GUERNSEY
FINANCIAL
SERVICES
COMMISSION

# Annual Report & Financial Statements 2004

# ANNUAL REPORT & FINANCIAL STATEMENTS

For the year ended 31 December 2004

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

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

GUERNSEY
FINANCIAL
SERVICES
COMMISSION


**Guernsey Financial Services Commission**

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*The Guernsey Financial Services Commission is the regulatory body for the finance sector in the Bailiwick of Guernsey.*

*The Commission's primary objective is to regulate and supervise financial services in Guernsey, with integrity and efficiency, and in so doing help to uphold the international reputation of Guernsey as a finance centre.*

# COMMISSIONERS

**John Hallam FCA**
Chairman of the Commission

John Hallam has served as a Commissioner for 17 years, becoming Chairman in 2003. He has 30 years' experience in accountancy, latterly as the partner in charge of PricewaterhouseCoopers in Guernsey, specialising in the provision of audit and advisory services to financial service sector companies. He is currently a non-executive director of a number of financial institutions involved in banking, insurance and investment management. He has served as Vice-President of the Guernsey Society of Chartered and Certified Accountants, Treasurer of the Guernsey International Business Association, a member of the committee of the Guernsey Insurance Company Management Association and on various other bodies associated with the business life of Guernsey.

**Leslie Priestley TD, FCIB, FCIM, CCMI, FRSA**
Vice-Chairman of the Commission

Leslie Priestley has served as a Commissioner for six years, becoming Vice-Chairman in 2003. He has been involved in banking for 40 years, holding senior appointments in Barclays and TSB, finally as Chief Executive, TSB England and Wales plc and a director of the TSB Group. He is currently a director of Prudential Banking plc, Egg plc and other companies. During his career he was Secretary General, Committee of London Clearing Bankers; a member of the Monopolies & Mergers Commission; a director of the Civil Aviation Authority, London Electricity plc and Pinnacle Insurance plc; an adviser to Touche Ross & Co., Financial Services Adviser at ICL plc; a Visiting Fellow at Bangor University and Chairman of the CAA Pension Scheme.

**Mel Carvill FCA, ACII, MSI**

Mel Carvill has served as a Commissioner for six years. He is Direttore Centrale, Head of Strategy and Corporate Finance, at Assicurazioni Generali SpA and is a director of financial services companies in North America, Europe and Asia. He has served as President of the Guernsey Society of Chartered and Certified Accountants, the Insurance Institute of Guernsey and the Guernsey Association of Pension Funds.

**Peter Harwood LL.B**

Peter Harwood was appointed as a Commissioner in 2004. He was admitted as a solicitor of the Supreme Court of England and Wales in 1972 and worked with Coward Chance and Hill Samuel Bank in London, before returning to Guernsey in 1981. He was admitted as an advocate of the Royal Court of Guernsey in 1982 and has been a partner of Ozannes since 1983. He is currently the Chairman of the Guernsey Bar Council. He served as Chairman and non-executive director of TSB Bank Channel Islands Limited and as a non-executive director of TSB Group plc. He serves as non-executive director of N M Rothschild & Sons (C.I.) Limited and as a director of a number of captive insurance companies and collective investment fund companies.

**David Mallett BA (Dunelm) FCA**

David Mallett was appointed as a Commissioner in 2003. He has over 30 years' experience in banking and banking supervision. He joined the Bank of England's Banking Supervision Division in 1975 and was closely involved in the rescue and orderly rundown of a number of failed banks, the development of regulatory practice and a number of national and international accounting and auditing standards. From 1988 to 2000 he was successively Group Head of Audit and Group Head of Finance at Standard Chartered Bank. He has been a member of the Council of the Institute of Chartered Accountants in England and Wales and is co-author of "Banking: a Regulatory Accounting and Auditing Guide". In 2004 he completed 15 years as a member of the Financial Reporting Review Panel.

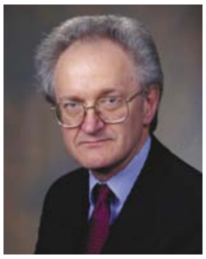
# SENIOR EXECUTIVES

**Peter Neville MA (Oxon), FCA**
*Director General*

Peter Neville read law at Oxford University and is a Fellow of the Institute of Chartered Accountants in England and Wales. Following a period working in the field of insolvency, he spent 12 years as a banker and merchant banker in the United Kingdom and the Far East. He joined the Investment Management Regulatory Organisation in 1987, holding a number of senior positions over a period of seven years. In 1994 he established the investment services regulatory regime for Malta and provided advice on financial services regulation to the government. In 1997 he joined the Regulatory Division of Lloyd's of London as general manager responsible for authorisation, individual registration and conduct of business permissions. He took up the position of Director General of the Commission in April 2001.

**Alan Fleming ACII**
*Director of Insurance*

Alan Fleming started his career with British Engine Insurance Company, then moved to ICI where he gained 29 years' experience of insurance and reinsurance. In 1993 he was seconded to the Association of Insurance and Risk Managers ("AIRMIC") as Executive Director and also served on the Court of Governors of the Institute of Risk Management. He was appointed Head of Risk Management for Guinness plc in 1995 and subsequently in 1997 became Director of Global Risk Management for Diageo. He joined Railtrack in 1999 as Head of Insurance and Risk Management and also in 2000–2001 served as Chairman of AIRMIC. He was appointed as Strategic Account Manager at Aon in November 2001 and joined the Commission in November 2003.



**Philip Marr MSc (Econ), CFE**
*Director of Banking*

Philip Marr graduated in Economics at the University of Hull in1968 and joined the Bank of England after a postgraduate degree. He was Economic Adviser to the government of Bermuda from 1974 to 1977 and entered Banking Supervision on his return to the Bank. He was appointed Adviser to the Bahrain Monetary Agency from 1982 to 1984. He was manager of several groups of banks in Supervision at the Bank of England. After a secondment to Hambros Bank in 1988–1989 he was Manager, On-Site Review Teams. He was appointed Senior Manager, Enforcement in 1995 and joined the Commission in June 1997.

**Peter Moffatt MA (Oxon)**
*Director of Investment Business*

Peter Moffatt joined the Overseas Department of the Bank of England in 1968. International work involved liaison with European Community institutions and the Bank for International Settlements. He was a supervisor during the 1970s and later became Secretary of the City Capital Markets Committee. Leaving the Bank in 1987, he became a compliance officer in investment banking with PaineWebber and JP Morgan and then in investment management with John Govett and Framlington. He has served on legal and regulatory committees of the Association of Investment Trust Companies, the Association of Unit Trusts and Investment Funds and the Financial Services Authority. He joined the Commission in June 2000.

**Stephen Trevor LL.B**
*Director of Fiduciary and Intelligence Services*

Stephen Trevor read law at Exeter University before qualifying as a solicitor of the Supreme Court of England and Wales in 1991. He practised with Trump & Partners (subsequently TLT Solicitors) in Bristol in commercial litigation, acting for financial institutions in negligence claims against lawyers and other professionals and for insolvency practitioners in contentious insolvency matters. In 1997 he joined the Solicitors Indemnity Fund to settle and defend claims against solicitors' firms. In 1999 he joined the Commission as Assistant to the Director of Fiduciary Services and Enforcement. He was appointed Assistant Director in March 2001, Deputy Director in March 2002 and Director of Fiduciary and Intelligence Services in August 2004. He has served as a member of Guernsey's Trust Law Review and Company Law Reform Committees and is a Certified Fraud Examiner.

**Neville Roberts FCA**
*Head of Finance and Operations*

Neville Roberts is a Fellow of the Institute of Chartered Accountants. He served articles with Thomson McLintock where, following qualification, he worked in the field of receivership. In 1976 he moved to Ford Motor Co. before transferring to Schroder Life and Unit Trusts as Group Financial Accountant. He came to Guernsey as Director of Finance and Operations for the Schroder international group of companies. For 12 years prior to joining the Commission, he was Head of Finance and Operations for NRG Distribution. In August 2003 he was appointed as the Commission's first Head of Finance and Operations.

# CHAIRMAN'S STATEMENT

The Commission continues to ensure that its regulatory approach is appropriate to the fast-evolving financial services industry in Guernsey.

The positive reports by international bodies on our regulatory regime clearly indicate that the worldwide regulatory community recognises our high standards of regulation and that we are serious in what we say and in what we do. In addition, the finance sector in Guernsey has matured and, increasingly, there is a culture in which regulatory standards are seen as contributing positively to the management of risk by financial institutions. These factors, combined with the evolution of international thinking on regulatory standards, led the Commission to introduce guidance in 2004 that establishes frameworks for the governance of financial institutions rather than prescriptive requirements which do not take account of the circumstances of individual institutions. To achieve this, the Commission spent significant time considering how institutions manage and mitigate their risks. More responsibility has been placed on institutions to consider the implications of regulatory standards for their businesses and how they should apply them to their specific circumstances. Equally, the Commission has to ensure that firms have taken this risk-driven approach seriously and tailored procedures, systems and controls appropriately to their businesses. To do this we now place more emphasis on gaining a detailed understanding of firms in order to tailor our monitoring to the potential risks presented by those firms.

This move towards greater individual responsibility promoted by the Commission is only one of a series of changes taking place within Guernsey's business community. A combination of political influences (a change in the structure of government in May, with a new focus on the development of all parts of the economy, including the finance sector) and commercial influences (consolidation arising from merger and acquisition activity and an enhanced concentration on value-added business), as well as our own regulatory approach, is fostering a climate of change and enterprise. The Commission is itself aware of the need for change and of making sure that we can meet the challenges presented by such an energetic business environment. We welcome the opportunity to work with industry and government in taking forward their plans for developing the economy.

Advocate Nigel Carey, who became a Commissioner in 1992, has retired from that position, while Talmai Morgan, the Commission's first Director of Fiduciary Services and Enforcement, has joined GuernseyFinance as its chief executive. Talmai was instrumental in developing the regulatory regime for fiduciaries. Their wise counsel was greatly valued by both myself and my fellow Commissioners. Advocate Peter Harwood was appointed as a Commissioner in August 2004, while Stephen Trevor became Director of Fiduciary and Intelligence Services in the same month. We look forward to continuing to work with both Peter and Stephen in meeting the challenges that lie ahead.

John Hallam
Chairman

# DIRECTOR GENERAL'S STATEMENT

2004 was a busy year for the Commission, but in line with the approach adopted in 2003, we have kept the number of changes to the regulatory regime to a minimum. After a number of years during which major revisions were made in preparation for the visit by the International Monetary Fund ("IMF"), we decided it was important to give industry a respite from the introduction of new laws and regulations. This approach has been welcomed by industry.

In all other respects, however, the Commission has been very active. For example, our commitment to protecting the interests of those who deal with financial services businesses in Guernsey has led us to become increasingly involved in taking non-routine regulatory and enforcement action. We have also contributed significantly on the international front.

**Looking to the future of the industry**

The Commission is responsible not only for supervising financial services in the Bailiwick but also for assisting in providing the right environment for the healthy development of the finance industry. The consultation document entitled "Building Confidence", recently published by the Commerce and Employment Department of the States of Guernsey, is an important and positive step. The Department has assumed the principal role in developing all business sectors, including financial services. The Commission looks forward to working in partnership with the Department.

The financial services industry in Guernsey is both healthy and diverse. Mergers and acquisitions in the banking sector have created stronger and more efficient operations. The Commission is seeing continuing interest in various sectors. These include fiduciary business, captive insurance business, the use of protected cell companies ("PCCs") in both the insurance and funds sectors, and specialist fund administration – especially in the fields of hedge funds and private equity. As an indication of the healthy state of the industry, funds under management and administration in the investment business sector increased over the year to December 2004 by £17.2 billion to a total of £73.6 billion – an increase of 30%. In the insurance field the number of cells of PCCs licensed to conduct insurance business continues to grow at a fast rate.

The Commission is very aware of the need to achieve the right balance between, on the one hand, protecting customers, the public and the financial system by meeting international standards and on the other, providing an environment that does not smother the industry and stifle innovation. What is important is to implement the standards in a way that is thoughtful and pragmatic. Our aim is to make the burden on industry as light as possible and to see that the regulations bite effectively. The Commission works closely with industry in the development and implementation of standards to make sure they are adequate and not unduly intrusive. Illustrations of this during 2004 have been our work in the areas of corporate governance, the regulations in respect of hedge funds, the requirements for banks to undertake Annual Reviews, and the pragmatic risk-based approach to anti-money laundering standards for existing customers. We have worked closely with industry associations, in conjunction with the Guernsey Training Agency, to assist them in producing sectoral training matrices. These are intended to achieve good standards of training and competence without resorting in most areas to regulatory compulsion as has been the case in certain other jurisdictions. Equally importantly, we have been working closely with industry to introduce a lighter regulatory regime for investment funds aimed at professional and experienced investors. This regime came into effect on 7 February 2005. The Commission is also playing its part as a member of the committees established by the Commerce and Employment Department considering developments in the areas of company law, the company registry, trust law and investment business.

**Relations with government**

A close working relationship with the Commerce and Employment Department will become increasingly important, but the Commission's primary reporting line remains to the Policy Council with which we meet formally twice a year. In addition we will be continuing with our programme of meetings with States Members on issues of current interest, and with our annual meeting with senior representatives of the Chief Pleas of Sark.

**The international scene**

2004 was another year of extensive international involvement. A number of senior Commission executives play active roles in the international standard-setting and evaluating bodies: the Basel Committee Cross Border Banking Group, the International Organization of Securities Commissions ("IOSCO"), the International Association of Insurance Supervisors ("IAIS"), the Financial Action Task Force ("FATF") and the IMF. This provides us with the opportunity to keep abreast of what is going on and also to influence developing standards to ensure they are appropriate for industry in Guernsey. For example, in the fields of anti-money laundering and countering the funding of terrorism, and also in respect of captive insurance public information disclosure, we have demonstrated that we are serious about engaging with the international community and that Guernsey will not support international standards that are inappropriate to local circumstances.

We have continued our programme of international cooperation. This includes entering into memoranda of understanding ("MoUs") with appropriate regulatory bodies, meeting other regulators both formally and informally, liaising with law enforcement and other agencies, making presentations at international gatherings and taking part in international assessments of other jurisdictions.

**Regulatory and enforcement action**

Seeking to ensure that firms and individuals undertaking financial services business in Guernsey are fit and proper is an important part of our role. It is heartening that the process of vetting applicants for fiduciary licences who were operating before the fiduciary regime was introduced is drawing to a close. Just eight cases remain outstanding. All are in the process of being concluded; four of these are either closing their Guernsey operations or moving them elsewhere.

A significant amount of the Commission's time is spent protecting investors, depositors, policyholders, other customers, the public in general and the reputation of the Bailiwick in ways that are not apparent to most observers, because of the confidential nature of the work. This is, nevertheless, one of the Commission's most important areas of activity.

A considerable number of cases, some long-drawn-out and some swiftly resolved, some of considerable regulatory concern and some less serious, were dealt with by the Commission during the year. Regrettably, investigative and enforcement action seems likely to grow in importance. We will continue to take a robust line where firms that are already licensed have fallen below the standards expected of them, particularly where customers' interests have been harmed or jeopardised.

Although the Commission was not involved in the prudential regulation of Equitable Life, a substantial number of policyholders entered into their contracts of insurance through the Guernsey branch, and the Commission continues – within the powers we have and in the context of our very limited regulatory role – to seek to protect their interests.

In December 2004, an agreed settlement with certain of the firms involved in the split capital investment trust affair was announced. The text of the public statement relating to that settlement is set out in Appendix 4.

**The Commission itself**

On the financial front, careful cost control has meant that in 2004 the Commission was very close to breaking even, a more favourable outcome than that originally budgeted. We were able to achieve this by cutting expenditure in ways that have not compromised our ability to operate effectively. This has included a reduction in the number of staff. We have also been able to reduce our development effort and the associated costs as other agencies have assumed responsibility for this work.

We were very sorry to see Nigel Carey retire as a Commissioner and Talmai Morgan leave to head GuernseyFinance. They have, however, been replaced by two strong successors: Peter Harwood as a Commissioner and Stephen Trevor as the new Director of Fiduciary and Intelligence Services. We wish them well in their new roles.

The Commission's staff have continued to prove that they are by far our greatest asset, working as hard, as professionally and as effectively as ever. My sincere thanks go to them all.

Peter Neville
Director General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## Sector trends

In profit terms, 2004 was a notably brighter year for the banking sector than 2003. Overall, profits were up around 11%, having declined by some 7% in 2003, thereby achieving a noteworthy swing in performance despite the business environment remaining tough. The contribution of private banking to the sector has been maintained in the absence of much activity in the securities markets. Nevertheless, some upward movement in interest rates was enough to give some worthwhile improvement in interest margins and net interest income earned. There was also an improvement in the amount of income relating to fees and commissions from banking services in 2004. Costs and expenses were contained remarkably well, enabling a turnaround in aggregate operating profits in the banking sector. This improvement was achieved in spite of the reduction in the number of licensed banks from 59 at the beginning of 2004 to 54 at the end. Within the expenses were material amounts reflecting investment in higher-quality buildings and infrastructure.

Deposit levels were relatively steady in 2004, finishing the year 1% up in sterling terms at £70.4 billion compared with £69.7 billion at the previous year end (table 1). Exchange rate movements explain a part of this overall modest increase as sterling strengthened against the US dollar over the course of 2004 thereby depressing the sterling equivalent value of US dollar deposits. In their base currencies US dollar deposits increased some 3% over the year and although deposits in euro declined marginally, when taken together with the 8% increase in sterling deposits the underlying annual growth was encouraging. Swiss fiduciary deposits declined in the initial part of the year but recovered in the second half to remain unchanged over the year, standing at £25.7 billion at the end of the year. One feature of the year was the convergence of the currency proportions of the deposit base. The amount held in US dollars and in sterling each now account for some 36% of deposit business, with deposits in euro holding steady at around 23% (figure 1).

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

| *End* | *Banks licensed* | *Deposits £mns* | *Annual % change in deposits* |
|---|---|---|---|
| 1995 | 73 | 46,855 | 11.1 |
| 1996 | 72 | 43,324 | -7.5 |
| 1997 | 78 | 49,357 | 13.9 |
| 1998 | 78 | 52,922 | 7.2 |
| 1999 | 79 | 57,059 | 7.8 |
| 2000 | 77 | 68,474 | 20.0 |
| 2001 | 72 | 77,211 | 12.8 |
| 2002 | 67 | 71,943 | -6.8 |
| 2003 | 61 | 69,703 | -3.1 |
| 2004 | 54 | 70,426 | 1.0 |

Figure 1. **Analysis of deposits with Guernsey banks by currency at end 2004**

*Currency*

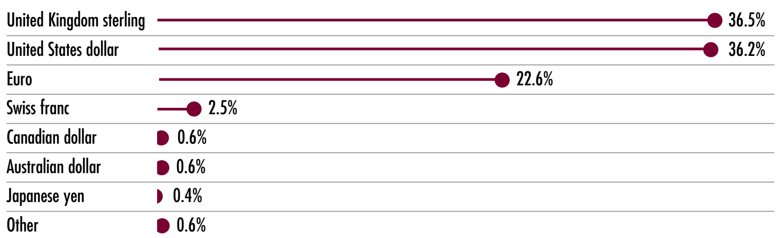



Figure 2. **Assets at the year end**

*£mns*

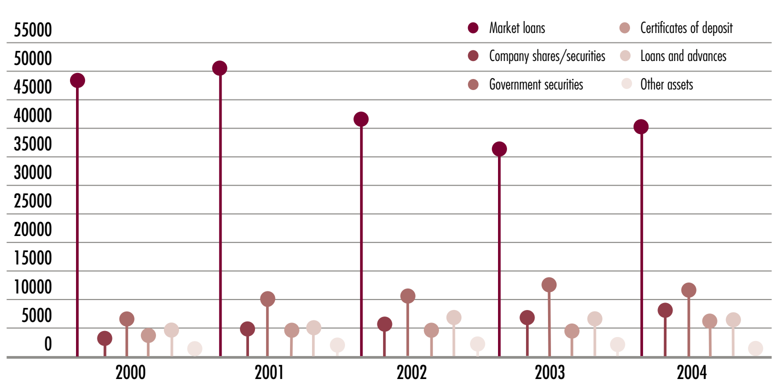



Figure 2 provides an analysis of banks' assets over the last five years. Bank lending continued to provide a valuable source of revenue for banks. There was a steady increase in mortgage business secured against owner-occupied residencies and in lending to corporate customers. The unwinding of a very large one-off transaction led to a decline in overall cash-backed lending (figure 3).

