audit reporting, external risk reporting to the Financial Services Authority and embedding new "Treating Customers Fairly" processes. In 2005, she was responsible for the launch and ongoing promotion of the Guernsey-domiciled M&G Property Fund to the UK Market. She also previously assisted the Investment Management Association in developing a new investment management syllabus for Independent Financial Advisors.



SENIOR OFFICERS OF THE COMMISSION

COMMISSIONERS



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Investment Supervision and Policy

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

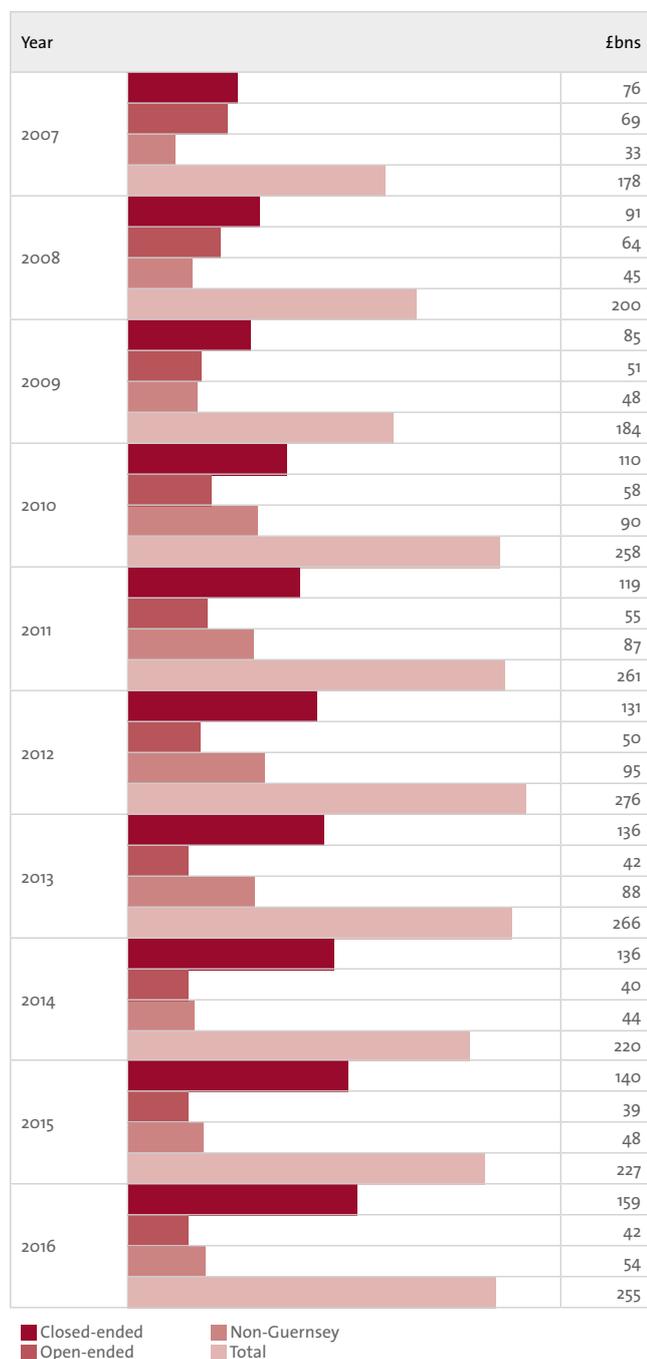


Figure 2. Total number of investment funds at the year end

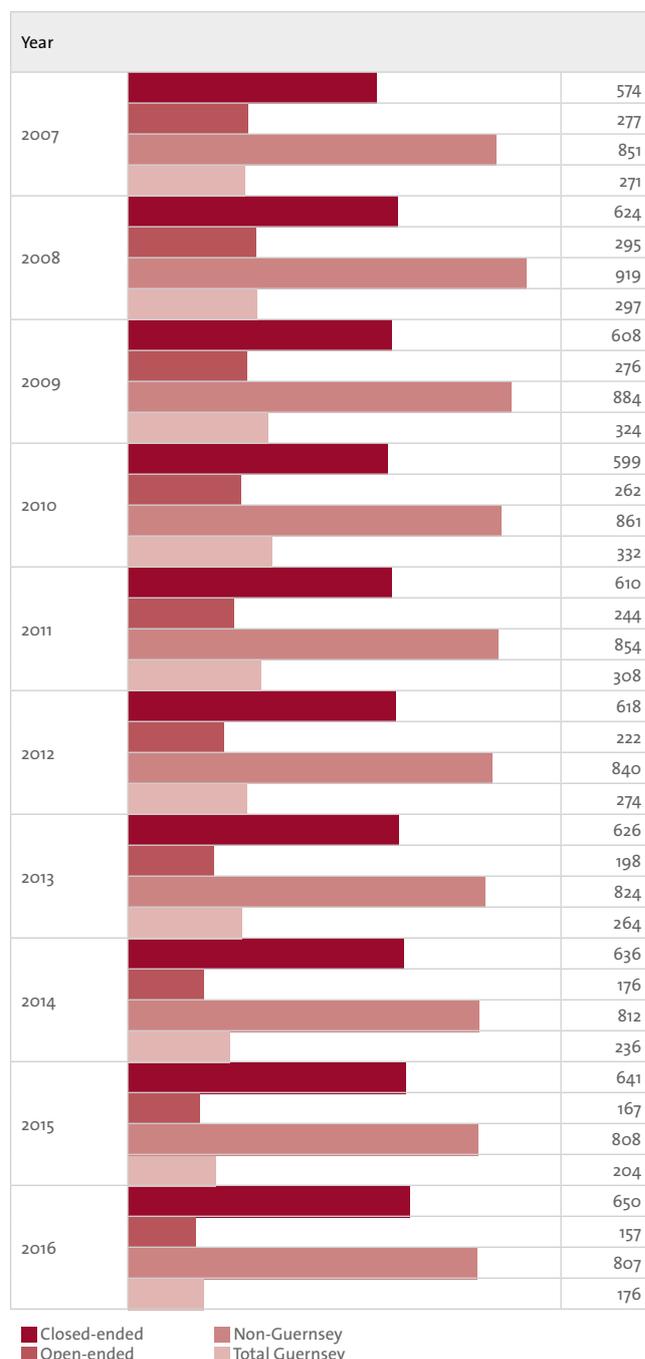
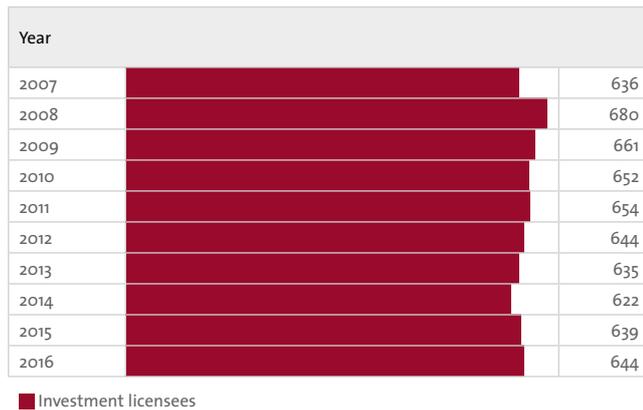


