GUERNSEY
FINANCIAL
SERVICES
COMMISSION

Annual Report & Financial Statements 2005

ANNUAL REPORT & FINANCIAL STATEMENTS

For the year ended 31 December 2005

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.

Peter Harwood LL.B Chairman of the Commission

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 has served as 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, FCA Vice-Chairman of the Commission

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 2005 he completed 16 years as a member of the Financial Reporting Review Panel.

Mel Carvill FCA, ACII, FSI

Mel Carvill has served as a Commissioner for seven years. He is Deputy General Manager, Head of Strategy, Finance and Risk Management, at Assicurazioni Generali SpA and is a director of financial services companies operating 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.

Susie Farnon FCA

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

Howard Flight MA (Cantab) MBA, FRSA

Howard Flight was appointed as a Commissioner in 2005. He was the Conservative Member of Parliament for Arundel and South Downs from 1997 to 2005 during which time he was Shadow Economic Secretary to the Treasury, Shadow Paymaster General and Shadow Chief Secretary to the Treasury. He led the Conservative opposition during the committee stages of the Financial Services and Markets Act and the Finance Acts between 2000 and 2004. Howard Flight was also co-founder and Managing Director of Guinness Flight Global Asset Management, formed in l986, and upon its acquisition by Investec in 1998 he became joint Chairman of Investec Asset Management. His career started as an investment adviser at Rothschilds in 1971 and in the second half of the 1970s he worked for the Hong Kong Bank's Merchant Bank in both Hong Kong and India. He pioneered the Managed Currency Fund and the Umbrella Fund structures and in 1988 Sedgwick & Jackson published his book *All You Need to Know About Exchange Rates*. He is currently a director of Panmure Gordon plc, Investec Asset Management Limited and a number of other companies and investment funds.

Rosemary Radcliffe CBE, MA, MPhil, FIMC

Rosemary Radcliffe was appointed as a Commissioner in February 2006. She is an economist and business consultant. She was for many years PricewaterhouseCoopers' Chief Economist, retiring from PricewaterhouseCoopers in 2001. She continues to undertake high-level project work in the field of economics and policy analysis and has served on a number of UK government advisory and review bodies, including the Review of Company Law. She is currently a member of the Advisory Panel for the Queen's Award for Industry. From 2001 to 2004 she was the first independent Complaints Commissioner for the UK Financial Services Authority. She was awarded the CBE in 2001 for services to business competitiveness.

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*

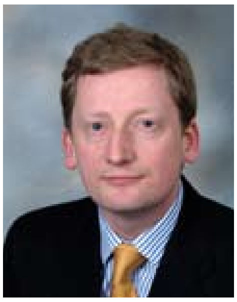
Philip Marr graduated in Economics at the University of Hull in 1968 and joined the Bank of England after a postgraduate degree. He was Economic Adviser to the government of Bermuda from 1974 to 1977 and entered Banking Supervision on his return to the Bank. He was appointed Adviser to the Bahrain Monetary 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, CFE *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.



Richard Walker BA, CFE *Director of Policy and International Affairs*

After a period in stockbroking, Richard Walker joined the Commission's Investment Business Division in 1990. In 1997 he was appointed as Assistant to the Director General. The Policy and International Affairs Division evolved from this work and he was appointed Director in March 2006. His role has included involvement in committees on regulation, anti-money laundering and combating the financing of terrorism ("AML/CFT"), and company and trust law. He has undertaken work on behalf of the International Monetary Fund and the Financial Stability Institute on AML/CFT and countering fraud. He also works with the International Association of Insurance Supervisors and the Offshore Group of Banking Supervisors, and is a member of the Financial Action Task Force Money Laundering and Financing Terrorism Trends Working Group.

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

I have pleasure in presenting for the first time this statement as Chairman of the Guernsey Financial Services Commission. I would like to take this opportunity to express the gratitude and appreciation of myself and my fellow Commissioners, to my predecessor John Hallam who retired as Chairman of the Commission at the end of January of this year. John had been involved with the Commission since its inception, initially as a Commissioner and then since 2003 as its Chairman. John brought to the deliberations of the Commission a depth of knowledge and experience of the finance industry in Guernsey and its regulation that is hard to replicate. In September last year, Leslie Priestley also retired, having reached the compulsory retirement age. Leslie was first appointed a Commissioner in 1999. His background in banking and his experience in managing large organisations meant that he was able to make an especially valuable contribution to the establishment of the Commission's own internal audit and risk control procedures.