The sources of the deposits held by the Bailiwick's banks at the end of 2004 was substantially the same as at the end of 2003, with the proportion of deposits

# BANKING CONTINUED

Figure 3. **Reported loans and advances at the year end**

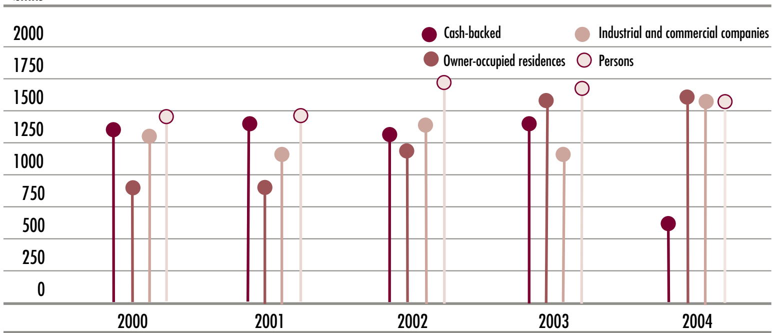



Figure 4. **Source of bank deposits at end 2004**

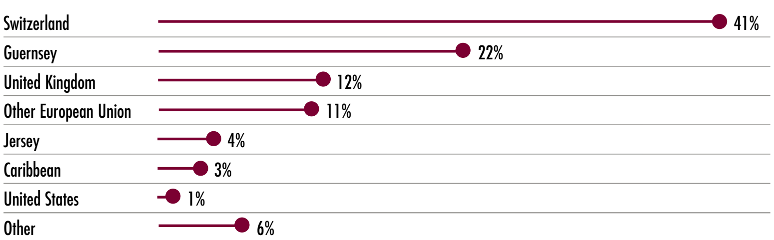
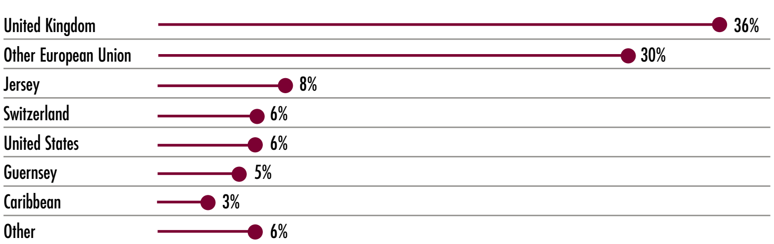



Figure 5. **Disposition of bank assets at end 2004**




from Switzerland increasing by 1% to 41% (figure 4). The disposition of assets was very similar to the position in 2003, albeit with some minor changes in percentages, these being essentially placements with group entities in the UK, EU and Switzerland or low-risk securities in the USA and EU member states (figure 5). The total tier 1 capital[1] of the banking sector had decreased slightly to £1.5 billion in 2004, reflecting the conversion of several subsidiaries to branches during the year (figure 6). However, the weighted risk asset ratio was healthier at 20.43%. Figure 7 shows the distribution of locally incorporated banks by risk asset ratio.

Although the amount of total deposits appeared little changed over the year, the amount of total liabilities and total assets increased more noticeably over the period from £72.8 billion to £74.9 billion (table 2). The growing gap between the amount of total deposits and total liabilities which is not accounted for by the quantum of capital (itself on a declining trend because of conversions of subsidiaries into branches) is explained by significant growth in the amount of short-term paper issued. This paper arises from structured products which, although constituting an on balance sheet liability of the bank, are not legally defined as

**Footnote 1**

*Tier 1 capital is the sum of share capital, disclosed reserves, current year's retained profit verified by external audit, current year's losses, share premium account and minority interests (in tier 1 capital).*

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

| | *2000 total £mns* | *2001 total £mns* | *2002 total £mns* | *2003 total £mns* | *2004 total £mns* |
|---|---|---|---|---|---|
| ***Liabilities*** | | | | | |
| Tier 1 capital* | 1715 | 1841 | 1686 | 1585 | 1479 |
| Tier 2 capital** | 27 | 27 | 23 | 21 | 23 |
| Deposits by: | | | | | |
| Banks etc. | 13065 | 12424 | 13040 | 13811 | 15063 |
| British Isles public sector | 50 | 59 | 51 | 44 | 34 |
| Companies, persons, other | 54626 | 64728 | 58852 | 55848 | 55329 |
| Other liabilities | 3080 | 2069 | 1108 | 1541 | 3020 |
| Total liabilities | 72563 | 81148 | 74760 | 72850 | 74948 |

| | *2000 total £mns* | *2001 total £mns* | *2002 total £mns* | *2003 total £mns* | *2004 total £mns* |
|---|---|---|---|---|---|
| ***Assets*** | | | | | |
| Loans, advances and market loans with: | | | | | |
| Banks etc. | 48599 | 51602 | 42521 | 37654 | 40076 |
| British Isles public sector | 2 | 12 | 10 | 5 | 5 |
| Companies, persons, other | 5242 | 5333 | 6437 | 6189 | 5752 |
| Certificate of deposit | 4638 | 5412 | 5833 | 5497 | 6012 |
| Government securities | 8209 | 10466 | 11257 | 13129 | 12733 |
| Company shares/securities | 3687 | 5401 | 6521 | 7062 | 8212 |
| Other assets | 2186 | 2922 | 2181 | 3314 | 2157 |
| Total assets | 72563 | 81148 | 74760 | 72850 | 74948 |

* Paid-up share capital and disclosed reserves

** Undisclosed reserves, revaluation reserves, general provisions, debt/equity instruments and subordinated debts deposits. The short-term paper issued increased from £0.24 billion at the end of 2003 to £1.45 billion at the end of December 2004. The growth in the demand for structured products has been a feature of private banking during the course of the year. Private clients have sought capital-protected products which may see some further growth if underlying securities markets recover and at the same time may also represent an attractive means of protecting wealth.

As in previous years the structure of the industry was affected by acquisitions and rationalisations during the year. Leopold Joseph & Sons (Guernsey) Limited (and its London parent bank) was acquired by the Bank of NT Butterfield Group and following some corporate restructuring that private bank now forms part of the business of Butterfield Bank (Guernsey) Limited. The business of Banca Monte dei Paschi (Channel Islands) Limited was acquired by the Swiss private bank, BSI (Channel Islands) Limited, and the business of the formerly Italian-owned subsidiary has now been incorporated into BSI's business in Guernsey.

During the year business of Ansbacher (Channel Islands) Limited, as part of the overall disposal of the Ansbacher Group, was sold by its South African owners FirstRand to Qatar National Bank, which has as its major shareholder the Arabian Gulf State of Qatar.

Three licences were surrendered in the closing days of the year. Alliance & Leicester Commercial Bank plc (the former Girobank plc) and Alliance & Leicester plc, whose business was transacted through the Guernsey Post Office, decided to discontinue their very limited amount of business in Guernsey during 2004. The business of Kleinwort Benson (Guernsey) Limited was transferred to the Guernsey branch of Kleinwort Benson (Channel Islands) Limited, so a banking licence was no longer required for that Guernsey subsidiary. However, that entity will continue to offer custody business under the Protection of Investors regulatory regime. Sabanci Bank (Guernsey) Limited ceased operations during the year as it was unable to attract its target market of affluent private clients

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

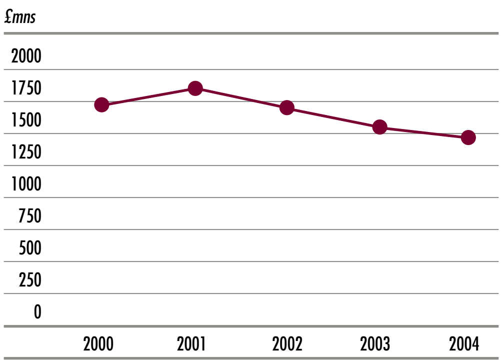



Figure 7. **Distribution of locally incorporated banks by risk asset ratio at end 2004**

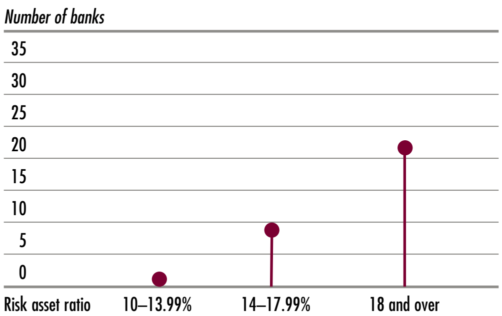



Figure 8. **Country of origin of Guernsey licensed banks – subsidiaries at end 2004**

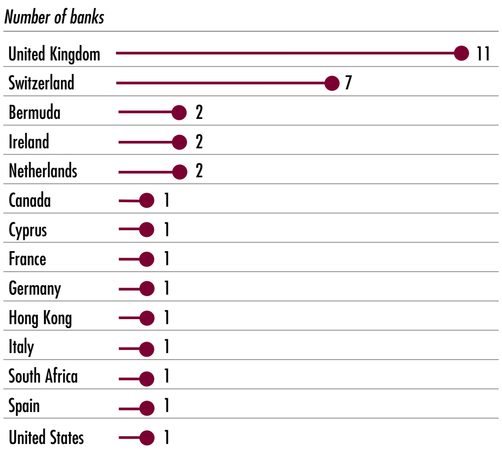
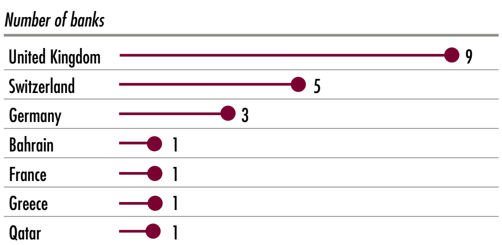



Figure 9. **Country of origin of Guernsey licensed banks – branches at end 2004**



from Turkey. This was because prevailing low interest rates meant that US dollar and euro deposits were uncompetitive when compared to the significantly higher rates available in Turkish lira deposits.

Towards the end of the year the Dutch group ING announced that it had agreed to sell the financial services businesses which operate in Guernsey under the Barings banner. Those businesses, forming part of the Financial Services Group Limited segment of ING, including the bank Barings (Guernsey) Limited, will be sold to the Northern Trust Company of Chicago. The latter is a specialist operator principally in the global custody and fund administration sectors but it is also active in private banking for wealthy families, so Northern Trust's operations and the Guernsey businesses being acquired appear to be complementary. Regulatory consent was given in January 2005 to enable the transaction to proceed but it is too early yet to say what the full impact will be under the prospective new owners.

The outcome of all these corporate actions was that the same amount of business, and in certain areas a growing amount of profitable business, was being conducted by a smaller number of more efficient banks. Very little of the business of the banks involved in corporate actions has left the Bailiwick. A further outcome of the mergers and amalgamations has been that management and personnel resources have been redeployed in the stronger, growing, acquiring banks. Efficiencies will also flow from the fact that more business is being conducted in the acquiring banks with essentially the same infrastructure and a lower amount of combined capital. The process of conversions of Guernsey subsidiary banks into bank branches of entities elsewhere is expected to continue in 2005; however, it is anticipated that the amount of business being undertaken will be substantially the same after those rationalisations. Figures 8 and 9 show the country of origin of the 54 banks licensed at end 2004; details of current licensees are available on the Commission's website at www.gfsc.gg

## Supervision and policy

There were few changes to banking supervisory policy during 2004. In large part this reflected the fact that the amendments to the Banking Supervision Law in 2003 (including the introduction of the Code of Practice for Banks) had provided a sound and wholly adequate regulatory foundation. As a consequence of these amendments the banking sector, through its industry associations, requested some form of breathing space to allow banks time to digest the cluster of changes which had been introduced in both 2002 and 2003. The Division was sympathetic to that request since it had made a series of policy changes in both years so that the Bailiwick would be compliant with the Basel Committee's Core Principles.

Accordingly, in 2004 the only change of note was the bringing into operation of the changes in corporate governance compliance introduced the previous year. After an extended period of consultation, formal, albeit general, guidance on the principles of good corporate governance was issued to the finance sector in December 2004.

Administrative arrangements were put in place by the Division to receive banks' annual review submissions made under section 36C of the amended law. In practice this amounted only to the creation of a sheet (known as form AR) to detail the evidence of compliance by the bank with the requirements set out in the law. This pragmatic approach allows banks the choice of indicating which internal forum or document provides evidence of compliance with the assessments required. The rationale for this approach is that all licensed banks in Guernsey are either subsidiaries or branches of international banks incorporated elsewhere and so already have to provide such material to their own group compliance functions. Hence there is no requirement to create any new documentation – banks can submit or point to documents which already exist.

Two meetings were held with the Jersey Financial Services Commission and the Isle of Man Financial Supervision Commission to discuss a common way forward on the implementation of the Basel II Accord among the Crown Dependencies.

The Division's annual trading book survey was undertaken once again in the middle of the year to determine to what extent banks were engaging in proprietary trading. The survey confirmed that there is little own-account trading by banks in the Bailiwick and that there was no material increase in such business compared with the previous year.

The Division continued with its second cycle of on-site visits, focusing on know your customer and anti-money laundering standards. However, this year the visits were supplemented with an additional emphasis on anti-fraud policies and procedures. Best practice in these areas continues to be fed back to banks. Twenty-two on-site visits were carried out in 2004.

As well as these anti-money laundering/fraud prevention reviews, the Division continued with its programme of on-site credit reviews. During the year eight credit reviews were carried out. These reviews continued to be targeted towards those banks with significant loan books or where loan books represented a material part of their overall assets.

The programme of prudential supervisory visits to banks continued in 2004. During the year 55 formal prudential meetings were held with bank managements. They included a prudential meeting in Jersey with a branch of a Guernsey bank operating in that island. Two other meetings, held outside the jurisdiction, were with the head offices of banks based in Switzerland. In addition there were 112 ad hoc meetings held in Guernsey with banks to discuss various matters, such as strategy, changes in personnel, corporate restructuring, bank and Commission policy, mergers and acquisitions.

The Assistant Director of Banking provided feedback in relation to the banking sector at seminars on preventing financial crime held in Guernsey in November 2004 and January 2005.

**International developments**

The Director and Deputy Director attended the two meetings of the Offshore Group of Banking Supervisors ("OGBS") held in 2004. A meeting in March held in London covered technical subjects and the second meeting, held in Madrid in September, covered international developments. The latter meeting was addressed by representatives of the Basel Committee, FATF, the Financial Stability Forum, the IMF and the Financial Stability Institute.

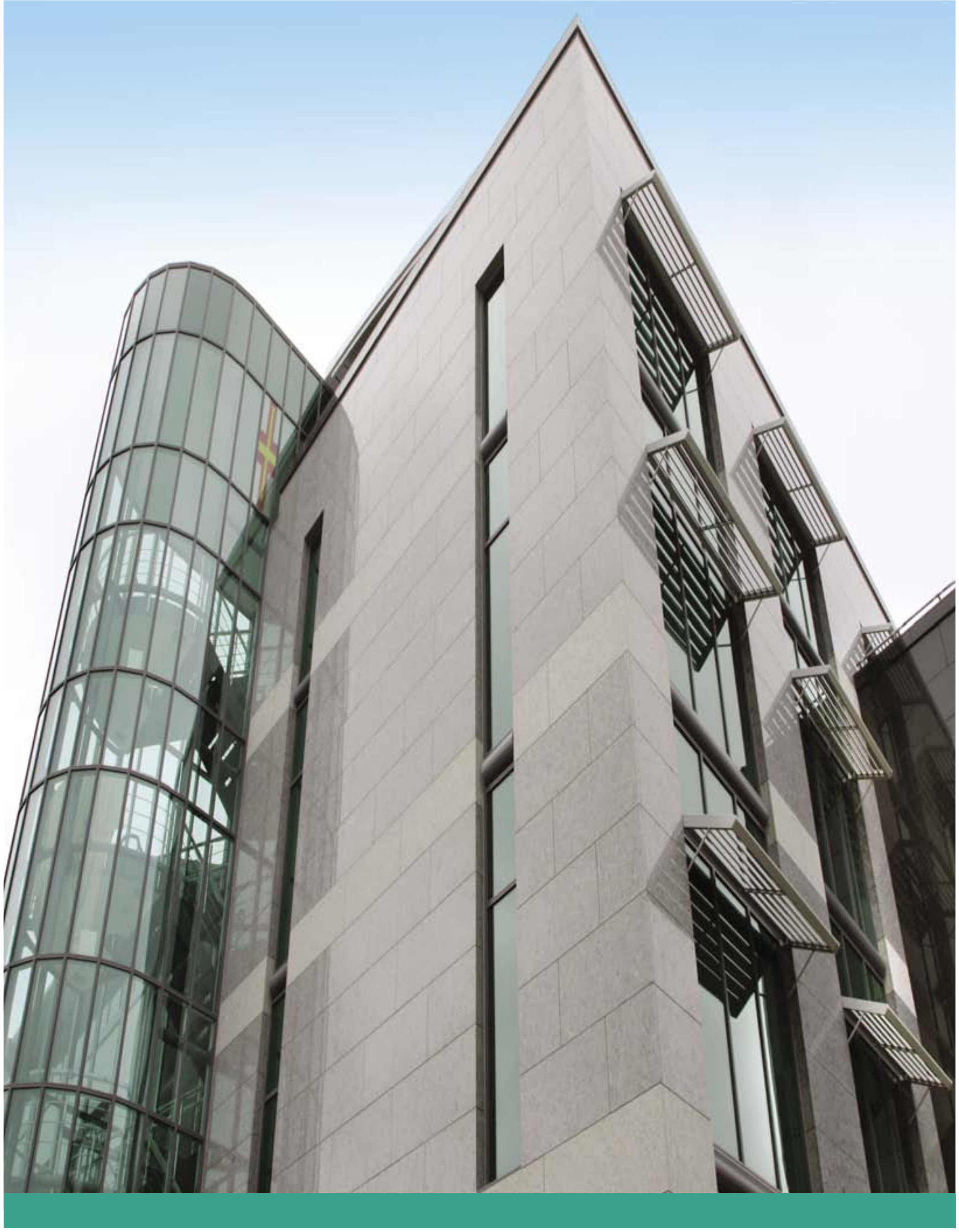
The Director of Banking attended the summer meeting of the Working Group on Cross-Border Banking held in Paris in July. The principal topic for discussion was the issues in international banks surrounding the proposed paper "Consolidated KYC Risk Management".