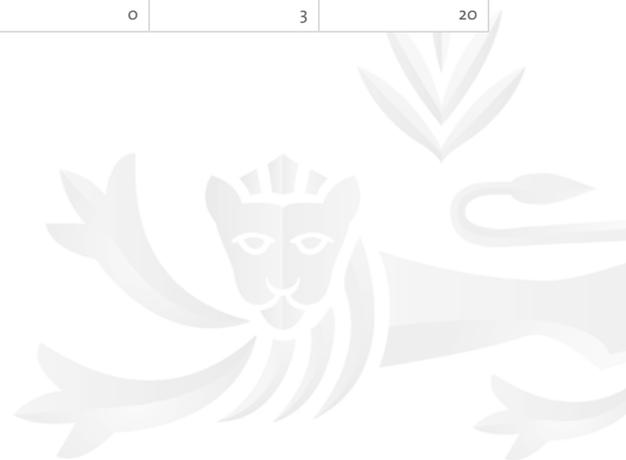
Figure 3. Total number of licensees at the year end



Under the Protection of Investors (Bailiwick of Guernsey) Law, 1987, investment funds (Figure 2.) are either Registered or Authorised; whereas the firms (Figure 3.) undertaking Controlled Investment Business are Licensed under the same law. There is no meaningful correlation to be drawn between the number of investment funds and the number of licensees in existence.

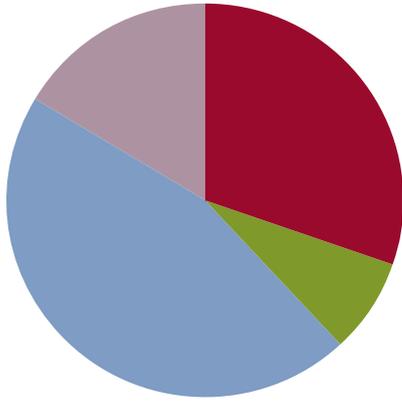
Table 1. Movements within period

Type	Total as at 31 December 2015	Approved in year	Lost in year	Total as at 31 December 2016
Total of open-ended schemes	167	4	14	157
of which Authorised	154	3	12	145
of which Registered	13	1	2	12
of which Qualifying Investor Funds (QIFs)	25	3	2	26
Total of closed-ended schemes	641	61	52	650
of which Authorised	406	20	34	392
of which Registered	235	41	18	258
of which QIF's	155	13	6	162
Total of licensees	639	47	42	644
Total of non-Guernsey schemes	204	11	39	176
of which QIF's	23	0	3	20



Fiduciary Supervision Policy and Innovations

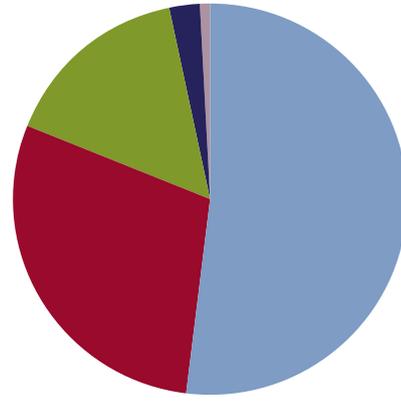
Figure 4. Ownership of lead licensees at 30 June 2016*



	2016	2015
International financial group	47	43
Lawyers and accountants	12	23
Privately owned – local	70	69
Privately owned – overseas	25	21

*Based on 154 persons holding a full fiduciary licence as at 30 June 2016.

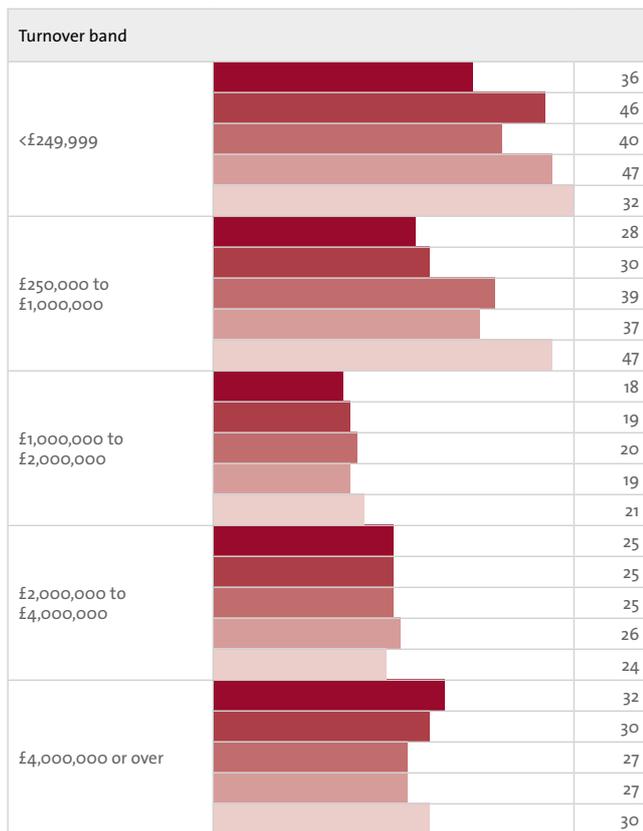
Figure 5. Staffing levels of licensees based on total number of staff carrying out regulated fiduciary activities*