In seeking replacements for both John and Leslie, the Policy Council in conjunction with the Commission, considered that it would be appropriate to amend the Commission's governing law in order to permit an increase of one in the maximum number of Commissioners that can be appointed. This has enabled the States of Guernsey to be able to appoint three new Commissioners offering a diversity of skills and experience and who offer a wider international perspective to our deliberations. The Commission are delighted to welcome Howard Flight, Rosemary Radcliffe, CBE and Susie Farnon. Howard Flight has had a long association with Guernsey and is no stranger to the Island nor to the local finance industry. Rosemary Radcliffe, was formerly the Chief Economist with PricewaterhouseCoopers in London. Susie Farnon is well known in the Guernsey finance community having previously been an audit partner at the Guernsey office of KPMG.

As will be apparent from the reports that follow of the Director General and the Directors and Heads of the Divisions within the Commission, the day-to-day regulatory demands upon the executive and the staff of the Commission show no abatement. The standards imposed by the international regulatory bodies against which the Commission is judged are also constantly evolving. It is important that the executive of the Commission maintain regular and continuing dialogue and involvement with these international regulatory bodies in order to protect the Bailiwick of Guernsey's international reputation. Smaller jurisdictions such as Guernsey must wherever possible seek to influence those international standards and temper some of the regulatory excess of such international organisations. It is, however, necessary that Guernsey recognises those minimum international standards that it must meet in order to avoid international regulatory discrimination against the local financial industry.

Notwithstanding the pressure to satisfy such international standards it is important that the Commission must not lose sight of the need to adopt a pragmatic and proportional approach in the manner and the extent to which it applies regulation within Guernsey. The Director General in his report has outlined a number of the positive steps that have been taken by the Commission in maintaining a pragmatic approach to regulation. The Commission recognises that it is crucial to maintain a constructive working relationship with those industry sectors that it regulates. For many years the regulatory Divisions have participated in working groups within the individual industry sectors and have made contributions at industry presentations. It is only by being alert to, and taking notice of, the concerns of the different sectors that the Commission will be able to continue to marry changing international standards with pragmatism. As always, the Commission will take advantage of its relationship with industry to maintain an appropriate balance in its approach to regulation.

Peter Harwood
Chairman

The financial service industry's successful growth and development are once again the centre of attention in Guernsey. As the Directors' reports on the following pages demonstrate, all four sectors of the industry are performing well. In the investment business sector in particular, the past year has seen impressive growth of 36% in funds under management and administration to a figure exceeding £100 billion. Political and economic attention is also now being focused on growth, as a result of proposals for revising Guernsey's corporate tax regime that depend for their success on growth in the economy as a whole – a large part of which is represented by the financial services industry.

At present the flow of business is very strong but there is no guarantee that this will continue in the medium term. The Commission supports a strategy based on policies which encourage growth in the financial services industry because this accords with one of our objectives – to foster the healthy development of that industry.

Pragmatic regulation

In his first statement as Chairman of the Commission, Peter Harwood has emphasised the importance of the Commission continuing to face with pragmatism the changes affecting industry and the international regulatory environment.

The Commission has taken a number of initiatives in the past year that have supported industry. These have included:

- streamlining the approval process for funds aimed at professional, experienced and knowledgeable investors. This fast track approach, known as the Qualifying Investor Fund ("QIF") regime, has been enormously successful. Although it was introduced only in February 2005, by the end of the year 36 QIFs had been approved;
- introducing greater flexibility into the protected cell company regime and, in appropriate circumstances, to the audit requirements for closed-end limited partnership funds used by professional and institutional investors;
- playing a central role in the committee established jointly with the Department of Commerce and Employment which has been considering the conditions required for the continued prosperity of the investment industry;
- making important contributions to three further reviews, of trust law, company law and the company registry;
- streamlining the corporate governance monitoring regime for banks by simplifying our annual review framework. The framework makes use of banks' existing documentation provided to group entities, thus avoiding the need for banks to complete separate returns for the Commission;
- working with the other Crown Dependencies to create a coordinated approach to implementation of the new Basel Capital Accord in Guernsey – this will be beneficial to the significant number of banks which operate in two or all three of the Crown Dependencies;
- establishing the Insurance Education Forum in conjunction with the Guernsey Training Agency to facilitate and exchange views on the education and training needs of the insurance sector; and
- reinforcing the message to other regulators about the effective nature of our regulatory regime – this enhances access to other jurisdictions for Guernsey's products and services.