The Director General and the Director of Banking attended the biennial International Conference of Banking Supervisors hosted by the Bank of Spain in Madrid in September. The primary subject for the conference was discussion of the implementation of the Basel II Capital Accord following the issue of the final document, entitled "International Convergence of Capital Measurement and Capital Standards – a Revised Framework", in June 2004. The secondary subject for discussion was the "accounting regime and banking supervision" which addressed recent developments in international accounting standards and fair-value accounting. The opportunity was taken to hold dialogues with banking supervisors from around the world, addressing issues of mutual interest, and in particular with those representing countries which have subsidiary or branch banks represented in Guernsey.

The Division carried out bilateral meetings in 2004 with the UK Financial Services Authority ("FSA") in November and with the Swiss Federal Banking Commission in December. Bilateral meetings also took place with the Jersey Financial Services Commission, the Isle of Man Financial Supervision Commission, the Bermuda Monetary Authority and the Gibraltar Financial Services Commission (the latter two after the OGBS meeting in Madrid). Formal letters were written to those home banking supervisors with whom a bilateral meeting had not been arranged to seek their views as home regulators on the ongoing prudential soundness of the banks represented in Guernsey.

The Director of Banking was invited to make a presentation to a gathering of international banking supervisors arranged by the Financial Stability Institute in Basel, Switzerland in February on the subject of evolving anti-money laundering standards, know your customer practice and supervisory experience. Finally, staff of the Division undertook further training on Basel II and anti-money laundering topics hosted by the British Bankers' Association in the UK. Other staff attended training on international accounting standards and operational risk issues put on by the Financial Stability Institute in Basel. In addition, the Assistant Director attended the Toronto International Leadership Centre for Financial Supervision course for banking supervisors in April in Toronto, Canada.

The Director attended the ninth Annual European Conference of the Association of Certified Fraud Examiners in London in October, the Deputy Director having attended the previous European Conference in 2003 in Copenhagen – these conferences have enabled the Division to stay abreast of current issues in fighting financial fraud.



## The fiduciary sector

The year saw some consolidation of Guernsey's fiduciary businesses, generally driven by global acquisitions such as the HSBC Group's purchase of Bank of Bermuda and Bank of Butterfield's purchase of Leopold Joseph, both of which involved the integration of Guernsey trust businesses. There have also been changes of ownership in favour of groups not already represented in Guernsey and which, therefore, have not resulted in consolidation locally. These have included the sale of the Ansbacher Group by FirstRand to Qatar National Bank and the agreed sale of the banking and fiduciary businesses of Barings by ING to Northern Trust.

The Division granted new licences to five full and 11 personal licensees during the year (in addition to the inclusion of further companies within existing group licences). These new full fiduciary licences included both stand-alone and managed operations and the new personal licensees largely reflected the fact that former trust professionals often retain some work on retirement; the sector thereby retains the benefit of their expertise. The number of new licences is a clear mark of confidence in the future of fiduciary business in the Bailiwick. At the end of 2004 there were 145 full and 56 personal licences in issue. A list of current licensees and applicants for licences is available on the Commission's website at www.gfsc.gg

Overall, Guernsey's fiduciary sector remains in good shape and a very important part of its economy. According to licensees' annual returns at 30 June 2004, 2,652 people were employed in the sector at that date, an increase of 250 on the 2003 figure of 2,402.

## Supervision and policy

During the year the Division focused its resources on on-site visits to licensees. These have proved an essential means of developing in-depth knowledge of licensees' businesses, and allowed the Division to supervise the sector from a position of understanding. Fifty-one licensees were visited during the year and the Division is on target to complete visits to all licensees by the end of 2005. Work was done during the year to refine the content of on-site visits, and this will continue as the Division moves towards and into the second cycle of visits.

The Division provided feedback to licensees on the issues that arose during their on-site visits at seminars for the sector on anti-money laundering matters held in November 2004 and January 2005. A further seminar is planned in Alderney later in 2005.

In relation to desk-based supervision, alongside the formal elements such as considering notifications, financial statements and annual returns, the Division has on an almost daily basis held ad hoc meetings with licensees on prudential matters such as changes of corporate structure, personnel and procedures within licensees' businesses.

In addition, further progress has been made in the few remaining transitionally-authorised cases. In particular, appeals by Castle Company Management LLC against the Commission's refusal to grant a licence were successfully defended in the Court of the Sénéschal of Sark in January and in the Royal Court of Guernsey in August 2004. The applicant's further appeal to the Guernsey Court of Appeal was heard in December 2004 and all its grounds of appeal were dismissed. The company no longer requires authorisation within the Bailiwick.

There remain eight applicants whose applications for fiduciary licences have yet to be finally determined, of which four are transferring their businesses under agreed timescales in order to be able to withdraw their applications.

The Public Trustee (Bailiwick of Guernsey) Law, 2002 came into force on 1 June 2004 and on the same date Mr David Trestain was appointed as Public Trustee. The Public Trustee's function is to act as "trustee of last resort", for example where there is no other trustee lawfully able to act, and this should help to protect beneficiaries' interests where a fiduciary licence application is refused or if a licensed fiduciary were unexpectedly to become unable to carry on business.

During the year the Division has continued to liaise closely with representative groups such as Guernsey Association of Trustees and Sark Association of Corporate Administrators, and with educational bodies, including the Society of Trusts and Estates Practitioners ("STEP") and the Institute of Chartered Secretaries and Administrators ("ICSA"). The input of these bodies on proposed regulatory developments has been valuable.

The Director will serve as a member of the group established by the Financial Industry Policy Advisory Group ("FIPAG") to review Guernsey's trusts law. The current legislation has not been updated since 1990 and needs to be reviewed against the background of legislation in other centres. The group will seek the views of the fiduciary sector and other interested parties before making recommendations to FIPAG.

**International developments**

The Director and Deputy Director maintained close contact with their counterparts in Gibraltar, the Isle of Man and Jersey. Meetings took place in July and November, with frequent bilateral contact between meetings. Such close liaison and cooperation are crucial to securing the avoidance of regulatory arbitrage between jurisdictions and to the effective supervision of groups operating in more than one jurisdiction.

The year has seen an increasing level of contact with regulators worldwide with an interest in exchanging information on companies or individuals involved in fiduciary business. This trend undoubtedly results from wider awareness of the Commission's supervision of fiduciaries in the Bailiwick, and reflects a greater interest from other regulators, whether or not they supervise fiduciaries, in the role of fiduciaries in their jurisdictions. This improved level of cooperation between regulators is a very positive development for the Bailiwick because it means not only that the Division has better access to information held by other regulators on persons applying for fiduciary licences in the Bailiwick, but also that regulatory decisions or action taken in Guernsey are more likely to have an effect in other jurisdictions than when regulation was introduced in the Bailiwick in 2001.

In August 2004, the then Director, Talmai Morgan, left the Commission to head GuernseyFinance. Before his departure, in March 2004 he spoke at the conference of the International Tax Practitioners' Association in Milan and in June 2004 he made a presentation on trusts to a two-day workshop in Guernsey attended by members of the Egmont Group (the international association of financial intelligence units). Such occasions provide invaluable opportunities to ensure that influential international audiences understand both the nature of trust work in the Bailiwick and the high quality of the regulatory regime applicable to it.

As an example of this increased understanding, the Division was approached by a foreign regulator about an insider-trading investigation involving transactions that had been made through a Guernsey trust in order to conceal a connection with an individual whose transactions should have been aggregated for the purpose of the relevant insider-trading provisions. The Commission was able to supply information to the other regulator, enabling it to take disciplinary action against its member firm. The disciplinary proceedings were settled by the firm accepting liability to the other regulator for a substantial fine.

**Companies**

Guernsey remains one of the very few jurisdictions of the world (alongside Jersey and Bermuda) requiring full disclosure of ultimate beneficial ownership before a company can be incorporated. This information, together with details of the company's proposed activities, is provided to the Commission in confidence and is the subject of due diligence by the Division. During the year 1,172 companies were formed and 15,840 were on the register at the year end.

The Commerce and Employment Department of the States of Guernsey has established a group to review Guernsey's company registration process and the possibility of introducing an electronic registry.

**Intelligence**

The Fiduciary Services and Enforcement Division was renamed in August 2004. The new name – the Fiduciary and Intelligence Services Division – better reflects the activities undertaken by the Division. The nature of the underlying work, however, continues in the same vein and involves frequent and close liaison with other bodies with a common interest in preventing and investigating financial crime. Within the Bailiwick this includes the Crown Officers, Guernsey Police, Customs and the Financial Intelligence Service ("FIS") and outside the Bailiwick there is regular contact with regulatory bodies in the UK and elsewhere.

Powers under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 were used in two investigations during the year. One involved suspected unlicensed fiduciary business and, in the other, the activities of an existing fiduciary warranted closer attention. In both cases the Division will be addressing issues that arose during the investigations.

In a separate case, an unlicensed Guernsey company was found to be offering fiduciary services on an internet website. No evidence of actual fiduciary activity was found and the matter was resolved with the removal of the offending site.

In the field of financial crime, the Division has continued its efforts to stamp out bogus bank websites which falsely claim that the "banks" have a presence in Guernsey. These are a sophisticated version of the Nigerian "419" type fraud, in which victims are lured into the scheme either with offers of a share in the proceeds of a fund which needs to be transferred through an independent account or with promises of lottery winnings. The victims are guided to the website of the bogus bank, where they are advised to open an account to handle the deal. Unfortunately the account requires a deposit from the victim to activate it and that is the last they see of their money.

Assistance has been provided by various overseas regulators in exposing such bogus sites, which compromise the reputations of Guernsey and other jurisdictions involved. The prevalence of US-based domain hosts being used by the fraudsters in these schemes has been reported to the Federal Bureau of Investigation in the hope that some guidance might be provided to that industry and preventive action can be taken.

The Division was made aware of another suspicious scheme that was being circulated by email. This scheme was seeking individuals who would be willing to use existing or new bank accounts in their names to cash cheques. Warnings were issued via the local media as it appeared that the scheme was either a fraud or an attempt to dupe victims into money laundering.

Another fraudulent scheme, this time aimed at local residents, was exposed during the year. This involved an advertisement by a firm purporting to be based in Toronto and offering mortgage and insurance services. Enquiries revealed that the firm in question was using false addresses and had used an unsuspecting person's identity in the documentation. The scheme was found to be an "advance fee fraud" and one local resident was discouraged from paying money over. Again, warnings appeared in the local media and advice was given to the press to be on notice for similar advertisements.

## International insurance market performance overview

As 2004 dawned the international insurance industry was in a buoyant mood. The previous two years had seen stable hard markets with premiums increasing and underwriting proving to be a profitable activity again. The major concern at the start of the year was how quickly the markets would soften. In the third quarter there were four major hurricanes in the Caribbean and Florida and a number of typhoons affecting Japan. Market softening was halted and a more stable, harder market seemed to be prevailing at the end of the year.

To compound the losses experienced in the third quarter, the investigations by Eliot Spitzer, the New York Attorney General, into the remuneration practices of insurance brokers and the potential abuse of conflicts of interest arising from contingent commission structures threw the practices of the international insurance community into sharp relief. The fall-out from these investigations will reverberate for some time to come as larger commercial brokers seek to increase the transparency of their remuneration arrangements.

## Guernsey market performance

Traditionally, the captive sector profits from hard markets when policyholders disaffected by rising insurance premiums offered by traditional carriers look to alternative forms of risk transfer. This includes the formation of captive vehicles, be they stand-alone captives, PCCs or cells within PCCs. Guernsey continued to see the benefit of this in 2004, with a good number of licences being granted. See table 3.

However, the effect of Guernsey's mature captive market also continued to be felt, with a net reduction in the number of captives offset by a net increase in the number of PCCs and cells. The total number of international insurers licensed at the end of 2004 stood at 611. A breakdown of these figures is available on the Commission's website at www.gfsc.gg

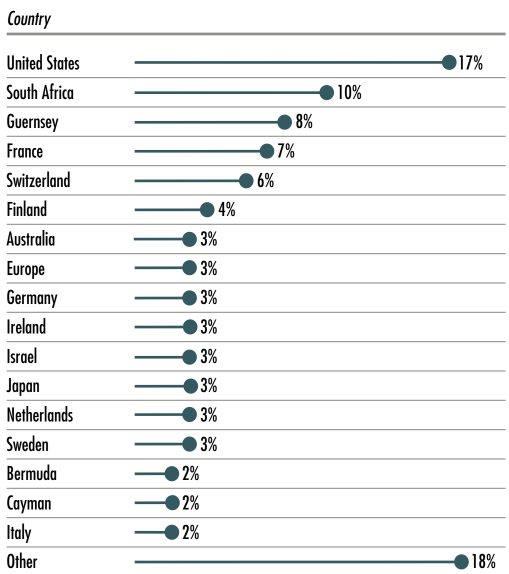
A number of larger companies, including BskyB Group plc, and BHP Biliton plc, which migrated its operation from another domicile, established captive insurance companies in the Bailiwick during 2004. The majority of new licensees were formed by small to medium-sized enterprises looking to use the low cost of entry and flexibility of the cell arrangement in order to reduce the cost of, and increase the control over their own insurance arrangements. The year also saw an increase in the use of Guernsey licensed vehicles by major insurance industry players such as direct personal lines insurers, international reinsurers and insurance brokers. Overall the only discernible trend was one of diversity, with no particular type of business, structure or shareholder dominating the year's activity.

Table 3. **New licences issued by the year end**

| *Type* | *2000* | *2001* | *2002* | *2003* | *2004* |
|---|---|---|---|---|---|
| Captives | 19 | 18 | 30 | 20 | 19 |
| PCCs | 8 | 16 | 7 | 12 | 8 |
| Cells | 43 | 41 | 43 | 60 | 52 |
| Totals | 70 | 75 | 80 | 92 | 79 |

The diversity of shareholder location is illustrated by figure 10. While 58% of captive vehicles (captives, PCCs and cells) is owned by UK shareholders, the ownership of the 42% of captive vehicles owned by non-UK shareholders is spread across 37 different jurisdictions. The majority of PCCs and cells (52%) is owned by non-UK shareholders.

Figure 10. **Non-UK shareholdings of captives, PCCs and cells at end 2004**



# INSURANCE CONTINUED

Figure 11. **Distribution of new licences issued in 2004 by shareholder business type**

| *Business type* | |
|---|---|
| Insurance | 26% |
| Legal | 14% |
| Automobiles | 9% |
| Construction | 8% |
| Bank | 6% |
| Other financial services | 6% |
| Support services | 6% |
| Aviation | 4% |
| Diversified industrial | 4% |
| Electronics | 3% |
| Mining | 3% |
| Oil and gas | 3% |
| Pharmaceuticals | 3% |
| Food | 1% |
| General retailers | 1% |
| Real estate | 1% |
| Water | 1% |
| Other | 1% |

Figure 11 shows the diversity of shareholder business type for those licences granted in 2004.

The life assurance sector has maintained its position, with two new licences being granted during the year. The market for Guernsey life assurers continues to be mainly expatriates, generally residing in countries outside Europe, and citizens of countries where residents are able to use their foreign exchange allowance to invest outside their home jurisdiction.

The local insurance intermediary sector is focused primarily on servicing the domestic market and is largely unaffected by the investigations in the United States of America. It has continued to thrive even though it has experienced a hard year. Increasing costs and volatile markets have resulted in margins being squeezed. Constant monitoring of business plans and entrepreneurial thinking have enabled the sector to progress during a difficult time.

Although the number of licensed insurance intermediaries reduced during the year, from 53 to 47, the number of Authorised Insurance Representatives remained stable. The reduction in the number of licensees is almost wholly due to consolidation of businesses, with post-merger entities retaining the vast majority of staff. The Commission is aware of an improvement in the quality and professionalism of the remaining licensees as a result of this pooling of talent and resource. Bailiwick residents continue to have a wide choice of licensed insurance intermediaries, ranging from the large multinational operations to the small, bespoke companies.

2004 has seen an increase in the number of expressions of interest, mainly from outside the Bailiwick, relating to the possibility of being granted a licence to conduct intermediary business in the Bailiwick. These enquiries have principally been from businesses operating in "niche" markets which believe there are opportunities in Guernsey. The Commission is keen to encourage quality businesses that are able to offer Bailiwick residents a wider choice and that can enhance the reputation of Guernsey as a finance centre.

A list of current licensed entities is available on the Commission's website.

## Education

The Division has remained focused on improving standards within the sector and continues to support various educational initiatives designed to keep Guernsey licensees at the forefront of the international insurance market. In conjunction with the Guernsey Training Agency, the Commission has been instrumental in the setting up of the Insurance Education Forum, whose stated purpose is "to facilitate and exchange views on education and training needs of the insurance sector within the Bailiwick of Guernsey".

There have been a number of events, conferences and seminars, with specific emphasis on education, in which the Division has participated. These have ranged across the whole sector and included a number of presentations to enhance knowledge of corporate governance; anti-money laundering; the captive sector; on-site visits; and regulatory action within the intermediary sector.

The Commission has helped design and implement the Guernsey Insurance Certificate. This Certificate forms an element of the minimum qualification requirements for Authorised Insurance Representatives providing advice on long-term insurance products and becomes mandatory in June 2006. The syllabus, which is Bailiwick-specific, can be found on the Commission's website.

The Commission continues to actively encourage insurance managers and those working in the captive sector to complete the Certificate in Captive Management, which was launched in Guernsey in 2002 and has now received international recognition.

**Supervision and policy**

The Division continued to perform on-site visits in accordance with its three-year rolling programme. These visits are designed to enable the Division to add to its understanding of licensees and their control environments. They serve to reinforce the Division's understanding of the risk profile of licensees. Written policies and procedures are reviewed and the degree of compliance with them assessed. The visits also help to enhance the working relationship between Commission staff and licensees. In some cases, it has been beneficial to perform a "themed" on-site visit, designed to address a specific issue, process or function in order to gain a deeper insight into a particular aspect of the licensee's operations. During 2004, the Division performed on-site visits to 18 insurance intermediaries, four insurance managers, three international life companies (two of which were "themed" visits looking at market conduct issues only) and two domestic insurers. A similar number of visits are planned for 2005.

During the year, members of the Division also had a number of meetings with insurance managers and other licensees to discuss new applications, changes in business plan and other issues such as capital requirements. Many of these meetings included owners or potential owners of captive insurance companies. In addition, regular meetings were held with industry bodies, including the Guernsey Insurance Company Management Association ("GICMA") and the Association of Guernsey Insurance Brokers.

The Commission took regulatory action against a number of licensees during 2004. This was in the form of compulsory and voluntary liquidation of entities and conditions being placed on licences. The conditions range from restrictions on payments by licensees to limitations on the writing of new business. Additionally, it has been necessary to suspend a number of licences pending remedial action being taken or further investigatory work being carried out.

The Commission continues to monitor developments in connection with the Equitable Life Assurance Society ("Equitable"). Regular meetings are held with the FSA and our lawyers to discuss issues and any developments that may affect the interests of policyholders of Equitable's Guernsey branch. During 2004, our attention has been focused on any issues arising out of the publication of the report from the Right Honourable Lord Penrose, the entitlement to potential redress available to policyholders through the Financial Ombudsman Service and the implications of various action group initiatives. Recently the Parliamentary Ombudsman has reopened her inquiry into Equitable. We will keep our website updated with information helpful to Guernsey branch policyholders.

The Division has begun its review of the Insurance Business (Bailiwick of Guernsey) Law, 2002 and the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002, which were introduced in November 2002. As with any new laws, experience will invariably highlight potential issues that need to be addressed either by way of new regulations or guidance notes or by eventual change to the laws themselves. It is intended that, once the internal discussions of the two laws have been completed, a panel of representatives from each industry sub-sector will be invited to participate in the review process.