	2016	2015
Up to 10 staff	80	81
11-25 staff	45	50
26-50 staff	24	21
51-75 staff	4	3
76-100 staff	1	1

*Based on 154 persons holding a full fiduciary licence as at 30 June 2016.

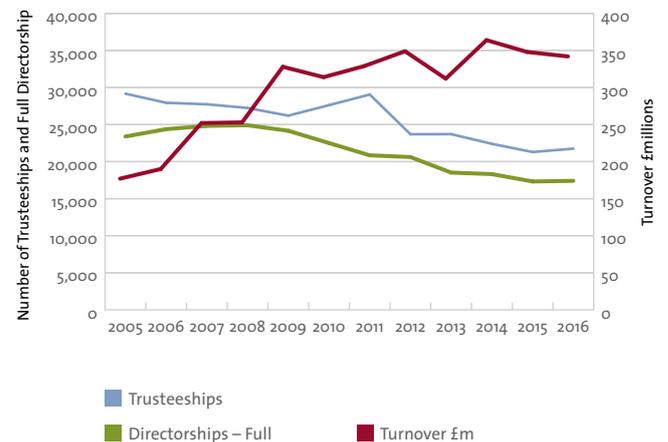
Figure 6. Number of licensees in each turnover band based on fiduciary turnover for accounting periods falling in the year ended 30 June 2016*



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

■ 2012
 ■ 2013
 ■ 2014
 ■ 2015
 ■ 2016

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.