On a more personal note, I took advantage of my participation in an international conference in Beijing in May 2005 to carry out an initial assessment of opportunities in China for the Guernsey financial services industry. My findings and recommendations have been submitted for further consideration by the appropriate bodies.

The Commission continues to carry out its roles of supervising the financial services industry and taking the steps necessary to counter financial crime and the financing of terrorism, as the reports from the regulatory Divisions make clear. This work ranges from undertaking desk-based and on-site inspections, through reviewing training and education needs in each of the sectors, to taking the inevitable remedial and enforcement action in individual cases. In this context, one disappointing aspect of the introduction of the QIF regime has been the need for the Commission to emphasise to certain firms the importance of undertaking proper due diligence in respect of their clients, to avoid damaging Guernsey's reputation. The QIF regime places a much greater responsibility in this respect on firms in return for lighter supervisory oversight.

The International Monetary Fund ("IMF") is due to carry out a further assessment of Guernsey's regulatory and law enforcement regimes in 2008. The previous IMF report, published in 2003, was very positive and strongly endorsed the work being done by the Commission and the law enforcement bodies. Preparations for the next visit are already under way and will involve the Commission in close and detailed discussions with industry, government and the Law Officers' Chambers.

One of the main themes of the IMF's assessment is likely to be the effectiveness of cooperation and information exchange between supervisors internationally. The Commission is one of the leaders in a project in this area being undertaken by the International Association of Insurance Supervisors ("IAIS"), which is considering introducing a Multilateral Memorandum of Understanding between insurance supervisors. This is an example of our engaging in international affairs so that we not only know and understand what standards are being discussed, but so that we can also influence those standards as they are being set.

The emphasis being placed by the international community on the subject of supervisor cooperation is demonstrated by recent developments involving the Financial Stability Forum ("FSF"), the body charged by the G7 nations to monitor risks to the international financial system. In 2002 the FSF published a list of offshore centres which was often seen as a blacklist. This list has recently been discontinued as it ceased to have relevance when offshore centres agreed to publish their IMF assessments. However, the group which drew it up has been reinstated in order to assess the progress being made to ensure that offshore finance centres meet evolving international standards. As a member of the IAIS Executive Committee, I have been appointed as the IAIS representative on this group. While there is a growing recognition that what matters is whether a jurisdiction is well regulated and cooperative, not whether it is onshore or offshore, it is clear that not all jurisdictions are yet of this view.

The Commission will continue to seek to ensure that Guernsey meets but does not get ahead of established international standards. We believe we have been successful in achieving a proper balance by:

- resisting the inappropriate interpretation by international assessors of the regulatory standards set by the Basel Committee on Banking Supervision, the IAIS, the International Organization of Securities Commissions and the Financial Action Task Force;
- avoiding the indirect imposition of unnecessary and potentially very costly EU wire-transfer provisions on local industry; and
- persuading the IAIS to permit supervisors to exclude certain captive insurance companies from having to publish accounts unnecessarily.

Our constructive engagement with the international standard setters and supranational bodies in this way will help us to achieve our aim of regulating and supervising effectively and pragmatically. No new regulatory laws or requirements were introduced in 2005, but this situation cannot continue because of the need to bring the local framework into line with updated standards. We do not expect that the practical effects of these changes on financial services firms in Guernsey will be significant, and we will be discussing the changes with industry as the details become clearer.

Extending financial literacy

Turing to the local environment, although the Commission is not charged with the responsibility for educating the public in relation to financial services, it is clear that one of the most effective forms of consumer protection is consumer education and training. With this in mind, I invited representatives of the Guernsey financial services industry, educational bodies, the Guernsey Training Agency, the Guernsey Press and the Citizens Advice Bureau to join me in establishing a Guernsey Financial Literacy Advisory Group. This group has met three times and has already begun to act as a catalyst in raising the level of cooperation between the various parties, which should serve to enhance the standards of financial literacy education and training in Guernsey.