The Division has instituted the Forum for Insurance Development. This body has taken over the role of the insurance think-tank and provides an opportunity for members from industry and the Commission to discuss ideas for the further development of Guernsey as an international insurance centre.

With the move towards International Financial Reporting Standards ("IFRS") and the introduction of "IFRS 4 Insurance Contracts", the Division was pleased to be asked to participate in the IFRS Discussion

Forum, which consisted of representatives from industry and the major accounting firms. The Forum was used to discuss the potential issues affecting the captive insurance industry in Guernsey arising from the implementation of IFRS. The initial findings were presented in two events held in December 2004, which were attended by members from both GICMA and the Guernsey Society of Chartered and Certified Accountants. The Forum intends to continue to monitor developments and advise industry throughout 2005.

**Division reorganisation**

The Division reorganised during the year, changing the emphasis from teams responsible for specific sectors of business – captives, life companies and insurance intermediaries – to a function-based approach. The Division is currently divided into three teams: approvals and licensing, monitoring, and review. This reorganisation has enabled the Division to drive forward with required regulatory action while remaining highly responsive when dealing with approvals and more routine issues.

**International developments**

Guernsey is a leading jurisdiction among the world's captive insurance markets. It is the fourth largest captive insurance domicile in the world and the largest in Europe. As a consequence of this, Guernsey has a high profile within the international supervisory and standard-setting bodies. The IAIS is the standard-setting body for the international insurance industry. The Offshore Group of Insurance Supervisors ("OGIS") represents jurisdictions concerned with cross-border insurance business.

There is a perception that the insurance industry globally has been lagging behind the banking sector in relation to the development of, and compliance with international standards and accounting transparency. This perception has undermined, to some extent, the confidence of the capital markets in the insurance industry, thus increasing the cost of capital to the insurance market. As a consequence, the IAIS has engaged in a major effort to introduce and update standards on a range of issues, including accounting issues, solvency criteria, fraud and anti-money laundering. The IAIS standards are developed by working subcommittees and involve extensive consultation with industry observers.

Particularly during this time of substantial change it is important that the Commission can monitor and influence trends and developments. It therefore plays a very active role in the committee work of the association. The Director General represents OGIS on the Executive Committee of the IAIS. In addition, he is an active member of the Insurance Fraud subcommittee of the IAIS. This subcommittee also deals with anti-money laundering and counter terrorist financing standards. The Director of Insurance attends the Technical Committee meetings of the IAIS and is a member of the Emerging Markets, Core Curriculum and Reinsurance subcommittees. The Division's Actuary is also a member of the IAIS Solvency and Enhanced Disclosure subcommittees. These are important committees as the Solvency subcommittee is currently developing a worldwide framework for insurance company solvency assessment, whilst the Enhanced Disclosure subcommittee is developing standards for public disclosure of information on insurance company technical and investment performance. The Commission liaises closely with members of OGIS and other jurisdictions to ensure that these subcommittees are aware of the specific impact of the standards on captives and other international insurance companies. During 2004, it played a leading role in negotiating an exclusion for captive insurance entities from the recently introduced standard on public disclosures for non-life insurers. As captives have fewer external stakeholders, a lower level of disclosure was deemed to be more appropriate.

It was evident from the negotiations on this enhanced disclosure standard that, at a senior level in the international supervisory community, there is a widespread lack of appreciation of the value of the captive insurance industry. To counter this, the Director of Insurance is leading a working group to produce an education paper for the IAIS on captive insurance. This initiative is sponsored by OGIS and supported by several major international jurisdictions.

In addition to the IAIS committee work, the Commission maintains a working liaison with other international regulatory bodies. In 2004, discussions were held with the FSA and the Bermudian, Manx, Gibraltarian, Mauritian, Australian and Dutch regulatory bodies. The Insurance Division has also contributed to international conferences.

In 2004 the Deputy Director was invited to join an Insurance Typologies working group set up by FATF to conduct an analysis into the money laundering vulnerabilities in the insurance sector and attended meetings in Paris and Moscow.

In addition, the Deputy Director represented the IAIS at a special meeting of the United Nations Counter-Terrorism Committee which was held in Vienna.

With the full support of the Commission, Steve Butterworth (former Director of Insurance at the Commission) has been appointed as the Executive Director of OGIS.

During the year the Division produced three guidance papers for OGIS on "Regulatory Issues for Variable Life & Variable Annuity Products", "Supervision of Captives Using an Exposure-Based Approach to Capital" and "The Issues and Guidance for Supervisors of Licensed Insurance Special Purpose Vehicles". These papers have been formally adopted by OGIS.

## Market sentiment

Despite rising interest rates and continuing uncertainties in the Middle East, market indices tended to improve in developed markets during 2004. Some smaller markets showed very substantial gains, and even in those countries where economic growth was sluggish, markets nonetheless were set on a rising trend.

Against that background the strong flow of new business applications, first apparent towards the end of 2002 and accelerating through 2003, was felt even more strongly in 2004. Last year, new record totals for approvals of both closed and open-ended funds and their associated cells were achieved.

In the open-ended sector, a total of 36 new funds and 139 new classes of existing funds were authorised. This compared with 26 new funds and 108 new classes in 2003 (table 4). Last year it was anticipated that there would be even greater use of PCC and umbrella structures as a way of developing fund portfolios; that expectation has been borne out in the figures for 2004. The corollary, that there would be fewer new funds created, has not been borne out in practice, and the increasing authorisation of new vehicles reflects the fact that Guernsey remains an attractive jurisdiction for promoters to domicile their investment funds. The total value of open-ended funds increased by 52% during the year from £22.2 billion to £33.7 billion. Table 5 and figures 12 to 14 provide an analysis of open-ended funds. Table 6 and figures 15 and 16 provide an analysis of closed-ended funds. The closed-ended sector experienced a revival of interest compared with 2003: a total of 47 new closed-ended funds received consent, compared with 33 in 2003 (table 4). The trend over time in the number of Guernsey open and closed-ended funds and the assets under management are shown in figures 17 and 18.

The number of open-ended non-Guernsey schemes permitted to be serviced from the Bailiwick increased again in 2004, with a total of 42 new approvals granted. This was at a lower rate than experienced in 2003, but was more than offset by the very strong domestic fund growth noted in the previous paragraphs. The value of funds under management, administration or custody in the Bailiwick under the non-Guernsey scheme arrangements increased from £14.6 billion at the end of 2003 to £17.0 billion at the end of 2004, an increase of 17% (table 7).

Table 4. **New collective investment fund business at the year end**

| | *2003* | *2004* |
|---|---|---|
| Open-ended funds – authorised | 26 | 36 |
| Open-ended funds – new classes approved | 108 | 139 |
| Closed-ended funds – approved | 33 | 47 |

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

| | *2003* | *2004* | *% change* |
|---|---|---|---|
| Number of funds | 208 | 218 | +4 |
| Number of investment pools | 792 | 956 | +20 |
| Value of assets (£bns) | 22.19 | 33.70 | +52 |
| Net new investment over year (£mns) | 5,731 | 8,131 | +42 |
| Number of registered shareholders (000's) | 117.5 | 89.6 | –24 |
| Stock exchange listed | 57 | 71 | +24 |

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

Figure 12. **Open-ended funds: geographic distribution of investments at end 2004**

*Country*

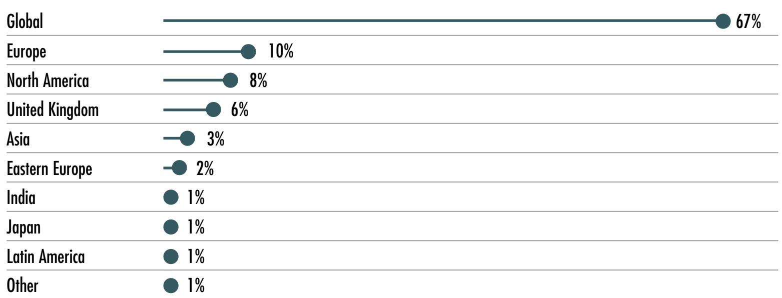
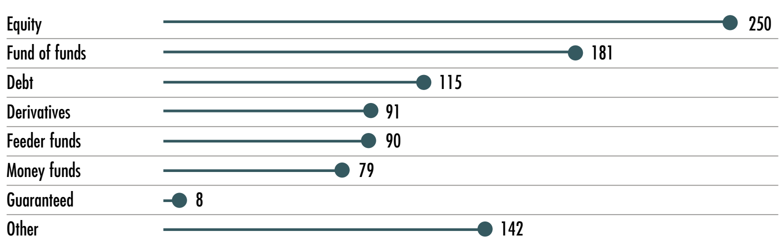



Figure 13. **Open-ended funds: analysis by type of investment pool at end 2004**

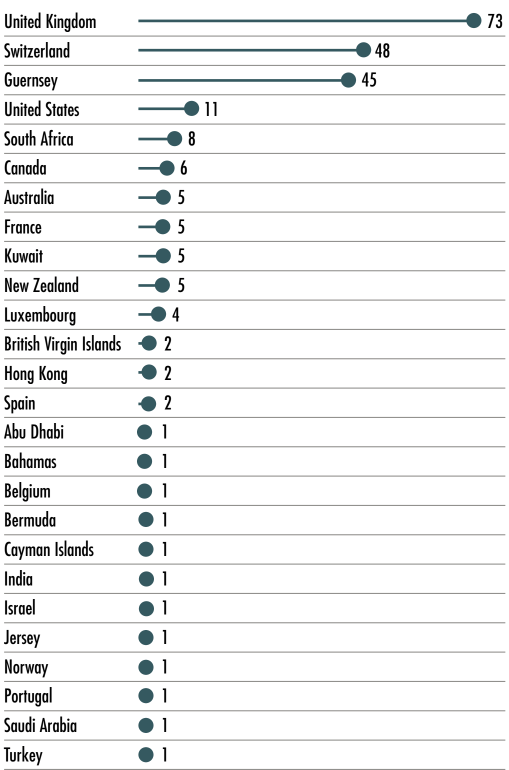
*Number of schemes*



# INVESTMENT BUSINESS CONTINUED

Figure 14. **Nationality of sponsors/joint sponsors of Guernsey open-ended funds at end 2004**

*Number*




Note: Some funds may have more than one sponsor.

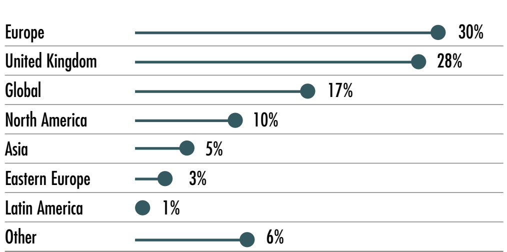
Table 6. **Closed-ended funds at the year end**

| | *2003* | *2004* | *% change* |
|---|---|---|---|
| Number of funds | 280 | 298 | +6 |
| Value of assets (£bns) | 19.58 | 22.86 | +17 |
| Number of registered shareholders (000's) | 47,396 | 38,423 | –19 |
| Stock exchange listed | 66 | 84 | +27 |

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

Figure 15. **Closed-ended funds: geographic distribution of investments at end 2004**

*Country*




Overall, the total value of funds serviced in Guernsey rose from £56.4 billion at the end of 2003 to £73.6 billion at the end of 2004, an increase of 30%.

A further reflection of the very strong domestic fund growth during 2004 was the significant increase in the number of new investment business licences granted during the course of the year. A total of 58 new licences were granted compared with 30 during 2003. The net number of institutions licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended ("PoI Law") increased to 446 at the end of the year (figure 19). A list of current licensed institutions is available on the Commission's website at www.gfsc.gg

## Supervision and policy

As noted in last year's report, the Commission gave feedback on the consultation initiated in November 2003 on hedge fund operation. The initiatives to provide additional flexibility over custody arrangements, valuation and on segregation of assets were designed to deal with issues faced by existing Guernsey vehicles, and a number of applications have been processed to take advantage of the more flexible regime. It is also clear that the initiative attracted new promoters to use the Bailiwick's services. Later in the year further consultation was held with the Guernsey Fund Managers Association ("GFMA") (now renamed the Guernsey Investment Fund Association) and other interested parties on a more streamlined authorisation regime for funds limited to Qualifying Investors – i.e. professional investors, expert investors and knowledgeable employees of investment businesses. The intention was to provide a guaranteed timetable for delivery of authorisation under the PoI Law or consent under the Borrowing (Control) (Bailiwick of Guernsey) Law, 1946 as amended, to provide additional certainty for promoters and sponsors. In return Guernsey licensees would have to warrant to the Commission that they had satisfied themselves as to the fitness and properness of applicants, that the scheme was economically viable, and that they had appropriate procedures in place to ensure that it is only available to Qualifying Investors, as defined. The formal arrangements came into force on 7 February 2005, and the relevant guidance to sponsors is included in Appendix 3 and on the Commission's website.

A committee has been established to report jointly to the Commission and to the Department of Commerce and Employment on the investment business sector in Guernsey. Part of that committee's remit is to review the working of the PoI Law and to recommend changes. It is expected, therefore, that some of the Division's other objectives – particularly in examining scope for further development of the qualifying funds regime, and exempting interprofessional business from the scope of the PoI Law – will be subsumed within that committee's deliberations. The committee is chaired by Advocate Peter Harwood.

During 2004, 33 normal monitoring and inspection visits were carried out, compared with 27 in the previous year. Of those, eight were to designated managers, six to designated custodians, 17 to investment advisors and independent financial advisors, and one was to a principal manager. There was also a regular visit to the Channel Islands Stock Exchange LBG.

These figures included three follow-up visits to licensees, including two entities which had had restricted conditions imposed on their licences and one to a licensee that was on an accelerated visit schedule following a previous visit. As at 1 January 2004, two licensees had conditions imposed on their licences owing to concerns at the Commission over the effectiveness of their internal administrative arrangements. During the course of 2004 one of those conditions was lifted, and the other licensee had its condition lifted early in 2005. No additional restrictive conditions were imposed during the year

Figure 16. **Nationality of sponsors/joint sponsors of Guernsey closed-ended funds at end 2004**

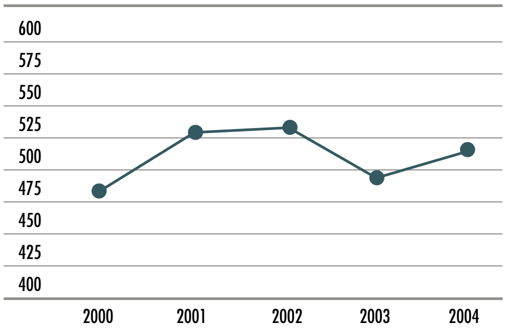
*Number*

| | |
|---|---|
| United Kingdom | 172 |
| Guernsey | 35 |
| United States | 27 |
| Switzerland | 14 |
| Germany | 10 |
| France | 9 |
| Netherlands | 7 |
| Sweden | 6 |
| Finland | 5 |
| Italy | 5 |
| Australia | 4 |
| Greece | 4 |
| Denmark | 3 |
| Singapore | 3 |
| Spain | 3 |
| Austria | 2 |
| Hungary | 2 |
| Japan | 2 |
| Luxembourg | 2 |
| Norway | 2 |
| South Africa | 2 |
| Belgium | 1 |
| Bermuda | 1 |
| Canada | 1 |
| Colombia | 1 |
| Egypt | 1 |
| Iceland | 1 |
| New Zealand | 1 |
| Portugal | 1 |
| Republic of Ireland | 1 |
| Turkey | 1 |

Note: Some funds may have more than one sponsor

Figure 17. **Total funds authorised and approved at the year end**

*Number of funds*



INVESTMENT BUSINESS CONTINUED

Figure 18. **Total assets under management in Guernsey domiciled funds at the year end**

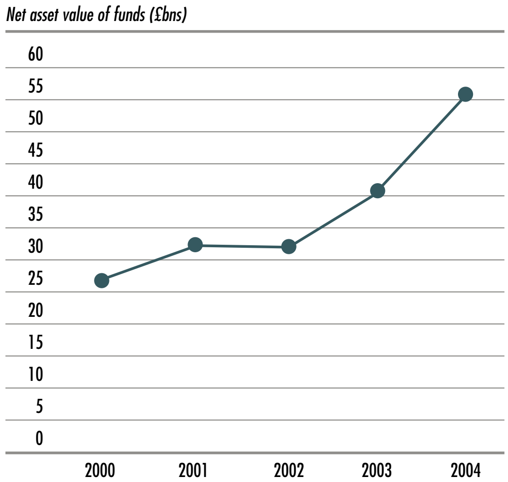
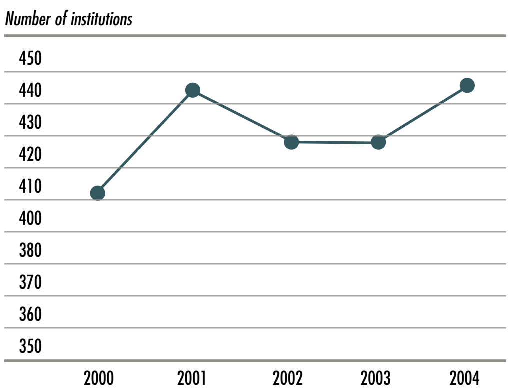



Table 7. **Non-Guernsey schemes at the year end**

| | *2003* | *2004* | *% change* |
|---|---|---|---|
| Number of funds | 174 | 187 | +7 |
| Value of assets (£mns) | 14,612 | 17,043 | +17 |
| Stock exchange listed | 36 | 37 | +3 |

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

Figure 19. **Number of institutions licensed under the Protection of Investors Law at the year end**




but four licensees were placed on an accelerated-visit programme so that the Commission could monitor their progress in dealing with issues that had arisen during our inspection visits.

In addition, one investigation visit was made to a business which appeared to be carrying on investment business without the required PoI licence.

Alongside the formal visit programme, the Division routinely held ad hoc meetings with licensees on prudential matters such as changes of corporate structure, personnel and procedures within licensees' businesses.

Representatives from the Division participated in the seminars held in November 2004 and February 2005 on preventing financial crime, providing feedback on issues arising at on-site visits.