Insurance Supervision and Policy

Figure 8. International insurers as at 31 December 2016

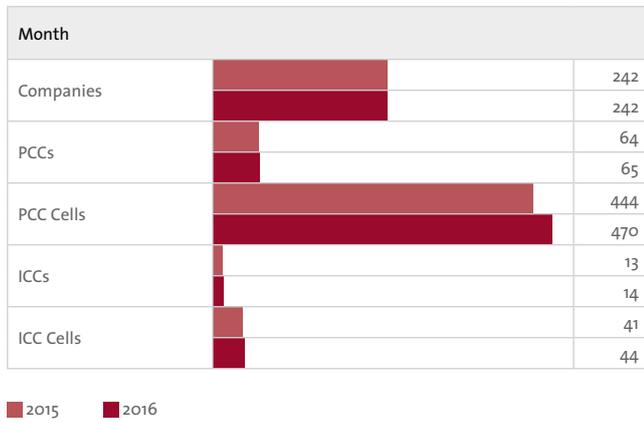


Figure 9. International insurers – net worth

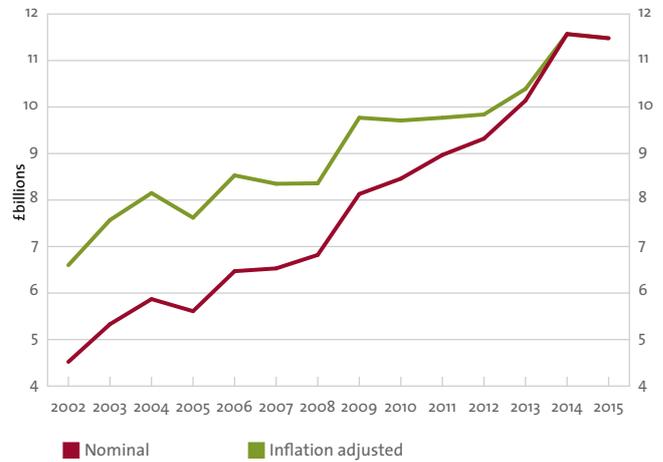


Figure 10. International insurers – gross assets

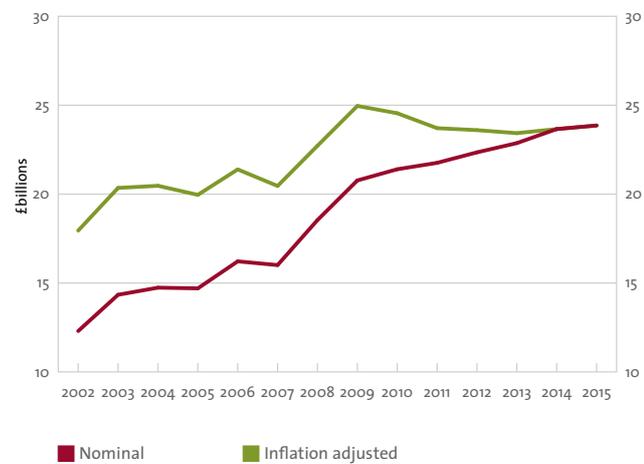
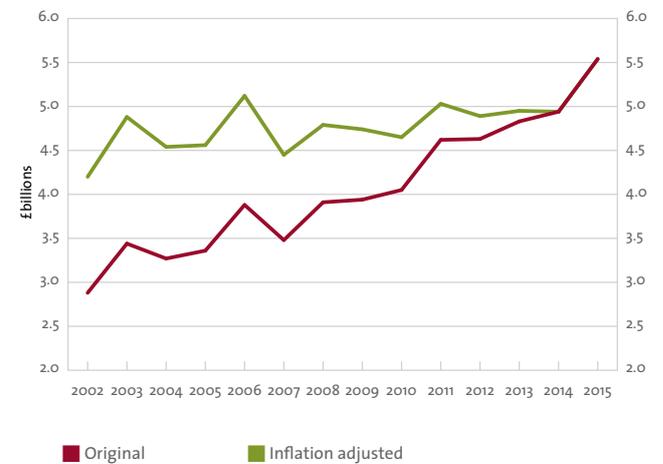