Commission finances

Readers of the Commission's financial statements on pages 50 to 61, will see that adopting the Financial Reporting Standard 17 ("FRS 17") has meant that we have had to include a report on the funding position of that part of the States of Guernsey Superannuation Fund that relates to the employees of the Commission and the Guernsey Training Agency. Current advice from the actuaries indicates that on the basis of an approximate actuarial valuation of the scheme as at 31 December 2005, the scheme showed a surplus of £61,000. Adopting the FRS 17 accounting valuation, however, which is based on a revised discount rate supplied by the actuaries at the end of 2005, gives a net pension liability of £1.2 million. The note to our accounts makes it clear that we have received actuarial advice to the effect that the asset and liability values under FRS 17 are expected to vary greatly from year to year without prejudicing the scheme's long term ability to provide the required benefits.

Such substantial differences in valuation, caused principally by a change to the discount rate applied to future liabilities, makes the use of the resultant figures unhelpful in relation to the Commission's current financial position. A more relevant measure of current stewardship is provided by the Commission's income and expenditure figures. Here the picture is very favourable. As a result of careful cost controls, and despite the effects of inflation, the total cost figure before our contribution to the Guernsey Training Agency reduced between 2004 and 2005 by £119,000. The surplus of income over expenditure achieved in 2005 amounted to £598,500, reflecting both this tight cost control and the very buoyant business conditions.

The future of the States pension scheme is under review by the government, and before deciding what action the Commission should take towards our pension liabilities we are waiting to hear the outcome of that review which is due to be completed around September 2006. What is clear, however, is that a deficit of the magnitude shown by the FRS 17 valuation would reduce our reserves by more than half. The actuaries have recommended that an increase in annual contributions to the scheme would be appropriate, but a decision on this has been deferred until the future of the scheme as a whole becomes clear. The implications of the funding requirement and the effects of the scheme valuation on the Commission's financial position, when taken in the context of the need for the Commission to hold adequate reserves to cope with future shocks, will have to be taken into account when fees are being set for 2007. We will be discussing this with industry during the course of 2006.

Commission staff

I would like to offer my congratulations to Richard Walker on his promotion to the position of Director of Policy and International Affairs, and my thanks to all staff for their continued hard work and professionalism.

Peter Neville
Director General

Sector trends

The brighter tone experienced in 2004 carried through into 2005 to produce a most satisfactory year for banks in earnings terms. Clearly some of the restructurings and the cost-saving exercises of recent years had begun to bear fruit in a stronger profit line across the sector as volumes of business picked up through the year. Overall there was healthy growth in profits in all segments, albeit there were a few cases where restructuring had a negative impact on a specific business line.

Corporate actions continued to be a feature of the sector, in the main reflecting decisions taken at group level. These resulted in a reduction in the number of licensed banks; by the end of 2005 the number of licensees had fallen to 50, having started the year at 54 (table 1).

Most of the business conducted by banks that surrendered licences was retained in Guernsey, thereby reinforcing the trend that more business was being conducted by fewer, larger, more efficient banks. Indeed, by the end of the year there were some 16 large banks in Guernsey (taking both branches and subsidiaries) with balance sheets in excess of £1 billion.

The first quarter saw the surrender of the licence of Banco Santander (Guernsey) Limited as a result of group restructuring which made the Guernsey operation no longer essential in the group's international network. Group restructuring also resulted in the conversion of the previous business of the subsidiary, known as Bristol & West International Limited, into a branch of Bank of Ireland (Isle of Man) Limited. Second-quarter corporate actions saw the outright surrender of the banking licence of HSH Nordbank (Guernsey) Limited after its business was moved out of the Island to another group entity in Luxembourg. The previously mooted amalgamation of the Bank of Bermuda (Guernsey) Limited into HSBC Private Bank (Guernsey) Limited took place in May and the acquired bank's business was allocated among other HSBC Group entities on the Island. Following a Credit Suisse Group decision to amalgamate its flagship bank with its Credit Suisse First Boston investment banking arm, the Credit Suisse Guernsey Branch was amalgamated into Credit Suisse First Boston Guernsey Branch ("CSFB") and the combined entity continues to trade as Credit Suisse Guernsey Branch. The net effect of that legal transaction was the surrender of one of Credit Suisse Group's banking licences in Guernsey, but all of the business has been retained on the Island.