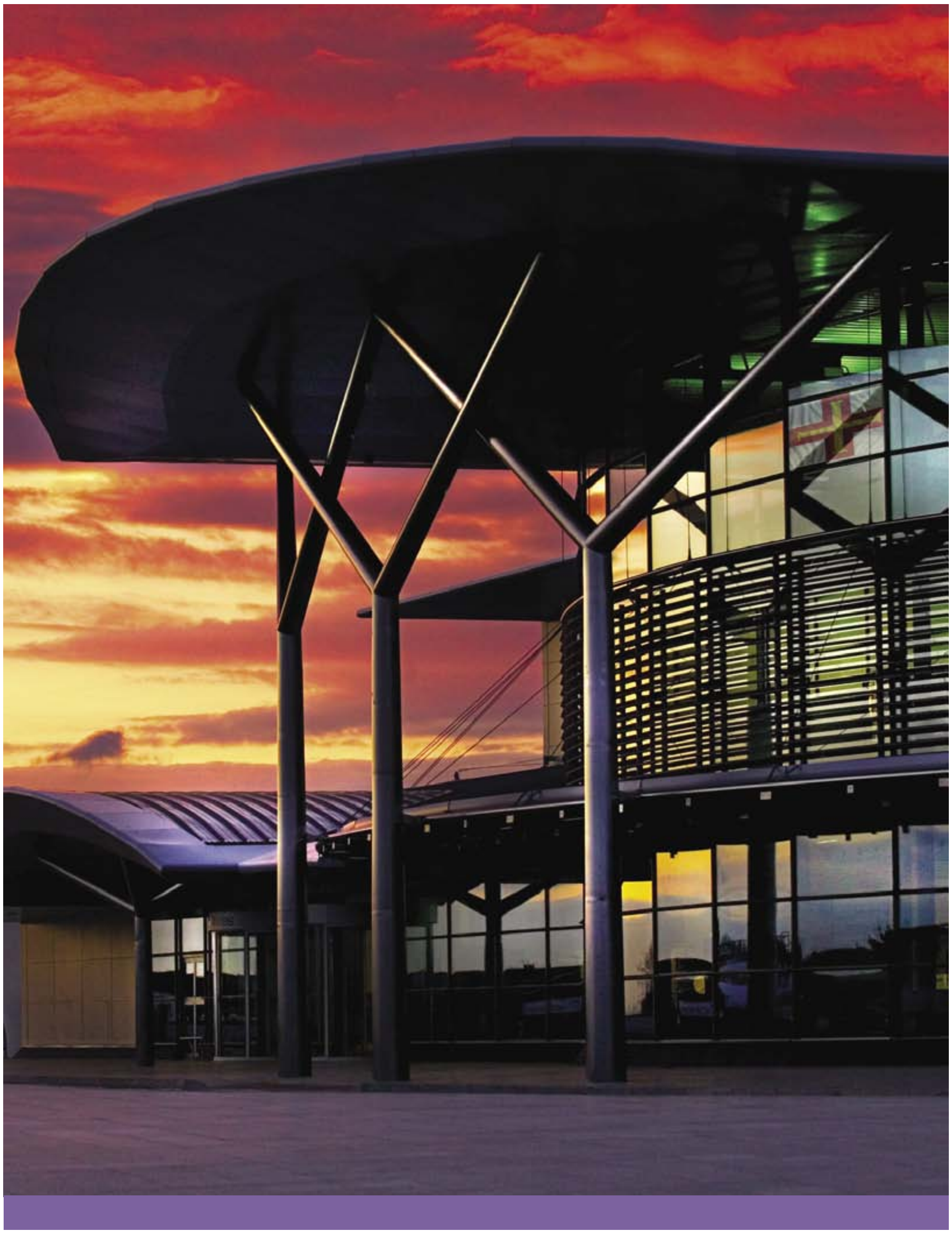
At the end of the year, it finally became possible to disband the dedicated team dealing with split capital investment trusts. This followed the announcement on 24 December of an agreed settlement with certain of the firms involved. The text of the public statement relating to that settlement is shown in Appendix 4.

## International developments

The Division continues to develop its international contacts and relationships with regulators in other jurisdictions.

The Director of Investment Business represented the Commission at meetings of IOSCO's European Regional Committee and also at the IOSCO annual meeting held in May. In October, the Director and one of the Assistant Directors from the Division represented Guernsey at the annual meeting of the Enlarged Contact Group of Collective Investment Scheme supervisors. The Director also represented Guernsey at the Toronto Centre's inaugural Executive Programme and one of the Assistant Directors attended the Toronto Centre's Leadership Programme for Associates. Senior Analysts from the Division attended the FSA's International Regulatory seminar and the US Securities Exchange Commission's Securities Enforcement and Market Oversight programme. There were also liaison meetings with the Jersey Financial Services Commission. In addition the Director and Deputy Director attended a four-way meeting with representatives of the FSA, the Isle of Man and Jersey Commissions to review the designated territories' collective investment scheme arrangements.

Members of the Investment Business Division also attended a number of conferences and seminars in the UK on corporate governance, hedge funds and private equity finance.



## General

The Policy and International Affairs Division has responsibility for coordinating many of the local and international policy issues facing the Commission, including changes to legislation. The Division also has day-to-day responsibility for the Commission's anti-money laundering and counter terrorist financing framework, including the Guidance Notes on the Prevention of Money Laundering and Countering the Financing of Terrorism ("Guidance Notes"). Together with the Director General, it is the Commission's main link with the Attorney General's Office, the Policy Council and certain international bodies including the IMF.

## Cooperation between anti-money laundering authorities

The Crown Dependencies Anti-Money Laundering Group met in London during 2004. It was attended by representatives from the regulatory agencies, Police, Customs, financial intelligence units and the Attorneys General from the three Crown Dependencies. These meetings coordinate the Islands' anti-money laundering/anti-terrorism policies, discuss issues of common interest and provide a forum for the exchange of ideas and views.

The Bailiwick Financial Crime Committee met twice in 2004. It is a forum for closer coordination at a strategic level between the Attorney General's Office, the Commission, Police, Customs and the FIS in the prevention, detection, investigation and prosecution of economic crime and the countering of terrorist financing. The Deputy Director (Policy and International Affairs) is secretary to the committee.

The Bailiwick Financial Crime Committee has established a Financial Crime Group. The group's objectives are to discuss the implications for policy and practice of particular cases of interest and provide practical assistance to interested parties. The group met three times in 2004. The Terrorist Finance Team, which was established by the group to coordinate action and responsibilities relating to terrorism matters, met four times in 2004.

## Initiatives

Following the issuing of FATF's new Forty Recommendations, the Commission recognised that the finance sector required clarity on the anti-money laundering standards applying to existing customers. After consultation with the Guernsey Joint Money Laundering Steering Group, a statement was issued in June, embodying the standards in FATF's Recommendations.

Another important initiative was the issuing of a leaflet in January on fighting crime and terrorism. This leaflet was sponsored by the Association of Guernsey Banks, together with the States of Guernsey, the Commission and the FIS. The leaflet provides general information to the customers of banks and other financial institutions on why they are asked to provide proof of identity to those institutions and contains a commitment by banks that they will deal with their customers in a fair manner and with common sense.

During 2004 the drafting of new guidance was commenced in anticipation of issuing revised Guidance Notes in 2005. This draft will be issued initially to the Joint Money Laundering Steering Group. Once the views of the group have been taken into account, a revised draft will be issued to the finance sector for consultation.

In November representatives of the Commission took part in four industry-specific half-day seminars for the finance sector on preventing financial crime. The seminars were sponsored jointly by the Commission, the FIS and the Guernsey Police Commercial Fraud and External Affairs Department. The aim was to provide the finance sector with commentary and case studies on recent and proposed developments locally, and to provide firms with information on common issues arising at on-site inspections by the Commission. Six further seminars were held in January and February 2005 and a seminar is planned to take place in Alderney in the spring.

During 2004 the Commission undertook 124 on-site inspections of institutions' anti-money laundering and counter terrorist financing frameworks ("AML/CFT"). While all of these on-site inspections which review AML/CFT are undertaken by the regulatory Divisions, the Senior Analyst within the Policy and International Affairs Division responsible for drafting AML/CFT guidance began a programme of participation with the regulatory Divisions on some inspections. The main purpose of this is to ensure that the Division gains first-hand experience of the practical issues faced by financial services businesses in achieving compliance with the Guidance Notes.

**International work**

As indicated throughout this report, the Commission devotes significant resources to engaging with the international community.

The Director General sits on the Executive Committee of the IAIS and in 2004 attended meetings of the IAIS in Budapest, Oslo and Amman. On behalf of the IAIS, at a conference hosted by the IMF in Washington DC, he made a presentation concerning cooperation by insurance supervisors. On behalf of the Director General, the Deputy Director (Policy and International Affairs) participated at two meetings of the IAIS Insurance Fraud subcommittee. These meetings were responsible for completing the revised IAIS guidance notes on combating money laundering and terrorist financing. The Deputy Director also represented the IAIS on behalf of the Director General at an IMF roundtable in Basel and made a presentation on cooperation between the international regulatory associations. The Deputy Director participated in an IMF mission to provide technical assistance on countering insurance money laundering, terrorist financing and fraud, and also made two presentations for the Financial Stability Institute on these subjects. The Director General spoke at conferences in London and Switzerland on the Commission's regulatory standards in insurance.

The Director General attended the biennial International Conference of Banking Supervisors in Madrid and took the opportunity of having bilateral meetings with the Secretary General of IOSCO and the Spanish investment regulator, Comisión Nacional del Mercado de Valores, to discuss international and European investment regulatory developments respectively. During the year, the Commission also made a presentation to the Committee of European Securities Regulators ("CESR") on recent and proposed regulatory developments within Guernsey and trends in requests for assistance made to the Commission in 2004 by foreign securities regulators. Representatives of the Jersey and Isle of Man Commissions also made presentations to CESR. The Commission represented the OGBS at the plenary of Egmont, the international association of financial intelligence units, which was hosted by the FIS in Guernsey. The Senior Analyst responsible for AML/CFT also represented the OGBS at a meeting hosted by the United Nations in Vienna on the Convention on Transnational Organised Crime.

As usual, the Director General spoke at the Cambridge International Symposium on Economic Crime. The theme of the presentation was the internationalisation of financial systems and the impact of technology.

Throughout the year the Director General also met with the Directors General of the Jersey and Isle of Man Commissions to discuss matters of common interest to the Crown Dependencies.

**Memoranda of understanding**

Although the Commission does not require MoUs to be in place in order to cooperate fully with foreign regulators, increasingly such agreements are seen by regulators as necessary evidence of commitment by a regulatory body to cooperate and exchange information. The Commission has, therefore, adopted a more active approach to signing MoUs with foreign regulatory bodies. In January 2004 the Commission signed an MoU with the Malta Financial Services Authority. The Commission is currently negotiating bilateral MoUs with a number of overseas regulatory bodies.

**IMF survey**

The Commission provides statistics from Guernsey financial institutions to the IMF for its Coordinated Portfolio Investment Survey ("CPIS") on an annual basis. In May 2004 a CPIS workshop for small economies with international finance centres ("SEIFiCs") was hosted by the IMF and the Commission in Guernsey. This event was attended by representatives from Aruba, the Bahamas, Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, the Isle of Man, Jersey and the Netherlands Antilles. Representatives from several of the Commission's Divisions also attended. The cross-border data for 2002 were reviewed. Discussions also covered the role and significance of the SEIFiCs in international financial markets and issues arising from the collection of the statistics.

Each year, institutions are asked to provide cross-border investment statistics in respect of Guernsey banks, open-ended and closed-ended collective investment funds, insurers, insurance intermediaries/brokers and special purpose vehicles. The statistics for 2003 were obtained from 150 institutions, representing 950 entities. Table 8 provides a summary of the results for 2003. The total value of assets reported for Guernsey financial institutions as at 31 December 2003 was US$110.3 billion, an increase of US$25.6 billion over the assets reported in the 2002 survey. In addition to an increase in the value of reportable securities held, there was a significant move from investments in assets not falling within the scope of the survey (for example, market loans) to reportable securities. The weakening of the US dollar during 2003 also accounted for a large proportion of the increase. Figure 20 shows the results from Guernsey institutions over the last three years. Further details are available on the Commission's website at www.gfsc.gg

## Other developments

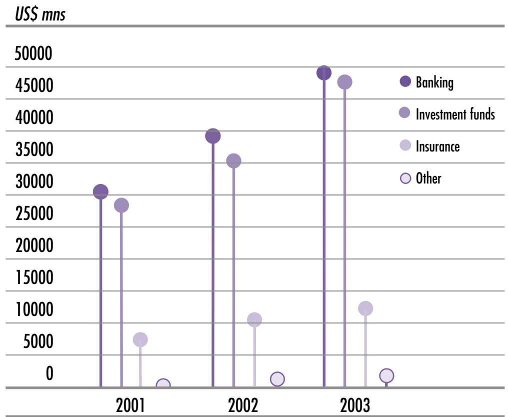
The Financial Services Commission (Bailiwick of Guernsey) (Amendment) Law, 2003 included explicit provisions under which the Commission can require regulated financial services businesses to provide information on documents to it for disclosure to another regulatory body. As part of the checks and

Table 8. **IMF Coordinated Portfolio Investment Survey 2003**
Cross-border securities* owned by institutions in the Bailiwick of Guernsey at end 2003

| *Sector* | *Equities* | *Short-term debt* | *Long-term debt* | *Total* |
|---|---|---|---|---|
| | *US$ mns* | *US$ mns* | *US$ mns* | *US$ mns* |
| Banks | 567 | 14,994 | 33,318 | 48,879 |
| Domestic insurers | 2 | – | 48 | 50 |
| Life insurers | 1,534 | 88 | 1,394 | 3,016 |
| Insurance managers and captives | 1,077 | 5,953 | 1,816 | 8,846 |
| Insurance intermediaries | – | – | – | – |
| Open and closed-ended collective investment funds | 36,211 | 1,892 | 10,459 | 48,562 |
| Special purpose vehicles | – | 15 | 257 | 272 |
| States of Guernsey | 8 | 366 | 321 | 695 |
| Total | 39,399 | 23,308 | 47,613 | 110,320 |

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

Figure 20. **IMF Coordinated Portfolio Investment Survey**
Cross-border securities by business sector at the year end

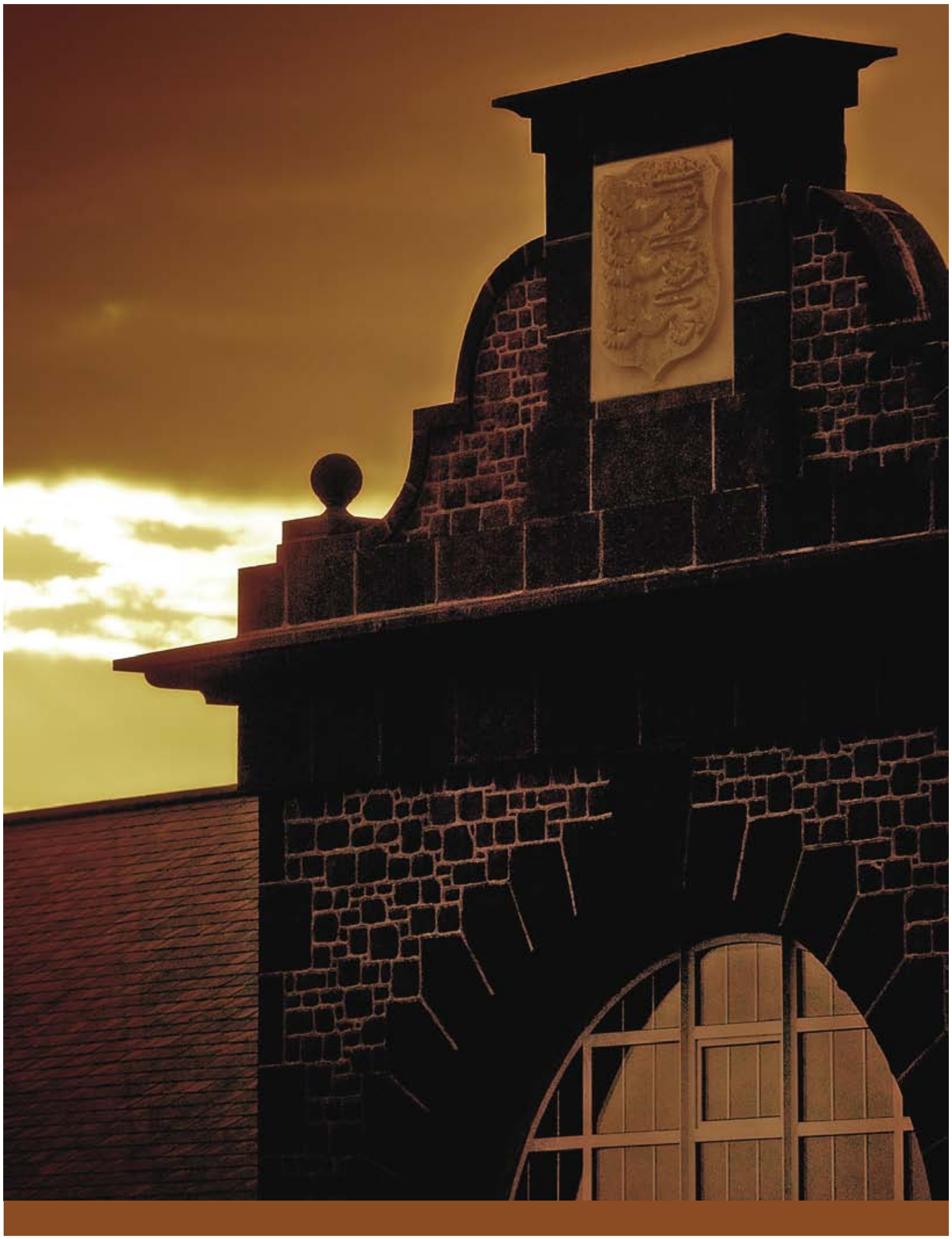



balances contained within that law, a public statement on the conduct of interviews held on behalf of foreign regulators was issued in April. This statement is available on the Commission's website.

During 2004 the Policy and International Affairs Division and the regulatory Divisions drafted guidance on corporate governance in the finance sector in response to requests from the sector to provide guidance on the Commission's expectations in this area for regulated firms. The finalised guidance was issued in December.

Changes to company law regained momentum in 2004. Following discussion with the Attorney General's Office, the Commission promoted an amendment law, including detailed administration provisions, and an increase in the maximum disqualification period for directors from five to 15 years. A consultation document was issued by the Commission to industry associations, the Company Law Reform Committee and practitioners with a particular interest in wider company insolvency issues. A States Report is expected to be submitted to the States for consideration in 2005. Following the machinery of government changes the Commerce and Employment Department has now become responsible for company law and it intends to issue a green paper on company law reform.

During 2004 a consultation paper was prepared for consideration by FIPAG on the introduction of a financial services ombudsman scheme. In addition, discussions were held with the Commerce and Employment Department on the matter. As the political body responsible for consumer protection, the decision as to how and when to proceed is one for the Department. The Department has stated that the determination of what is priority will take place after consideration of feedback on its own strategy consultation document, "Building Confidence".



# FINANCE AND OPERATIONS

## General

The Division is responsible for key support services to the Commission and is divided into four departments: finance, information and communication systems, human resources, and premises and general administration.

## Finance

The financial statements are shown on pages 49 to 57.

Fee income increased from 2003 as a result of increases in business activity across some of the Divisions, and fee-level changes for 2004. The Commission was aware of the importance to the finance industry of managing its costs in a competitive environment and took account of this when setting the fee levels for the year.

The Commission continued to incur significant legal and professional costs in respect of investigative and enforcement activity. However, a robust approach to controlling the cost base, including a reduction of headcount over the year, resulted in a reduced deficit of £77,807 for the year ended 31 December 2004.

The Commission's policy to increase reserves to a sum equivalent to six months' expenditure remains in place. This will enable absorption of unexpected or exceptional costs. However, the Commission has once again borne in mind the difficulties faced by the finance sector when setting fees for 2005 and has taken substantial steps to reduce its own costs even further in order to minimise the fee burden on licensees.

The Commission continues its close relationship with the Guernsey Training Agency. It contributed 50% of the Agency's budgeted net operating expenditure in 2004 (£378,000) and has committed to do so again in 2005 (£399,781).

## Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 October 2004, PricewaterhouseCoopers resigned on 1 November 2004 and PricewaterhouseCoopers CI LLP was appointed as its successor.

## Fee legislation

Revised fee regulations came into effect on 1 January 2005. The following regulations apply to fees payable by the finance sector in Guernsey:

The Financial Services Commission (Fees) Regulations, 2004
The Protected Cell Companies (Fees for Insurers) Regulations, 2004
The Regulation of Fiduciaries (Fees) Regulations, 2004
The Amalgamation of Companies (Fees) Regulations, 2000
The Migration of Companies (Fees) (Amendment) Regulations, 1999

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

## Information systems

Information systems remain critical to the Commission's operation and significant enhancements have been made to its central regulatory database in the year. The production of fee invoices to all licensees, with the exception of the fiduciary sector, was automated with effect from January 2005. The system will be operational for the fiduciary sector in time for the annual licence renewals that take effect from 1 July.