Figure 11. International insurers – gross premium



Banking Supervision and Policy

Figure 12. Guernsey bank assets

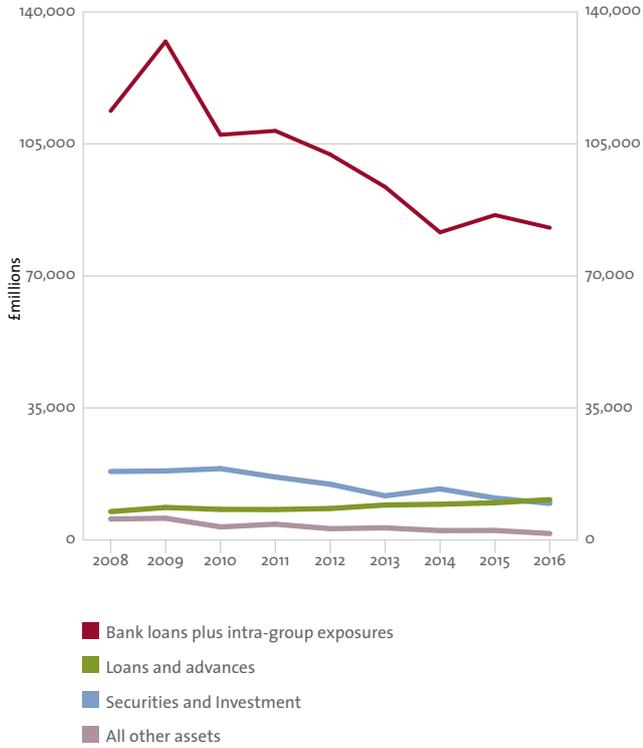
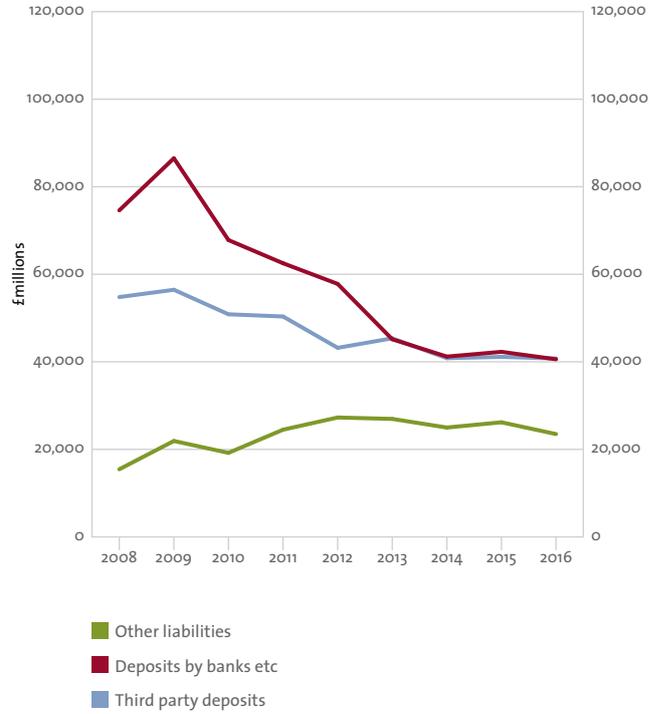


Figure 13. Guernsey bank liabilities



Authorisations Unit

Figure 14. Total application and one-off fees by volume and type - 2015 to 2016 comparison