Later in the year there was a local amalgamation of BSI Generali Bank (CI) Limited with BSI (Channel Islands) Limited, producing one combined private banking and treasury operation which has set out to do business for the

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

End	*Banks licensed*	*Deposits £mns*	*Annual change in deposits*
1996	72	43,324	–7.5%
1997	78	49,357	13.9%
1998	78	52,922	7.2%
1999	79	57,059	7.8%
2000	77	68,474	20.0%
2001	72	77,211	12.8%
2002	67	71,943	–6.8%
2003	61	69,703	–3.1%
2004	54	70,426	1.0%
2005	50	80,728	14.6%

Swiss private bank together with Generali Group treasury business. The net effect of that amalgamation was the loss of the BSI (Channel Islands) Limited licence, albeit the combined entity should be a bigger, more diversified bank.

In the third quarter SG Hambros completed the process of conversion from a local subsidiary to a branch. This was a three-stage process whereby SG Hambros (Guernsey) Limited migrated to Jersey and amalgamated with its former sister company, whereupon the combined entity changed its name to SG Hambros (CI) Limited and established a branch in Guernsey to accommodate the business of the former subsidiary.

Set against those surrenders of licences, a bank new to Guernsey, Laiki Bank (Guernsey) Limited, was licensed in February. This Cyprus-based bank trades as Cyprus Popular Bank in its home jurisdiction and intends to use its Guernsey subsidiary primarily as a deposit-taking vehicle. Separately, HSBC Private Bank (Guernsey) Limited had a branch in the Isle of Man licensed to conduct private banking in that Island.

Figures 1 and 2 show the county of origin of the 28 bank subsidiaries and 22 bank branches licensed at the end of 2005. A list of current licensees is available on the Commission's website at www.gfsc.gg.

Deposit levels recorded at the end of the year were in fact the highest levels we have recorded and that must be seen as a positive achievement for the industry. There was a slightly faster growth in total assets and total liabilities, in the main reflecting the continued growth of other short-term paper and non-deposit liabilities over the course of the year which mirrored the increasing issue of non-deposit structured products, which has been a feature of the resurgence of offshore private banking. Total deposits reached £80.7 billion (table 1) and total assets and liabilities reached £87.5 billion (table 2) compared with the figures of £70.4 billion total deposits and £74.9 billion total assets and liabilities at the end of 2004. Driving the significant 15% overall growth in deposits was the rapid 25% growth in Swiss fiduciary deposits which increased from £25.7 billion at the end of 2004 to £32.2 billion at the end of 2005. After declining earlier in the year, Swiss fiduciary deposits regained some of their attractiveness following increases in interest rates in several currencies during the year. There were some minor changes in the currency mix of total deposits during the year; the proportion of US dollars increased to 38.9% and the proportion of sterling fell back to 33.4%, while the proportion of euros eased slightly to 22.4% (figure 3).

Figure 4 provides an analysis of banks' assets over the last five years. The picture on the lending scene (figure 5) was of a modest but encouraging 5% increase overall. In the Guernsey market place local mortgages continued to grow steadily. Other lending activity had been driven by the inherent complementarity of the Guernsey finance

Figure 1. **Country of origin of Guernsey licensed banks – subsidiaries at end 2005**

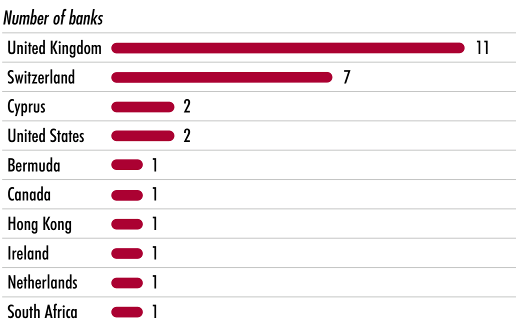
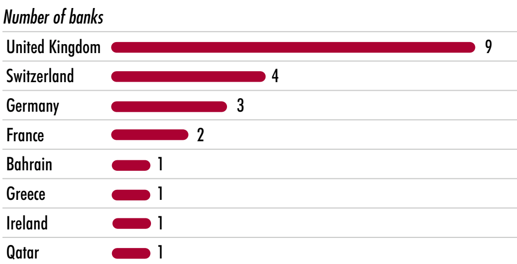


Figure 2. **Country of origin of Guernsey licensed banks – branches at end 2005**



sector. As the growth in investment funds, particularly funds of hedge funds, had grown in Guernsey during the year, so those banks that provided liquidity facilities to those funds had also experienced a significant growth in their credit requirements.