The website has been redesigned to make it more effective in providing information about the work of the Commission, with a more efficient search engine and a crisper look. It will be launched in the second quarter of 2005. The Commission will continue to make greater use of the website for the provision of documents which have previously only been available in paper form.

## Human resources

At the begining of 2004, the Commission's permanent headcount including vacancies was 91 but had fallen to 85 by the year end, a reduction of 7%. In addition the Commission had three contract employees throughout the year, and the Guernsey Training Agency had 13 staff seconded to it by the Commission. The Agency employs its Chief Executive directly.

2004 saw a number of staff changes. These included the departure of Talmai Morgan, Director of the Fiduciary Services and Enforcement Division, who left to head up GuernseyFinance, and the appointment of his replacement, Stephen Trevor, as Director of the renamed Fiduciary and Intelligence Services Division. Stephen was previously the Deputy Director of the Division.

Other staff movements included the promotion of an existing staff member to Deputy Director of Fiduciary and Intelligence Services and the recruitment of a new Assistant Director to the Finance and Operations Division.

The Commission is keen to support its employees with their continuing professional education and it is noteworthy that 13 staff attained relevant professional qualifications in the year, with a further 11 currently undertaking professional studies. The Commission remains committed to the development and training of its people, to ensure an enhanced contribution to the Commission's activities.

## Commissioners

In January 2005, the States re-elected John Hallam as Chairman of the Commission for one year with effect from 2 February 2005 and Mel Carvill as a Commissioner for a period of three years. In August 2004 Advocate Peter Harwood commenced his role as a Commissioner following the resignation of Advocate Nigel Carey.

## Premises

The premises at La Plaiderie Chambers and Le Marchant House have now reached capacity and it remains a long-term objective of the Commission to move to a more efficient, single location when economic conditions permit.

# INDEPENDENT AUDITORS' REPORT TO THE COMMISSIONERS OF THE GUERNSEY FINANCIAL SERVICES COMMISSION

We have audited the financial statements, which comprise the income and expenditure account, the balance sheet, the cash flow statement and the related notes.

**Statement of Commissioners' responsibilities**

The Commissioners are required by The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended to prepare financial statements for each accounting period that give a true and fair view of the state of affairs of the Commission and of the income and expenditure of the Commission for the period. In preparing these financial statements, the Commissioners are required to:

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

The Commissioners confirm that they have complied with the above requirements in preparing the financial statements.

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

**Respective responsibilities of the Commissioners and auditors**

The Commissioners are responsible for preparing the Annual Report. This includes responsibility for preparing the financial statements in accordance with applicable Guernsey law and United Kingdom accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for, and only for, the Commissioners as a body and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. We also report to you if the Commissioners have not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information as described in the contents section of this Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

**Basis of audit opinion**

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Commissioners in the preparation of the financial statements, and of whether the accounting policies

# INDEPENDENT AUDITORS' REPORT TO THE COMMISSIONERS OF THE GUERNSEY FINANCIAL SERVICES COMMISSION CONTINUED

are appropriate to the Commission's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion the financial statements give a true and fair view of the state of the Commission's affairs at 31 December 2004 and of its income and expenditure and cash flows for the year then ended in accordance with United Kingdom accounting standards and have been properly prepared in accordance with The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

PricewaterhouseCoopers CI LLP
Chartered Accountants
Guernsey, Channel Islands
24 March 2005

The maintenance and integrity of the Commission's website are the responsibility of the Commissioners; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in Guernsey governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# INCOME AND EXPENDITURE ACCOUNT
for the year ended 31 December 2004

| | Note | 2004 | 2003 |
|---|---|---|---|
| | | **£** | £ |
| **Income** | 2 | | |
| Fees receivable | | **6,635,438** | 6,191,175 |
| Contributions from the States of Guernsey for services provided on behalf of government | | **300,000** | 300,000 |
| Interest on deposits with States Treasury | | **125,503** | 103,137 |
| Other income, including bank interest | | **10,852** | 15,534 |
| | | **7,071,793** | 6,609,846 |
| **Expenses** | | | |
| Salaries, pension contributions, staff recruitment and training | | **4,926,038** | 4,402,697 |
| Commissioners' fees | | **78,000** | 73,584 |
| Legal and professional fees | | **581,608** | 476,243 |
| Premises and equipment, including depreciation | 4,9 | **740,013** | 727,987 |
| Other operating expenses | | **435,941** | 759,973 |
| Auditors' remuneration | | **10,000** | 4,650 |
| | | **6,771,600** | 6,445,134 |
| Commission's contribution to expenses of Guernsey Training Agency Limited | 8 | **378,000** | 365,000 |
| | | **7,149,600** | 6,810,134 |
| **Deficit of income over expenditure** | 2 | **(77,807)** | (200,288) |
| Balance brought forward | | **1,520,414** | 1,720,702 |
| **Balance carried forward** | | **£ 1,442,607** | £ 1,520,414 |

# STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There were no recognised gains or losses other than the deficit of income over expenditure for the financial year.

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

The notes on pages 52 to 57 form an integral part of these financial statements.

# BALANCE SHEET
as at 31 December 2004

| | Note | **2004** | 2003 |
|---|---|---|---|
| | | **£** | £ |
| **Fixed assets** | | | |
| Tangible assets | 4 | **319,011** | 412,350 |
| **Current assets** | | | |
| Debtors | 5 | **221,735** | 194,551 |
| Deposits with States Treasury | | **2,090,626** | 1,965,123 |
| Cash at bank and in hand | | **75,745** | 190,994 |
| | | **2,388,106** | 2,350,668 |
| Creditors – amounts falling due within one year | 6 | **(1,264,510)** | (1,242,604) |
| **Net current assets** | | **1,123,596** | 1,108,064 |
| **Total assets less current liabilities** | | **£1,442,607** | £ 1,520,414 |
| **Represented by:-** | | | |
| **Reserves** | | | |
| Balance brought forward on income and expenditure account | | **1,520,414** | 1,720,702 |
| Deficit of income over expenditure for the year | | **(77,807)** | (200,288) |
| **Balance carried forward on income and expenditure account** | | **£1,442,607** | £ 1,520,414 |

The financial statements on pages 49 to 57 were approved by the Commissioners and signed on their behalf on 24 March 2005 by:

| J E Hallam | L W Priestley | P J Neville |
|---|---|---|
| *Chairman* | *Vice-Chairman* | *Director General* |

The notes on pages 52 to 57 form an integral part of these financial statements.

# CASH FLOW STATEMENT
for the year ended 31 December 2004

| | Note | 2004 | 2003 |
|---|---|---|---|
| | | **£** | £ |
| **Reconciliation of deficit of income over expenditure to net cash outflow from operating activities** | | | |
| Deficit of income over expenditure | | **(77,807)** | (200,288) |
| Depreciation on tangible fixed assets | 4 | **193,801** | 197,166 |
| Interest receivable | | **(135,590)** | (118,671) |
| Increase in debtors | | **(27,184)** | (134,336) |
| Increase in creditors | | **21,906** | 208,832 |
| Net cash outflow from operating activities | | **£(24,874)** | £(47,297) |
| **Cash flow statement** | | | |
| Net cash outflow from operating activities | | **(24,874)** | (47,297) |
| Returns on investments and servicing of finance | 14 | **135,590** | 118,671 |
| Capital expenditure and financial investment | 4,14 | **(100,462)** | (286,339) |
| Increase/(decrease) in cash in the year | | **£10,254** | £(214,965) |
| **Reconciliation of net cash flow to movements in net cash** | | | |
| Increase/(decrease) in cash in the year | | **10,254** | (214,965) |
| Net cash at 1 January 2004 | 15 | **2,156,117** | 2,371,082 |
| Net cash at 31 December 2004 | 15 | **£2,166,371** | £2,156,117 |

The notes on pages 52 to 57 form an integral part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS
as at 31 December 2004

**1. Accounting policies**

**(a) Convention**

These financial statements have been prepared in accordance with the historical cost convention and under applicable accounting standards in the United Kingdom. The principal accounting policies which the Commissioners have adopted within that convention are set out below.

**(b) Fees receivable**

Fees receivable are recorded when they are invoiced and are recognised in the income and expenditure account on an accruals basis.

**(c) Interest**

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

**(d) Investigations and litigation**

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

**(e) Tangible fixed assets and depreciation**

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

| | |
|---|---|
| Leasehold improvements | over the shorter of the term of the lease and the estimated useful economic life of the assets |
| Office equipment and fittings | 25% straight-line |
| Computer equipment | $33\frac{1}{3}$% straight-line |

**(f) Foreign currency translation**

Assets and liabilities denominated in currencies other than sterling have been translated into sterling at the rates of exchange ruling at the balance sheet date. Transactions during the year have been translated at the rates of exchange ruling at the date of the transaction.

**(g) Leases**

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

**(h) Pension costs**

The costs of the defined benefit pension scheme are charged to the income and expenditure account over the period during which the Commission benefits from the employees' services. Surpluses or deficiencies are spread over the expected average remaining working lifetime of employees in proportion to their expected payroll costs.

**2. Income and deficit of income over expenditure**

Income and deficit of income over expenditure derive wholly from continuing activities.

**3. Taxation**

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

**4. Tangible assets**

| | Leasehold Improvements | Office Equipment and Fittings | Computer Equipment | Total |
|---|---|---|---|---|
| | £ | £ | £ | £ |
| **Cost** | | | | |
| At 1 January 2004 | 48,567 | 673,005 | 527,943 | 1,249,515 |
| Additions | 30,160 | 12,226 | 58,076 | 100,462 |
| At 31 December 2004 | 78,727 | 685,231 | 586,019 | 1,349,977 |
| **Depreciation** | | | | |
| At 1 January 2004 | 20,745 | 465,389 | 351,031 | 837,165 |
| Charge for the year | 5,041 | 84,212 | 104,548 | 193,801 |
| At 31 December 2004 | 25,786 | 549,601 | 455,579 | 1,030,966 |
| Net book value at 31 December 2003 | £ 27,822 | £ 207,616 | £ 176,912 | £ 412,350 |
| Net book value at 31 December 2004 | £ 52,941 | £ 135,630 | £ 130,440 | £ 319,011 |

**5. Debtors**

| | **2004** | 2003 |
|---|---|---|
| | **£** | £ |
| Fees receivable due but not paid | **43,473** | 27,006 |
| Other debtors | **14,962** | 14,995 |
| Amount due from Guernsey Training Agency Limited | **34,277** | 28,805 |
| Prepayments | **129,023** | 123,745 |
| | **£ 221,735** | £ 194,551 |

**6. Creditors – amounts falling due within one year**

| | **2004** | 2003 |
|---|---|---|
| | **£** | £ |
| Expense creditors and accruals | **658,105** | 568,003 |
| Fees received in advance | **606,405** | 674,601 |
| | **£ 1,264,510** | £ 1,242,604 |

**7. Superannuation**

**FRS17 Disclosure for the Guernsey Financial Services Commission Actuarial Account of the States of Guernsey Superannuation Fund**

Employees of the Commission are eligible to be members of the States of Guernsey Superannuation Fund ("the Fund"). This is a defined benefits pension scheme funded by contributions from both the member and the employer. The employer contributions are determined on the basis of independent actuarial advice and are calculated to spread the expected cost of benefits payable to members over the period of those members' expected service lives.

A full actuarial valuation of the Fund was carried out at 31 December 2001 and updated to 31 December 2004 by a qualified independent actuary. The comparative figures for 31 December 2003 are based on approximate data and should be viewed as estimates only.

A separate Actuarial Account comprising the assets and liabilities of the Fund attributable to the Commission's

**7. Superannuation** continued

members ("the scheme") has been established with effect from 1 January 2004 within the Fund following an instruction from the former 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 set of members by another.

The Commission recognises that its financial statements should satisfy the requirements of Financial Reporting Standard 17 ("FRS 17") on Retirement Benefits, and sets out below the disclosures required under the transitional rules.

It should be noted that the assets and liabilities have only been ringfenced since 1 January 2004. Accordingly, it is not possible to produce all the information for the 3 years (as at 31st December 2004, 2003 and 2002) required by the standard.

**a) The major assumptions used by the actuary were:-**

| | **At 31 December 2004** | At 31 December 2003 |
|---|---|---|
| Rate of increase in salaries | **4.40%** | 4.30% |
| Rate of increase in pensions in payment | **3.00%** | 2.90% |
| Discount rate | **5.30%** | 5.40% |
| Inflation assumption | **2.90%** | 2.80% |

**b) The assets in the scheme and the expected rate of return were:-**

| | **Long-term rate of return expected at 31 December 2004** | **Value at 31 December 2004 £** | Long-term rate of return expected at 31 December 2003 | Value at 31 December 2003 £ |
|---|---|---|---|---|
| Equities | **7.50%** | **4,281,057** | 7.75% | 3,569,317 |
| Bonds | **4.70%** | **1,141,787** | 4.90% | 1,017,004 |
| Cash | **4.75%** | **161,327** | 3.75% | 75,150 |
| Total market value of assets | | **5,584,171** | | 4,661,471 |
| Present value of scheme liabilities | | **(5,610,146)** | | (4,186,233) |
| (Deficit)/surplus in the scheme | | **(25,975)** | | 475,238 |
| Related deferred tax liability | | **–** | | – |
| Net pension (liability)/asset | | **£(25,975)** | | £475,238 |

The asset and liability values on the FRS 17 basis reflect market conditions at the Commission's year-end date and can be expected to vary greatly from year to year, without prejudicing the scheme's long-term ability to provide the required benefits.

**7. Superannuation** continued

**c) Balance sheet presentation**

| | 31 December 2004 £ | 31 December 2003 £ |
|---|---|---|
| Net assets excluding pension (liability)/asset | **1,442,607** | 1,520,414 |
| Net pension (liability)/asset | **(25,975)** | 475,238 |
| Net assets including pension (liability)/asset | **£1,416,632** | £1,995,652 |

**d) Reserves note**

| | 31 December 2004 £ | 31 December 2003 £ |
|---|---|---|
| Income and expenditure account reserve excluding pension (liability)/asset | **1,442,607** | 1,520,414 |
| Pension reserve | **(25,975)** | 475,238 |
| Income and Expenditure reserve including pension liability)/asset | **£1,416,632** | £1,995,652 |

**e) Analysis of the amount charged to income and expenditure account**

| | 2004 £ |
|---|---|
| Current service cost | **521,541** |
| Past service cost | **–** |
| Total operating charge | **£521,541** |

**f) Analysis of the amount charged to other finance costs**

| | 2004 £ |
|---|---|
| Expected return on pension scheme assets | **(349,002)** |
| Interest on pension scheme liabilities | **222,362** |
| Net return | **£(126,640)** |

**g) Analysis of amount that would be recognised in statement of total recognised gains and losses ("STRGL")**

| | 2004 £ | 2003 £ |
|---|---|---|
| Actual return less expected return on pension scheme assets | **65,610** | n/a |
| Experience gains and losses arising on the scheme liabilities | **(307,859)** | n/a |
| Changes in assumptions underlying the present value of the scheme liabilities | **(237,578)** | n/a |
| Actuarial gain/(loss) that would be recognised in STRGL | **£(479,827)** | n/a |

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

**7. Superannuation** continued

**h) Movement in surplus during the year**

| | **2004** | 2003 |
|---|---|---|
| | **£** | £ |
| Surplus in scheme at beginning of the year | **475,238** | n/a |
| Movement in year:- | | |
| Current service costs | **(521,541)** | n/a |
| Contributions | **373,515** | n/a |
| Past service costs | **–** | n/a |
| Other finance income | **126,640** | n/a |
| Actuarial gain/(loss) | **(479,827)** | n/a |
| (Deficit)/surplus in scheme at end of the year | **£(25,975)** | n/a |

Following the actuarial valuation of the Fund as at 31 December 2001 and the establishment of the Actuarial Account for the Commission, it was agreed that the employer contribution rate to the Actuarial Account would be 7.25% of members' salaries with effect from 1 January 2002, increasing to 10.4% of members' salaries with effect from 1 January 2004. The employee contribution remains unchanged at 6%.

**i) History of experience gains and losses**

| | **2004** | 2003 |
|---|---|---|
| **Difference between the actual and expected return on scheme assets:-** | | |
| Amount | **£65,610** | n/a |
| Percentage of scheme assets | **1%** | n/a |
| **Experience gains and losses on scheme liabilities:-** | | |
| Amount | **£(307,859)** | n/a |
| Percentage of the present value of the scheme liabilities | **(5%)** | n/a |
| **Total amount recognised in statement of total recognised gains and losses:-** | | |
| Amount | **£(479,827)** | n/a |
| Percentage of the present value of the scheme liabilities | **(9%)** | n/a |

The claims of the Commission's pensioners and employees will be met from the Fund and in the final resort would be met by the States of Guernsey.

**8. Guernsey Training Agency Limited**

Guernsey Training Agency Limited arranges training for the finance industry and for other industry sectors. The company's staff, excluding its Chief Executive, are employed by the Commission and permanently seconded to the company. The Commission provided a grant of £378,000 in 2004 to the company in order to meet 50% of its budgeted net operating expenditure, the same amount being provided by the States of Guernsey via the Commerce and Employment Department.

**9. Financial commitments**

The Commission leases office accommodation at La Plaiderie Chambers and Le Marchant House. The lease for La Plaiderie Chambers expires on 25 March 2020 and the underlease for Le Marchant House on 10 December 2011. The rentals payable in 2004 under the terms of the leases amount to £290,954 (2003: £285,697).

**Operating lease commitments**

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

**9. Financial commitments** continued

| **Land and buildings** | 2005 | 2004 |
|---|---|---|
| Lease which expires more than five years after balance sheet date | £296,497 | £290,954 |

**10. Investigation and litigation costs**

As a consequence of fulfilling its regulatory responsibilities the Commission undertakes investigations and is a party to legal actions from time to time, the costs of which may be significant. No provision has been made in the financial statements for any future costs in respect of current investigations or legal actions because the nature, complexity and duration of such actions remain uncertain. In a few cases, some or all of the Commission's investigation and legal costs may be recoverable although not necessarily in the same financial year as the expenditure is incurred. In such cases the recovery is recognised when received.

**11. Contingent liability**

On 22 December 2004, the Commission became a member of Fund Distribution Limited ("FDL"), a company limited by guarantee. The Commission has undertaken to contribute an amount not exceeding £5 to the assets of FDL in the event that FDL is wound up while the Commission is a member of the company, or within one year of the Commission ceasing to be a member, and FDL's assets are insufficient to meet its liabilities.

FDL was formed to administer a fund established to pay compensation in respect of zero dividend preference shares issued by certain split-capital investment trusts. The Director of Investment Business has been appointed to the board of Directors of FDL.

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**12. Related-party transactions**

The States appointed Peter Harwood, who is a partner of Ozannes, as a Commissioner in August 2004. During the year the Commission engaged Ozannes to provide certain legal and professional services. These were contracted on an arms-length basis and are not considered to be significant in the context of the business of the parties.