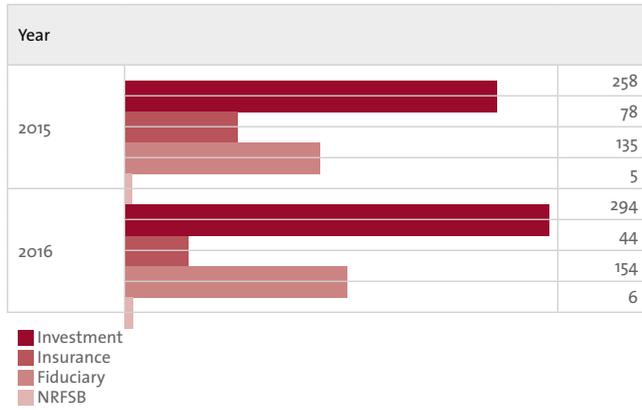


Figure 15. Online submissions 1 November 2015 to 31 December 2016

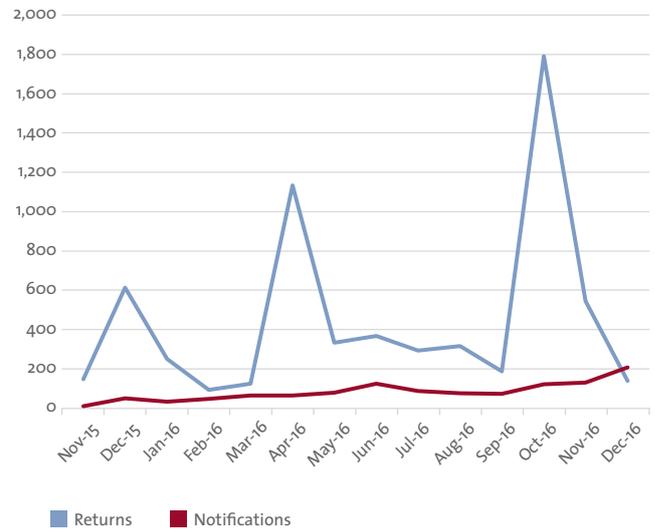
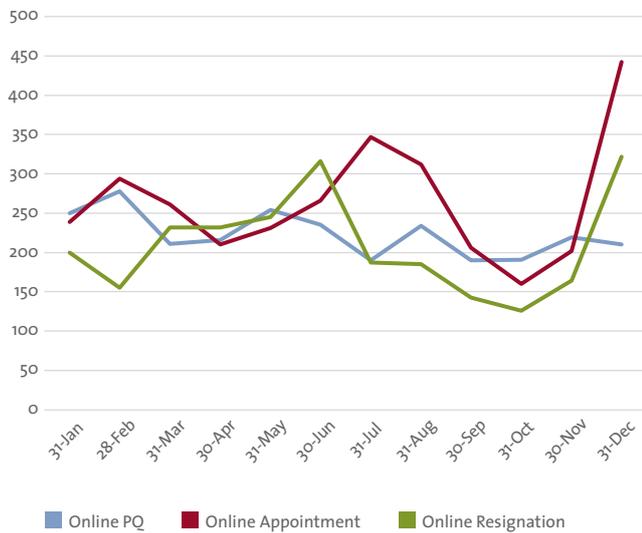


Figure 16. Online Personal Questionnaire portal submissions 1 January to 31 December 2016



Finance and Operations

Table 2. Expenditure by functional area

	2016	2015
	£'000	£'000
Enforcement	1,481	1,208
Authorisations	814	821
Risk and Transformation	419	764
Supervisory and Policy divisions	5,644	4,838
Internal operational support functions	1,361	1,201
Overheads incl. Premises, IT expenses and depreciation	3,149	3,005
Other pension adjustments	333	359
Total	13,201	12,196

Table 3. Salaries and related costs

	2016	2015
	£'000	£'000
Salaries	6,845	6,653
Pension costs	723	689
Social insurance, permanent health and medical insurance	780	735
Recruitment and training	352	391
Total	8,700	8,468

Table 4. Number of staff by salary band

Annual salary	2016	2015
£0 - £39,999 p.a.	42	37
£40,000 - £79,999 p.a.	46	53
£80,000 - £119,999 p.a.	16	12
£120,000 - £159,999 p.a.	7	6
£160,000 p.a. and above	1	1
Total number of staff	112	109
Full time equivalent	106.9	103.8
Comprising:		
Full-time staff	97	91
Part-time staff	15	18
	112	109
FTE vacancies at year end	5	7

Table 5. Movement in number of staff

	2016
Employed at start of year	109
Recruited into new positions	3
Positions removed	(2)
Existing vacancies filled	2
Employed at end of year	112



Finance and Operations

Table 6. Legal and professional fees

	2016	2015
	£'000	£'000
Legal fees - enforcement	156	140
Legal fees - judicial process	70	80
Legal fees - advisory	8	15
Professional fees	205	199
Internal audit	40	29
Total	479	463

Table 7. Commissioners' fees

		2016	2015
		£	£
Cees Schrauwers		65,431	57,000
Susie Farnon	Retired as Vice-Chairman 31 March 2015	-	6,250
Alex Rodger		25,667	25,000
Lord Flight		35,667	31,000
Richard Hobbs		31,667	30,000
Robert Moore		25,667	25,000
Simon Howitt		25,667	25,000
Wendy Dorey	Appointed 1 November 2015	25,667	4,167

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.

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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 Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended;
- the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended;
- the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999;
- 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;
- the Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) Law, 2008.

Relationship with the States

The Policy and Resources Committee is responsible for 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 and Resources Committee.