The percentage of bank deposits from Switzerland increased from 41% at the end of 2004 to 46% at the end of 2005 because of the rapid growth of Swiss fiduciary deposits at the end of the year. Other sources remained substantially the same, albeit with some minor changes in the proportions (figure 6). Deposits from Ireland, previously part of the Other European Union category, are separately identified. The bulk of the figure represents corporate business – essentially intercompany deposits from finance sector entities incorporated in Ireland. At the end of 2005 the disposition of assets was a little different than in the previous year: holdings of certificates of deposit were reduced but there was a large increase in placements with banks in the UK, predominantly with the treasury operations of group banks in the City of London. There were also some adjustments in the holdings of low-risk securities, reflected in lower EU figures and an increase in holdings of US paper (figure 7). Claims on Ireland reflect interbank placements and corporate assets.

Tier 1 capital continued its downward trend, declining by 6% in 2005 (figure 8), reflecting the corporate actions mentioned above, notably the exit of Banco Santander and HSH Nordbank, the amalgamations involving the Bank

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

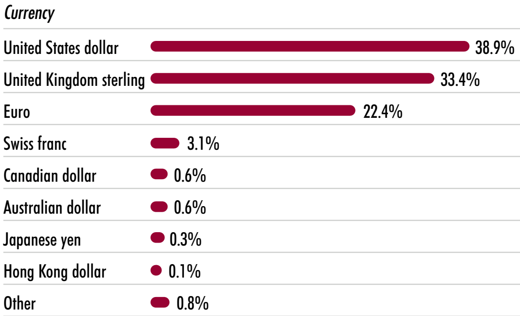
	2001 total £mns	*2002 total £mns*	*2003 total £mns*	*2004 total £mns*	*2005 total £mns*
Liabilities					
Tier 1 capital*	1,841	1,686	1,585	1,479	1,385
Tier 2 capital**	27	23	21	23	28
Deposits by:					
Banks etc.	12,424	13,040	13,811	15,063	16,433
British Isles public sector	59	51	44	34	36
Companies, persons, other	64,728	58,852	55,848	55,329	64259
Other liabilities	2,069	1,108	1,541	3,020	5,341
Total liabilities	81,148	74,760	72,850	74,948	87,482

	2001 total £mns	*2002 total £mns*	*2003 total £mns*	*2004 total £mns*	*2005 total £mns*
Assets					
Loans, advances and market loans with:					
Banks etc.	51,602	42,521	37,654	40,076	59,731
British Isles public sector	12	10	5	5	10
Companies, persons, other	5,333	6,437	6,189	5,752	6,067
Certificate of deposit	5,412	5,833	5,497	6,012	2,079
Government securities	10,466	11,257	13,129	12,733	6,965
Company shares/securities	5,401	6,521	7,062	8,212	10,337
Other assets	2,922	2,181	3,314	2,157	2,293
Total assets	81,148	74,760	72,850	74,948	87,482

* Paid-up share capital and disclosed reserves

** Undisclosed reserves, revaluation reserves, general provisions, debt/equity instruments and subordinated debts

Figure 3. **Analysis of deposits with Guernsey banks by currency at end 2005**



of Bermuda (Guernsey) Limited and BSI (Channel Islands) Limited and the conversions of Bristol & West International Limited and SG Hambros (Guernsey) Limited into branches of banks incorporated elsewhere. These corporate actions resulted in the transferring away of a significant amount of tier 1 capital. However, the weighted risk asset ratio of the continuing subsidiaries remained healthy at 18.76% (figure 9).

Supervision and policy

There were very few changes to supervisory policy in 2005, as indeed had been agreed with the industry associations in the wake of the more substantial regulatory changes in the early years of the decade. The only change of note was by way of refinement and clarification of the new annual review corporate governance monitoring regime which harnesses material that banks already submit to their parent or the rest of their group. The Division issued a clarifying memorandum in September 2005 which sets out to improve the responses under some of the headings, reduce the amount of paperwork involved and establish a more systematic and consistent approach, notably in addressing the requirement that banks should have directors with expertise in the business lines in which they choose to be active. A number of proposals were put forward to assist banks in completing their submissions and clarifying who should sign off statements that are made under the law.