**13. Controlling party**

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

| **14. Notes to the cash flow statement** | **2004** | 2003 |
|---|---|---|
| | **£** | £ |
| **Returns on investments and servicing of finance** | | |
| Interest received | **135,590** | 118,671 |
| **Capital expenditure and financial investment** | | |
| Payments to acquire tangible fixed assets | **(100,462)** | (286,339) |

**15. Analysis of net cash**

| | **At 1 January 2004** | **Cash Flow** | **At 31 December 2004** |
|---|---|---|---|
| | **£** | **£** | **£** |
| Deposits with States Treasury | **1,965,123** | **125,503** | **2,090,626** |
| Cash at bank and in hand | **190,994** | **(115,249)** | **75,745** |
| | **£ 2,156,117** | **£ 10,254** | **£ 2,166,371** |


BRASSERIE
RESTAURANT

# GUERNSEY TRAINING AGENCY LIMITED

## General

The Guernsey Training Agency Limited is owned by a charitable trust with the protectors of the trust being the Commission and the Chief Minister of the Policy Council. The Director General of the Commission is one of the four trustees. The Agency continues to be funded jointly on an equal basis by the Commission and the States Commerce and Employment Department.

The long-term objective of the Agency is to engender a training and development culture within all organisations throughout the Bailiwick, and procure and facilitate high-quality training and development programmes in all business sectors. The culture is expected to generate a highly qualified, knowledge-based workforce enabling all organisations to compete in a global marketplace, and to broaden the Bailiwick's skills base whilst adding value to all Bailiwick businesses. The Agency's work covers all sectors of the Bailiwick's economy – only those initiatives pertinent to the finance sector are outlined below. During 2004 the Agency has once again proved to be very successful in facilitating high-quality training and development initiatives for the Bailiwick workforce.

In March 2004 the States considered and adopted a States Report which set out proposals on the future of the Agency. The recommendations adopted included provisions for the development of a training policy for the Bailiwick and a three-yearly external review of the work of the Agency. The States approval of the States Report should be viewed as a seminal moment in the Agency's development. The Agency is now accepted as an established part of the Bailiwick's education and training infrastructure.

The Agency engaged in a major exercise with the Guernsey International Business Association and other local finance associations, professional institutes and the Commission to identify an appropriate education/qualifications regime and the mapping of the regime to create a matrix for each of the four sectors of the finance industry. In most cases the Agency took responsibility for creating the training matrices and, working with each of the professional associations, created a final draft which has been adopted by the association's membership. In support of the training matrices, the Agency secured the commitment of the associations, the Commission and the professional institutions to the creation of three fora along the same lines as the well-established Insurance Forum. These fora act as a catalyst for providing strategic direction for the development of finance education and training within the Bailiwick. The Agency attends the meetings and acts as a secretariat.

A Senior Management Forum was established during 2003 in order to ensure that the strategic relationship between the Guernsey College of Further Education and the Agency was developed and sustained. The members of the forum are the Principal and Vice-Principal of the College and the Chief Executive and the Deputy Chief Executive of the Agency. This forum meets monthly.

An extensive education and training programme took place throughout the year and the Study Centre continued to act as a focal point for education and training within St Peter Port. Staff at the Agency worked closely with all the stakeholders in determining training priorities and meeting their requirements.

At the end of 2004 the Agency had 951 registered students, who made 2,731 study visits to the centre. Over 320 training events took place, attracting 4,695 delegates. Additionally, 236 examinations took place, during which 874 candidates were examined on a range of award-bearing programmes (table 9).

Table 9. **Training event/delegate numbers at the year end**

| *Key statistics* | *2000* | *2001* | *2002* | *2003* | *2004* |
|---|---|---|---|---|---|
| Registered number of students | 614 | 715 | 818 | 887 | 951 |
| Recorded number of study sessions | 2423 | 2731 | 1971 | 2341 | 2731 |
| Number of training events | 270 | 254 | 295 | 322 | 321 |
| Number of delegates attending | 2221 | 2549 | 2811 | 4463 | 4695 |
| Number of examination days | 50 | 53 | 69 | 92 | 113 |
| Number of examinations | 144 | 140 | 158 | 194 | 236 |
| Number of examination candidates | 602 | 599 | 686 | 793 | 874 |

## Award-bearing programmes

The two new Masters programmes which commenced in 2003, the MSc in e-Commerce and the MBA, both continue to progress satisfactorily, with all students successfully completing year one of the respective programmes.

A new postgraduate programme, the MA in Strategic Human Resource Management, offered through the University of East London, was commenced. This one-year programme provides the Masters top-up to the Postgraduate Diploma in Personnel Management.

The third cohort of the two-year Postgraduate Diploma in Personnel Management through the University of Portsmouth entered its final year with 10 delegates. It is planned that a fourth cohort will be offered in 2005. Twenty-three delegates have qualified since this programme began.

The fourth cohort of the two-year MSc Corporate Governance/Grad ICSA with 12 delegates finished in June. Following the dissertation stage it is expected that the students will graduate early in 2005. Some 50 people have graduated since the commencement of this programme.

The prestigious Institute of Directors Company Direction Programme commenced in October with 12 delegates; this is the fifth time the programme has been offered in Guernsey.

Central Law Training once again delivered the Foundation and Diploma programmes in Offshore Trust Management on behalf of STEP. Thirty-four students completed the Foundation programme with a further 34 students completing the Diploma programme. Forty-three students completed the Company and Practice Law module.

The International Compliance Association was established during 2002, offering diplomas in anti-money laundering and compliance. In 2004, 21 students undertook the Diploma in Compliance and eight took the Diploma in Anti-Money Laundering Reporting and Prevention.

Thirty-three students embarked on Chartered Institute of Marketing programmes and 32 students successfully completed the Certificate, the Advanced Certificate or the Diploma programmes.

Ten students commenced the Certificate in Training Practice programme, leading to Associate Membership of the Chartered Institute of Personnel and Development.

During 2004 some 21 students undertook the Introductory Certificate in Team Leading, a three-day programme delivered by the staff from the Guernsey Business School. A further seven students enrolled for the Introductory Certificate in First Line Management.

In conjunction with BPP Professional Education the Agency offered the AFPC (Advanced Financial Planning Certificate) for the first time, attracting four students.

Twenty-four students have successfully completed the Captive Insurance Certificate since the introduction of this qualification. Following representations from the Agency, this locally designed programme has been awarded 20 points towards the diploma in the Chartered Insurance Institute qualifications framework.

Twenty-five students successfully completed the locally examined Guernsey Insurance Certificate qualification during 2004. Once again, following representations from the Agency, this programme has been awarded 16 points under the Chartered Insurance Institute qualifications framework.

## Short courses and conferences

Working with the GFMA, 145 delegates attended a seminar on anti-money laundering for the funds sector. Over 150 delegates attended prevention of financial crime seminars which were facilitated on behalf of the Commission, the FIS and the Guernsey Police Commercial Fraud and External Affairs

Department (see page 39). Five hundred and twenty delegates have attended short courses pertaining to the finance sector, covering topics such as company law, designing an internal compliance framework and anti-money laundering.

An introduction to the financial services sector was held in October for new recruits to the industry. Additionally an introductory day on the finance industry was run for sixth-formers from local schools.

Over 30 lunchtime seminars and short courses for managers covering subjects such as leadership and motivation, presentation skills and personal development were held during 2004, with 298 delegates attending in total.

Back-office training, which was developed in conjunction with the GFMA following a recommendation from the Commission, attracted 23 delegates.

**Investors in People**

The Agency continues to manage the Investors in People ("IIP") project on behalf of the Commerce and Employment Department. It is pleasing to note that four new organisations achieved recognition during 2004. An introductory session was held by the Agency on the IIP standard, with 14 organisations represented.

**Other initiatives**

The Chief Executive and Deputy Chief Executive continued to meet with senior staff from the finance sectors to hear first-hand the training needs of organisations. The meetings continue to prove most informative and valuable.

Working with the Commerce and Employment Department, the Agency is facilitating a series of seminars on intellectual property; 73 delegates attended the two seminars held in 2004. It is planned that an intellectual property conference will be held in May 2005.

A further three personal development programmes commenced during 2004 with 35 delegates. In conjunction with the Learning Company a management development programme was introduced, attracting 12 delegates.

The Agency is assisting the Law Officers of the Crown with the administration of the Guernsey Bar examinations. In conjunction with the Guernsey Bar a continuing professional development ("CPD") programme for the Guernsey legal profession has been established. Over 80 delegates attended the first two seminars and the Agency has been asked to facilitate a number of similar events.

In conjunction with the local branch of the Institute of Financial Services ("IFS"), the Agency carried out a training needs analysis of members to help determine the CPD requirements as well as the likely demand for IFS qualifications. Based on feedback, a seminar programme has been developed, with the first two seminars attracting 90 delegates.

**e-Business and information technology**

The Agency is particularly pleased with the growth in information technology ("IT") training that it has facilitated during 2004.

Over 400 delegates have attended seminars and short-course programmes covering topics such as network security, IT service management, and operational excellence. The IT conference held in June proved popular, attracting 60 delegates.

The Agency has continued to work closely with the British Computer Society ("BCS") and is represented on the committee of the Guernsey sub-branch. The Agency jointly badged a number of BCS seminars during 2004.

# APPENDIX 1
# FUNCTIONS AND STRUCTURE 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 development and effective supervision of finance business in the Bailiwick". The statutory functions include those under the following laws:-

> the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended;
>
> the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended;
>
> the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 as amended;
>
> the Insurance Business (Bailiwick of Guernsey) Law, 2002 as amended;
>
> the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 as amended;
>
> section 3 of the Road Traffic (Compulsory Third Party Insurance) (Guernsey) Laws, 1936 to 1989;
>
> section 1 of the Surf-Riding Long Boards (Compulsory Third-Party Insurance) Law, 1969; and
>
> section 1 of the Vessels and Speed Boats (Compulsory Third-Party Insurance, Mooring Charges and Removal of Boats) (Guernsey) Law, 1972.

Following a review of the machinery of government, in May 2003 the States approved proposals for the establishment of a new and more streamlined government structure. These proposals took effect from the beginning of May 2004. They included the creation of a new position of Chief Minister, heading a Policy Council, and a reduction in the number of committees/departments responsible for the day-to-day functions of government. The Policy Council is responsible for international financial matters and for establishing the policy framework for financial regulation, including the government's relationship with, and reporting lines for, the Commission. As part of these changes the Commission Law was amended to state that the Commission shall issue its audited financial statements and the two reports referred to later in this appendix to the Policy Council. References to the Advisory and Finance Committee in the laws administered by the Commission have been amended in favour of the Policy Council. The Policy Council is also responsible for the administration of the Control of Borrowing Ordinances. Individual officials of the Commission act for the Policy Council in matters requiring consent under the Ordinances.

The new Commerce and Employment Department, rather than the Policy Council, is responsible for overseeing company, trust and limited partnership law. Commission officials act for the Department in matters requiring action by the Commission under certain sections of the Companies (Guernsey) Law, 1994.

The Commission Law provides that the Commission shall consist of five members (Commissioners) elected by the States of Guernsey from persons nominated by the Policy Council and appearing to it to be persons having knowledge, qualifications or experience appropriate to the development and supervision of finance business in the Bailiwick. The Chairman is appointed from amongst the Commissioners and is elected by the States following nomination by the Policy Council. The Vice-Chairman is appointed by the Commissioners.

There were 14 meetings of the Commissioners in 2004. The attendance of the individual Commissioners at these meetings was as follows:- John Hallam – 13, Leslie Priestley – 13, Nigel Carey (resigned August 2004) – 7, Mel Carvill – 12, Peter Harwood (appointed August 2004) – 6, David Mallett – 13.

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 Director General.

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

- the power of the Commissioners to delegate functions;
- the Commissioners' duty to make an annual report on the Commission's activities during the previous year to the Policy Council;
- any statutory functions which:-

  (i) require the Commissioners to consider representations concerning a decision which they propose to take; or

  (ii) empower the Commission to cancel, revoke, suspend or withdraw a licence, consent, registration, permission or authorisation (except where the cancellation, revocation, suspension or withdrawal is done with the consent of the person who is, or who is acting on behalf of, the holder of the licence, consent, registration, permission or authorisation); or

  (iii) empower the Commission to petition for the winding-up of a body corporate.

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

The Commission Law also provides that the Commission shall:-

(a) keep proper accounts and proper records in relation to those accounts; and
(b) prepare in respect of each year a statement of accounts giving a true and fair view of the state of affairs of the Commission;

and that the accounts of the Commission shall be:-

(a) audited by auditors appointed by the States; and
(b) laid before the States.

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

By virtue of a change to the Commission Law in 2002, the Commission must review in each year, by the appointment of appropriately qualified and independent professional persons or otherwise:-

(a) the adequacy and application of the Commission's systems of internal control;
(b) the selection and application of the Commission's accounting policies and accounting procedures;
(c) the effective, efficient and economical management of the Commission's assets and resources; and
(d) the Commission's compliance with such generally accepted principles of good corporate governance as it is reasonable to regard as being applicable to the Commission.

The Commissioners are required to satisfy themselves in connection with the conclusions of each review and provide the Policy Council with a separate annual report on the matters covered by it. The report for 2004 has been provided to the Policy Council.

The Commission's Audit and Risk Committee covers oversight of the management of risk. The committee comprises Leslie Priestley (who is the committee's Chairman), Mel Carvill and David Mallett. Meetings are usually attended by the Director General, the Head of Finance and Operations and the Deputy Director (Policy and International Affairs) (who is the committee's secretary). The committee met six times in 2004.

Rather than appoint its own internal auditor to monitor the Commission's non-regulatory internal audit and corporate governance standards, the Commission has retained specialist external consultants to ensure that the Commission is up-to-date with current expectations. The Commission is satisfied that it meets expectations in these areas. A programme of assessment against international regulatory standards has also been put in place and is undertaken by the Commission's officers.

# APPENDIX 2
# COMMITTEES AND WORKING PARTIES

The following advisory groups and committees have assisted the Commission with its work. Only current outside members are listed.

**Company Law Reform Committee**

| | |
|---|---|
| Adv. Ian Kirk | Guernsey Branch of the Institute of Directors |
| John Loveless | SG Hambros Trust Company (Guernsey) Ltd |
| Adv. William Simpson | Guernsey Bar |
| Adv. Diana Thompson | Channel Islands Stock Exchange LBG |
| Mark Thompson | Guernsey Society of Chartered and Certified Accountants |

**Forum for Insurance Development**

| | |
|---|---|
| Mark Colton | Channel Islands Actuarial Society |
| John Copeland | Marsh Management Services Guernsey Ltd |
| Paul Cutter | Guernsey Association of Pension Funds |
| Stephen Jones | Financial Industry Policy Advisory Group |
| Chris Le Conte | Insurance Institute of Guernsey |
| Alex Lindsay | Association of Guernsey Insurance Brokers |
| Tony Mancini | PricewaterhouseCoopers |
| Kevin Rye | Guernsey Insurance Company Management Association |
| Peter Walpole | Insurance Corporation of the Channel Islands Ltd |
| Adv. Jeremy Wessels | Ozannes |
| Dominic Wheatley | Willis Management (Guernsey) Ltd |
| Nick Wild | JLT Risk Solutions (Guernsey) Ltd |

**Joint Money Laundering Steering Group**

| | |
|---|---|
| Antonia Bligh | Financial Intelligence Service |
| Adv. Paul Christopher | Guernsey Bar |
| Keith Corbin | Guernsey Association of Trustees |
| Richard Falla | Guernsey Insurance Company Management Association |
| Robin Fuller | Guernsey Investment Fund Association |
| Steve Le Page | Guernsey Society of Chartered and Certified Accountants |
| Shane Le Prevost | Association of Guernsey Resident Stock Brokers |
| Robert Moore | Guernsey International Business Association *and* Association of Guernsey Banks |
| Julian Parker | Guernsey Association of Compliance Officers |
| Ian Robinson | International Life Offices |
| Chris Schofield | Association of Guernsey Insurance Brokers |
| Peter Symes | Association of Guernsey Banks |
| Sue Thornhill | MHA Consulting |

*The Director General of the Commission and his colleagues take this opportunity of acknowledging the contribution made by the members of these groups and of thanking them for their support and assistance.*

APPENDIX 3
GUIDANCE ON APPLICATIONS IN RESPECT OF QUALIFYING INVESTOR FUNDS

The purpose of this appendix is to provide guidance in respect of relevant issues relating to Qualifying Investor Funds, due diligence issues that need to be considered by Guernsey licensed service providers to such funds and the information required to be submitted to the Commission in support of an application.

Any questions in relation to this guidance, including those in respect of the Commission's regulatory approach to Qualifying Investor Funds and the responsibilities of Guernsey licensed service providers in their operation of such funds should be referred in the first instance to the Applications Team within the Investment Business Division of the Commission.

## Background

### Qualifying Investor Funds and Qualified Investors

1. A Qualifying Investor Fund is either an open-ended collective investment scheme, authorised under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended or a closed-ended investment fund for which consent has been granted under the Control of Borrowing (Bailiwick of Guernsey) Ordinances, 1959 as amended.

2. Only Qualified Investors (as defined below) will be permitted to invest in a Qualifying Investor Fund.

3. A Qualified Investor is deemed able:

   (a) to evaluate the risks and strategy of investing in a Qualifying Investor Fund; and

   (b) to bear the economic consequences of investment in the Qualifying Investor Fund, including the possibility of any loss arising from the investment.

4. Qualified Investor means: a Professional Investor; an Experienced Investor, and/or a Knowledgeable Employee, as defined below.

   (a) A Professional Investor is:

      (i) a government, local authority, public authority or supra-national body (in the Bailiwick or elsewhere); or

      (ii) a person, partnership or other unincorporated association or body corporate (whether incorporated, listed or regulated in an Organisation for Economic Co-operation and Development ("OECD") country or otherwise) whose ordinary business or professional activity includes or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments whether as principal or agent, or the giving of advice on investments; or

      (iii) an affiliate of the Qualifying Investor Fund or an associate of an affiliate of the Qualifying Investor Fund. (The terms "affiliate" and "associate of an affiliate" are intended to refer to financial services businesses or financial services professionals associated, directly or indirectly, with the operation of the fund in question.)

   (b) An Experienced Investor is:

      a person, partnership, or other unincorporated association or body corporate which has in any period of 12 months (whether on his own behalf or in the course of his employment by another person) so frequently entered into transactions of a particular type in connection with:

      (i) open-ended collective investment schemes and/or

      (ii) general securities and derivatives as defined in Schedule 1 of the Protection of Investors Law. (In summary, that definition includes equities, bonds, participations in closed-ended investment vehicles, warrants, options, futures, contracts for differences and rights on any of those investments)

      being transactions of substantial size entered into with, or through the agency of, reputable persons who carry on investment business, that he can reasonably be expected to understand the nature of, and the risks involved in, transactions of that description; or who provides a certificate from an appropriately qualified investment advisor confirming that the investor has obtained independent advice.

   (c) A Knowledgeable Employee is:

      (i) a person who is (or has been within a period of three years up to the date of application for investment in the Qualifying Investor Fund) an employee, director, general partner, consultant or shareholder of, or to, an affiliate appointed by the Qualifying Investor Fund to advise, manage or administer the investment activities of the Qualifying Investor Fund, who is acquiring an investment in the Qualifying Investor Fund as part of his remuneration or an incentive arrangement or by way of co-investment, either directly or indirectly through a personal investment vehicle, such as a trust, for or substantially for, that person; or

(ii) any employee, director, partner or consultant to or of any person referred to at 4(a)(ii) above or anyone who has fulfilled such a role in respect of any person referred to at 4(a)(ii) above within a period of three years up to the date of application for investment in the Qualifying Investor Fund. The term "employee" would only cover persons who are, or have been, employed in a relevant role and would not extend to clerical, secretarial or administrative roles.

5. Funds, which are approved as Qualifying Investor Funds, must have in place measures to ensure that they are only available to investors who fall within the above definitions. The Commission would expect any warranties provided by potential investors to confirm what type of Qualified Investor they consider themselves to be, that is, whether they are a Professional Investor, an Experienced Investor, and/or a Knowledgeable Employee.