The Commission maintains regular dialogue with the States. During 2016, the Commission continued to engage with the Policy Council and, post the General Election and the introduction of a new Committee structure, with the Policy and Resources Committee, with meetings held in order to facilitate an open exchange of views on matters of importance to the States and the Commission. The Commission also engaged with the Committee for Economic Development (and its predecessor) in relation to

financial services legislation. In July, the Commission held an event for States Members where the Chairman and Director General were able to update them on the work of the Commission and the various challenges it currently faces and give a presentation on the Commission’s 2015 annual report. Outside of these formal meetings and presentations, the Commissioners and Director General maintain regular contact with senior States Members.

The Commissioners

The activities of the Commission’s executive are overseen by the Board of the Commission (Commissioners). The Commission Law provides that the Board shall consist of a minimum of five members elected by the States from persons nominated by the Policy and Resources Committee 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 from amongst the Commissioners and is elected by the States following nomination by the Policy and Resources Committee. The Vice-Chairman is appointed for a period of one year by the Commissioners. A Commissioner is appointed 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. Commissioners must currently retire on reaching the age of 75 years.

The Commissioners during 2016 were: Drs. Cees Schrauwers, The Lord Flight, Alex Rodger, Richard Hobbs, Bob Moore, Simon Howitt and Wendy Dorey. 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 13 meetings of the Board in 2016. The attendance was as follows: Drs. Cees Schrauwers 13, Alex Rodger 11, Howard Flight 11, Richard Hobbs 13, Bob Moore 10, Simon Howitt 13 and Wendy Dorey 13. 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. In addition, each year Commissioners undertake a board effectiveness review.

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 and Resources Committee;
- any statutory functions which:
 - (i) require the Commissioners to consider representations concerning a decision which they propose to take; or
 - (ii) empower the Commission to cancel, revoke, suspend or withdraw a licence, consent, registration, permission or authorisation (except where the cancellation, revocation, suspension or withdrawal is done with the consent of the person who is, or who is acting on behalf of, the holder of the licence, consent, registration, permission or authorisation); or
 - (iii) empower the Commission to petition for the winding-up of a body corporate.

Annual report and financial statements

The Commission must, as soon as possible in each year, make a report to the Policy and Resources Committee on its activities during the preceding year. The President of the Committee 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 and Resources Committee, 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 and Resources Committee with confirmation in the 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.

The Commission has robust policies and procedures in place to ensure that any conflicts of interest involving Commissioners or staff are managed effectively.

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

Audit Committee

In 2016, the Commission's Audit Committee comprised Alex Rodger, Simon Howitt and Wendy Dorey and was chaired by Richard

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

Hobbs. The Committee covered oversight of the management of risk, reviewed corporate governance and the systems of internal control and reported routinely to meetings of the Board as a whole. Meetings were usually attended by the Director General, the Chief Operating Officer and the Financial Controller.

The Committee met 4 times in 2016. The attendance of the individual members at these meetings was as follows: , Richard Hobbs 4, Alex Rodger 4, Simon Howitt 4 and Wendy Dorey 4. The Audit Committee has oversight for non-regulatory risk; regulatory risk is reviewed by the Board as a whole.

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.

The Committee has specific responsibility for proposing to the Board (1) the remuneration and reward of the senior executive and (2) the general policy for staff remuneration and benefits to ensure that all of our people are fairly rewarded for their individual contributions to the Commission.

Meetings were attended by the Chairman, Director General and the Chief Operating Officer. The Committee met twice in 2016 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 2016, the Commission appointed external parties to undertake internal audits in the following areas:-

- Finance - capital expenditure and management accounts;
- Cyber security;
- Supervisory IT systems review;
- Authorisations;
- IT.

The outcomes of the audits have been taken forward to the satisfaction of the Audit Committee and the Board.

In 2016, the corporate governance standards of the Commission were reviewed by the Board 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. This was reaffirmed by the Council of Europe's Financial Action Task Force regional inspectorate, Moneyval, which visited the Bailiwick in late 2014 and which published its final report in January 2016.

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