In order to help simplify the introduction of business by local fiduciaries to banks, the Association of Guernsey Banks

Figure 4. **Assets at the year end**

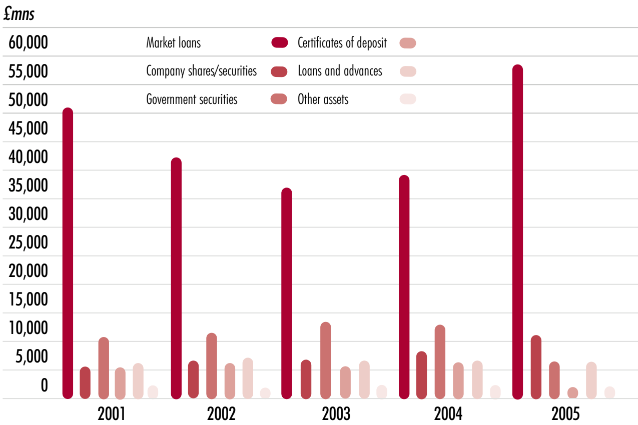
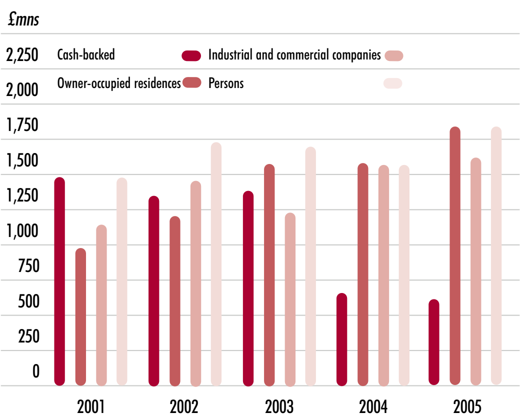


Figure 5. **Reported loans and advances at the year end**



and the Fiduciary Sector Policy Forum worked with the Commission to produce an introducer certificate.

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

The programme of on-site credit reviews was continued and eight credit reviews were carried out during the year, the same number as in 2004. These reviews are only targeted towards those banks where there are significant loan books or where loan books represent a material part of their overall assets. A feature of the programme this year was to understand how those banks that are active in providing liquidity facilities for the growing hedge fund and fund of hedge funds sector in the Bailiwick make their credit decisions for that specialist business.

The Division also continued its second cycle of on-site visits, focusing on know your customer ("KYC")/anti-money laundering ("AML") standards and fraud prevention; the number of banks that were in line to be visited on the two-year cycle was reduced in the year because mergers and acquisitions in the previous years have reduced the number of licensed banks. Twelve visits were conducted during the year and because of sickness within the Division later in the year some were pushed into the 2006 programme. The programme is risk-driven so we were still able to see the most pressing eligible cases.

The ongoing programme of prudential supervisory meetings continued in the year and some 49 formal prudential meetings were held with banks' managements compared with 55 last year, reflecting the reduced number of licensees. A prudential meeting in Jersey with a branch of a Guernsey bank operating in that Island was also held. In addition