   Commission staff will assess licensees' systems and controls in this respect as part of their post-facto monitoring of licensees.

6. The Commission does not wish to prescribe the exact requirements relating to the contents of warranties to be obtained from potential investors into Qualifying Investor Funds or the form of disclaimers that will be disclosed within the scheme particulars, offering document (or equivalent) of such a fund. However, the Commission does consider that, as a minimum, the following issues should be referred to in any such warranty or disclaimer relating to a Qualifying Investor Fund:

   (a) An acknowledgement that the fund has been established in Guernsey as a Qualifying Investor Fund and is only suitable for those investors who satisfy the definition of a Qualified Investor as published by the Guernsey Financial Services Commission as being a Professional Investor or an Experienced Investor or a Knowledgeable Employee.

   (b) A representation that the potential investor satisfies the definition of a Qualified Investor and that they will not acquire an interest in the fund for the benefit of any person who is not a Qualified Investor.

   (c) An acknowledgement that the potential investor has read and understood the fund's scheme particulars, offering document or equivalent including the risk warnings disclosed.

   (d) An acknowledgement that investing in the subject fund may involve special risks that could lead to a loss of all or a substantial portion of any investment that the potential investor makes in the fund.

## Guidance

### The Structure of the Fund

The Fund

1. A Qualifying Investor Fund is either an open-ended collective investment scheme, authorised under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended or a closed-ended investment fund for which consent has been granted under the Control of Borrowing (Bailiwick of Guernsey) Ordinances, 1959 as amended.

2. A Qualifying Investor Fund that is an open-ended collective investment scheme must comply with the requirements of the appropriate rules, that is the Collective Investment Schemes (Class A) Rules 2002, the Collective Investment Schemes (Class B) Rules 1990 or the Collective Investment Schemes (Qualifying Professional Investor Funds)(Class Q) Rules 1998.

3. Requests for modifications of the relevant rules must be made in writing to the Investment Business Division of the Commission in accordance with the relevant provisions of the appropriate rules. Such requests should be made at least three working days in advance of the submission of the formal application for the authorisation/consent of the fund.

The Promoter and/or Investment Manager

4. The promoter and/or investment manager should be an institution that is regulated and in good standing, or, if conducting activities which do not require regulation, otherwise in good standing.

5. Good standing would imply that the institution itself, its directors, controllers and senior managers, had not during the past five years been the subject of material disciplinary action by a regulator or professional body, or subject to any conviction for fraud, dishonesty or related offences of a financial nature.

6. The Guernsey licensed service provider associated with the application for authorisation under the Protection of Investors Law or consent under the Control of Borrowing Ordinances must certify to the Commission that they have performed sufficient due diligence to be satisfied that the promoter and/or investment manager are fit and proper. In that regard, such

service providers should take account of the issues referred to at 11(a), (b) and (c) below and should document their findings and conclusions accordingly.

7. For the avoidance of doubt, applications on behalf of newly formed promoters and/or investment managers will be considered. The Guernsey licensed service provider who is seeking the fund's authorisation or consent will need to consider the track record and experience of the controllers, directors and management of such entities, taking into account their previous employment history. Such previous employment history should demonstrate that the individuals possess relevant experience in relation to managing or advising on investors' funds using similar investment strategies to those that will be adopted by the Qualifying Investor Fund. The licensed service provider's consideration of these matters and conclusions arising should be documented.

8. Where applicants are aware of issues in relation to a promoter and/or investment manager (which term should be taken to include their controllers, directors and management) and associated parties, but are uncertain of their materiality or possible impact on the subject application, they should consult Commission staff prior to submitting the formal application at the time they become aware of the issue.

9. Commission staff will assess licensees' application due diligence as part of their post-facto monitoring of licensees. If the Commission were to find that warranties provided were defective, or misleading, the Commission would take action against the licensee and in appropriate cases would exclude that licensee from future participation in the self-certification programme.

10. The Commission expects each licensee to ensure that its due diligence in respect of the promoter and/or investment manager and associated parties is updated on a regular basis. The Commission will not prescribe the means by which this requirement is to be achieved but, as set out in 6 above, licensees should take account of the issues at 11(a), (b) and (c) below and should document their findings and conclusions. Where licensees become aware of issues in relation to a promoter and/or investment manager (which term should be taken to include their controllers, directors and management) and associated parties, but are uncertain of their materiality or possible impact on the subject Qualifying Investor Fund, they should consult Commission staff, prior to the submission of a formal application to the Commission, at the time they become aware of the issue.

11. Promoters and/or investment managers (including their directors, controllers and senior managers) must be fit and proper. This can be defined as being a requirement for integrity (or honesty), competence and solvency. Guernsey licensed service providers should ensure that the following issues are covered as part of their due diligence procedures in respect of new client relationships and that their findings and conclusions are documented.

(a) Integrity

Promoters and/or investment managers (which term should be taken to include their controllers, directors and management) should be of a high reputation and standing. Poor reputation would be considered to be a negative factor.

The promoter and/or investment manager must carry on their business with prudence, professional skill and honesty.

In the case of promoters and/or investment managers with a limited history, due to the fact that they are newly or recently established, the integrity of the controllers, directors and management should be assessed in the light of previous employment and experience. It would be expected that the Guernsey licensed service provider would make direct contact with relevant individuals' previous employers as part of the necessary due diligence enquiries.

Promoters and/or investment managers would be expected to deal openly and honestly with the Commission and any other regulatory authority to whose regulation they are subject (either on a consolidated basis or directly).

(b) Solvency

Promoters and/or investment managers should be solvent. A firm regulated in another jurisdiction should also comply with the solvency, capital adequacy or financial resources requirement (as appropriate) laid down by the relevant regulatory body to which it is accountable. Past performance in this respect should also be considered to ensure that relevant requirements have been consistently met in the past.

A promoter and/or investment manager that is not regulated would be expected to maintain a surplus of shareholders' funds as disclosed in its audited financial statements. Past performance in this respect should also be considered to ensure that relevant requirements have been consistently met in the past.

Promoters and/or investment managers would be expected to maintain adequate net liquid assets such that they are able to settle their debts when they fall due.

In the case of promoters and/or investment managers with a limited history, due to the fact that they are newly or recently established (that is, not being able to produce audited annual financial statements for a period of at least 24 months), it will be necessary for the Guernsey licensed service provider to consider financial projections relating to the proposal under consideration. It will also be necessary to consider whether the controllers, directors and management of such promoters and/or investment managers have previously been responsible for considering the solvency of an entity (for example, if they held a director role or financial control function). Where individuals have been directors or held relevant positions at entities that have gone into liquidation or suffered financial loss it will be necessary to consider the role undertaken by the relevant individual in such situations.

(c) Competence
The most obvious way to demonstrate competence is to have established a favourable track record, in a business similar to that to be conducted in the Bailiwick.

The promoter and/or investment manager should be able to demonstrate an acceptable complaints history. In the case of promoters and/or investment managers with a limited history, due to the fact that they are newly or recently established, it will be necessary for Guernsey licensed service providers to consider whether the controllers, directors and management of such entities have been subject to significant complaints whilst employed by other firms.

Promoters and/or investment managers should have staff of adequate skills, knowledge and experience to undertake and fulfil their duties efficiently and effectively.

**Authorisation of the Fund**

1. In order to consider authorising the fund (if it is open-ended) or granting the requisite consent (if it is closed-ended) the Commission must receive a copy of the application form (form QIF (2005)), which must be signed by the proposed designated manager/administrator of the fund. The form contains the following requirements:

(a) Confirmations to the Commission from the proposed designated manager/administrator that they have performed sufficient due diligence to be satisfied that:

(i) the promoter and associated parties are fit and proper;
(ii) effective procedures are in place to ensure restriction of the fund in question to only Qualified Investors, as defined; and
(iii) the economic rationale for the proposed fund and any attendant risks are clearly disclosed.

(b) Submission of fully completed, signed form APA/APB/APQ/APC (as appropriate) together with Forms PQ in respect of controllers, directors and senior managers of the promoter and fund (as appropriate);

(c) Payment of the application fee required under 7(1) of the Financial Services Commission (Fees) Regulations, 2004;

(d) Submission of certified complete final copies of the following documents:-

(i) scheme particulars, prospectus, offering document or equivalent;

(ii) the application form, subscription agreement or equivalent;

(iii) constitutive documents, that is, the memorandum and articles of association, trust deed or limited partnership agreement, as applicable;

(iv) all material agreements entered into by the fund.

(e) For Class A and Class B open-ended schemes, a lawyer's certificate. For Class Q open-ended schemes, a manager's certificate.

(f) The licensing under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended of persons intending to carry on a restricted activity within the Bailiwick of Guernsey in connection with the fund. Reference should also be made to 3 below.

2. The Commission will issue the necessary authorisation under the Protection of Investors Law or consent under the Control of Borrowing Ordinances within three working days of receipt/resolution of all of the above issues.

3. Should the promoter of a Qualifying Investor Fund require the establishment of a Guernsey incorporated management company it will be necessary for such company to be licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended before the relevant authorisation or consent can be issued in respect of the fund. The application process

relating to the issue of a licence under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended will normally take longer than the three working days referred to at 2 above.

**Non-Guernsey schemes**

1. The Licensees (Conduct of Business and Notification) (Non-Guernsey Schemes) Rules 1994 ("the Non-Guernsey Schemes Rules") require Guernsey licensees wishing to undertake the restricted activities of management, administration or custody to provide prior written notice to the Commission of such proposal. The Commission's formal approval under the Non-Guernsey Schemes Rules is required before the licensee can act.

2. Section 2.02 of the Non-Guernsey Schemes Rules requires the following information to be submitted in support of a relevant application:

   (a) the prospectus, or latest draft prospectus, of the non-Guernsey scheme;

   (b) a copy of the agreement, or latest draft agreement relating to the proposed management, administration or custody services to be provided by the licensee to the non-Guernsey scheme;

   (c) confirmation that no other licensee carries on or intends to carry on any of the restricted activities described in rule 2.01 in connection with the non-Guernsey scheme;

   (d) details of any regulatory approval given by, or applied for from, the authorities in the country or territory in which the non-Guernsey scheme is, or is to be, incorporated or established;

   (e) the notification fee as prescribed from time to time by Regulations made under Section 22 of the Law; and

   (f) such other information as the Commission may require.

3. The Commission will issue the necessary approval under the Non-Guernsey Schemes Rules within three working days of receipt of the information and documentation set out under 2(a) to (e) above, together with a certificate covering the issues referred to under 1(a) of "Authorisation of the Fund" above.

APPENDIX 4
SPLIT CAPITAL INVESTMENT TRUSTS

PUBLIC STATEMENT BY THE GUERNSEY FINANCIAL SERVICES COMMISSION (GFSC)
24 DECEMBER 2004

## GFSC and firms announce details of Split capital investment trust settlement

### Introduction

The GFSC has been conducting an investigation into the activities of certain Guernsey-based fund managers and brokers within the split capital investment trust ("splits") sector between September 2000 and February 2002. The United Kingdom Financial Services Authority ("FSA") and the Jersey Financial Services Commission have also been conducting their own investigations into the splits sector. Each of the GFSC, the JFSC and the FSA have reached agreement to resolve these investigations. The names of those firms and banks that have reached agreement ("The Firms") are listed at the end of this statement.

### Agreement

The FSA, the GFSC, the JFSC and the Firms have agreed a package of approximately £194 million for investors. The Firms have agreed to contribute without admissions to a fund, which will be available for distribution to eligible individuals who invested in zero dividend preference shares ('Zeros') and in a number of specified unit trusts and other financial products that invested in Zeros. The fund is in addition to specific amounts paid or estimated to be paid by specific Firms to their investors including the Aberdeen Progressive Growth Unit Trust Capital Uplift Plan.

An overview of who is eligible to seek a distribution from the fund, the basis on which distributions will be considered, the process for assessing distribution and the method of payment is covered under Next Steps below.

The Firms have agreed to the publication of this statement for the purposes only of this agreement and without any admissions. The GFSC has made no determination of regulatory breaches or imposed any penalties.

The GFSC considers that this agreement is in the best interests of investors, for the following reasons:

- The complexity caused by several features of this particular investigation, makes the outcome for many investors uncertain (even in the event of successful litigation): the differing capacities and involvements of the firms involved; the complexity of the matters under investigation; and the fact that investment trusts were not regulated products. This agreement brings certainty for eligible investors in Zeros.

- In the event of litigation the process could take a number of years. This agreement will ensure that money is quickly available to eligible investors.

- It has resulted in the agreement of the Firms based in Guernsey and Jersey, the GFSC and the JFSC to the establishment of an adjudication scheme.

Investors who are offered the opportunity to obtain a distribution will, of course, have a choice whether to accept it or not. If they accept it, it will be in full and final settlement of any claims or any remedies they may consider they would otherwise have. If they do not accept the offer, they will remain able to pursue their own claims or remedies including those arising under the adjudication scheme.

The United Kingdom's Financial Ombudsman Service provides an alternative means of dispute resolution for those investors who acquired holdings in any class of share of a split capital investment trust from or through a UK authorised entity. There is no such Ombudsman scheme currently operating in Guernsey or Jersey. Certain firms active in Guernsey, whose names are also listed at the end of this statement, have therefore agreed to the establishment of an independent adjudication scheme to provide an equivalent forum for resolving disputes over their Guernsey-based activities in the splits sector so as to mirror, as fully as practicable, the scope of the UK Financial Ombudsman Service arrangements. The adjudication scheme is designed to ensure that investors in the splits sector who were clients of the Guernsey firms identified at the end of this statement will have an alternative forum within which to pursue any complaints that they may have against the Guernsey firms in relation to their investments in the splits sector. The adjudication scheme has also been agreed by JFSC as a term of their settlement and will be operated in accordance with principles and rules agreed between GFSC, JFSC and the firms identified at the end of this statement. The scheme will be in operation by 1 May 2005. Further information relating to the operation of the scheme will be posted on the GFSC website in due course. The GFSC retains its right to seek compensation on behalf of investors who invested in split capital investment trusts through Guernsey firms not identified at the end of this statement.

### Summary of Market Activity

During 2000 and 2001, several key events contributed to the start of the collapse of a number of splits. These events included the collapse of the value of technology stocks, a marked downturn in the FTSE 100 and a global fall in the value of shares following the events of September 11 in the United States. The impact of these events on the splits sector was affected by the existence of financial gearing and the level of cross-holdings within the sector.

The consequences of these events for the splits sector included a lack of new investor demand and a reduction in the cover available to meet the requirements under bank covenants.

Certain Firms sought to address these matters by embarking on a series of actions in what they viewed as (but which subsequently proved not to be) a short term market downturn. These included:

- Undertaking new issues. It was recognised by some Firms that in view of the state of liquidity and demand in the market, the main potential purchasers of these new issues in significant amounts were splits themselves.
- Several splits fund managers invested in the issues of shares by other splits resulting in cross-holdings of shares between different splits.

As a result of the lack of investor demand, the launching of new splits and the issuing of new shares by existing splits brought little new cash into the sector. The market capitalisation and gross assets of the splits sector was increased by a significantly larger amount than the amount of external cash coming into the sector.

Some of the Firms continued actively to promote the shares in splits during the relevant period. The problems of the Split Capital Investment Trust sector adversely affected investor confidence in investor funds and had a significant negative impact on the investment trust sector, in particular.

### Lessons Learned

The GFSC, FSA and JFSC have identified several areas where the investment industry must learn lessons, if investors are to renew their confidence in the investment sector and investment trusts in particular:

- Practices which create misleading market information and impressions or conceal information, are not acceptable.
- The rights of different classes of shareholders must be clearly presented. Regard must be had to the suitability of investments for a specific fund.
- Firms must properly manage conflicts of interests. Where a firm manages or advises more than one investment fund, it must ensure that any transactions between such funds are conducted transparently, at arms-length and in the best interests of the investors in the funds affected.
- Material promoting investment products must properly disclose the specific and significant risks relevant to the product and/or the market at the time it is being promoted. Where the risk characteristics have changed markedly over time it is the responsibility of firms to reflect these changes in promoting the product.
- Investment decisions made by fund managers and advice given by brokers, should be motivated by proper consideration of the best interests of the investment fund they advise and their investors.

### Next Steps

A company, Fund Distribution Limited ("FDL"), has been set up to make distributions from the fund to eligible investors who invested in certain Zeros and in a number of specified unit trusts and other financial products that invested heavily in Zeros. Distributions will be focussed upon private investors and their small investment vehicles that held the specified financial products at any time between July 2000 and June 2002. An eligible investor will only be entitled to receive a distribution if the amount assessed by FDL in relation to them is at least £250 across all of their specified financial products. Further information about the criteria to qualify for the fund, including the list of specified financial products, is posted on the FDL website referred to below.

FDL will publish further details in the first quarter of 2005, including the application deadline. Investors will then have to apply for a distribution from the fund by that deadline. FDL will then inform applicants of their possible distribution. Applicants will have the opportunity to accept or reject this offer.

The current intention is that applicants who accept the offer will receive an initial distribution from FDL in the fourth quarter of 2005. If there are still monies available, subsequent distributions may be made with an intention to complete the distribution by the end of 2005.

Investors who do not accept an offer from FDL will retain their rights to take alternative action, including making a referral to the Financial Ombudsman Service or to the adjudication scheme referred to above, as appropriate, if they have jurisdiction.

Details of the adjudication scheme will be made available in due course.

FDL can be contacted by investors on any of the following:

- Telephone: From UK: 0845 606 6389<br>From Overseas: +44 1224 857555
- Website: www.funddistribution.org

Eligible investors in Aberdeen Progressive Growth Unit Trust ("Progressive") should shortly receive a letter from Aberdeen Unit Trust Managers Limited giving details of the Capital Uplift Plan. Investors in Progressive with any factual queries about the Capital Uplift Plan should call 0845 300 2890 between 9.00 am and 5.00 pm, Monday to Friday.

**Notes to Editors**

1. The Firms are:

- Aberdeen Asset Managers Limited
- Aberdeen Asset Managers Jersey Limited
- Aberdeen Private Wealth Management Limited
- ABN AMRO Equities (UK) Limited
- Brewin Dolphin Securities Ltd
- Britannic Investment Managers Limited
- Collins Stewart (CI) Limited
- Collins Stewart Limited
- Edinburgh Fund Managers Plc
- F&C Asset Management plc (formerly ISIS Asset Management Plc)
- Framlington Investment Management Limited
- Gartmore Investment Limited
- Govett Investment Management Limited (now called AIB Investment Management Limited)
- HSBC Investment Management (International) Limited (the continuing company post merger of Le Masurier James & Chinn Limited)
- HSBC Investment Residuary Limited (formerly HSBC Investment Bank plc)
- Insinger de Beaufort (International) Limited
- Jupiter Asset Management Limited
- LeggMason Investments (Europe) Limited
- Morley Fund Management Limited
- New Star Asset Management Limited
- Premier Fund Managers Ltd
- Royal London Asset Management Limited
- UBS AG (formerly trading as UBS Warburg)

The total package of approximately £194 million comprises the fund to be distributed by FDL of £143.03 million, the estimated cost of £43.30 million for the Capital Uplift Plan which Aberdeen Unit Trust Managers Limited has agreed to implement for investors in Aberdeen Progressive Growth Unit Trust who may otherwise have been eligible for a distribution from the fund and the estimated cost of £7.67 million in respect of payments that have been or are estimated to be made by the Firms to investors who may otherwise have been eligible for a distribution from the fund. The estimates are based on certain assumptions including that all offers made to eligible investors are accepted.

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