Figure 6. **Source of bank deposits at end 2005**

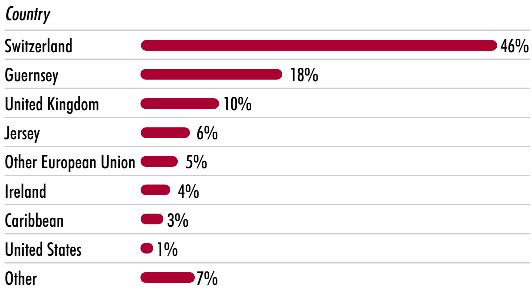


Figure 7. **Disposition of bank assets at end 2005**

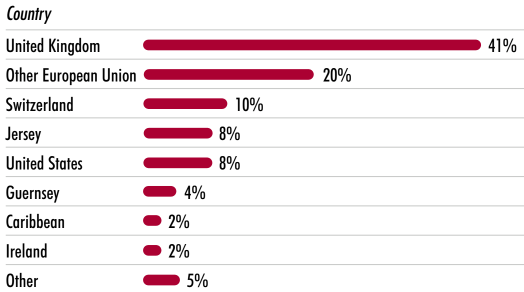


Figure 8. **Total tier 1 capital at the year end**

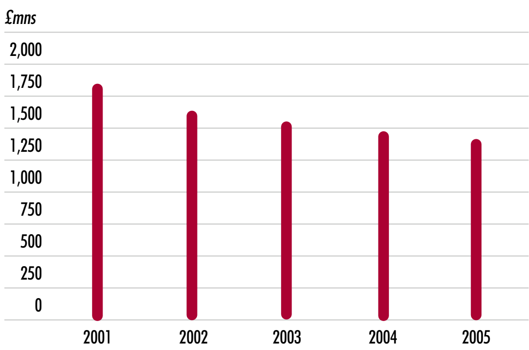
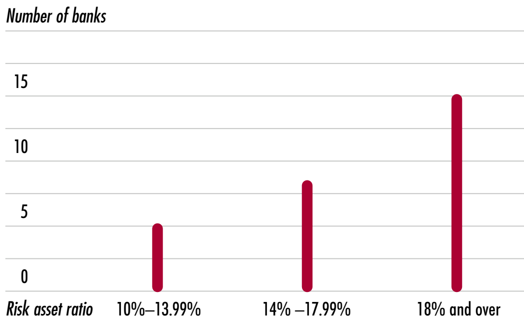


Figure 9. **Distribution of locally incorporated banks by risk asset ratio at end 2005**



there were 127 ad hoc meetings held in Guernsey with banks to discuss various matters; notably strategy, changes in personnel, corporate restructuring, bank and Commission policy and prospective mergers and acquisitions and other corporate actions.

In January 2005 the Assistant Director provided feedback in relation to the banking sector at a seminar on preventing financial crime held in Guernsey.

During the year the staff of the Division undertook a significant amount of training. This focused on two main areas. First, training on the new Basel Capital Accord ("Basel II") was provided to staff; they attended seminars run by the Financial Stability Institute ("FSI") in Basel and in Beatenburg, Switzerland. The FSI was established jointly in 1999 by the Bank for International Settlements and the Basel Committee on Banking Supervision to assist supervisors around the world in improving and strengthening their financial systems. FSI courses are run over several days and, apart from travel and accommodation, are provided to banking supervisors at no cost. Seven Banking Division staff received face-to-face training from the FSI in 2005 on Basel II related subjects. In addition two staff attended seminars run by the British Bankers' Association in London on Basel II, two attended courses run by the UK Financial Services Authority and one participated in a seminar on Basel II run by Deloittes in London.

As well as running courses in Switzerland, for a reasonable charge, banking supervisors may subscribe to an online training facility run by the FSI, known as FSI Connect. This is a very useful resource and the Division has subscribed to it. In 2005 staff studied 47 tutorials using this online service.

The second focus of training was AML, KYC and fraud prevention. Staff attended eight seminars based in Guernsey on these subjects. In addition staff attended the in-house AML training provided to Commission staff in 2005. The Division was particularly pleased that in 2005 one of its analysts obtained the University of Manchester Business School/International Compliance Association's Certificate in Anti-Money Laundering Awareness.

Other training in 2005 included two staff in the Division studying for legal qualifications with Nottingham Law School and another studying for the European Computer Driving Licence. One of the Division obtained her MSc in Corporate Governance from Bournemouth University in the year. Various other Guernsey-based seminars, on a range of subjects, were attended by the Division's staff.

International developments

The Director and Deputy Director attended the annual meeting of the Offshore Group of Banking Supervisors ("OGBS") in the Cayman Islands in June and July. The meeting was addressed by representatives of the Basel Committee on Banking Supervision, the International Monetary Fund, the Financial Action Task Force, the FSI and the International Organisation of Securities Commissions. Prior to the OGBS meeting they took part in an FSI training day covering topics such as AML, Basel II and corporate governance.

During the OGBS meeting in Cayman the Director and Deputy Director carried out bilateral meetings with the Central Bank of Cyprus and the Bermuda Monetary Authority. They also held bilateral meetings with the UK Financial Services Authority in London in November. During the year, meetings were also held with the Jersey Financial Services Commission and the Isle of Man Financial Supervision Commission – primarily to discuss coordination of efforts in the implementation of Basel II. Formal letters were written to those home banking supervisors with whom a bilateral meeting had not been arranged, or planned, to seek their views, as home regulators, on the ongoing prudential soundness of the parents of banks represented in Guernsey. In 2005 the Division did not hold a bilateral meeting with the Swiss Federal Banking Commission as a meeting in Guernsey had been suggested for early 2006.

The Director participated in two meetings of the Working Group on Cross-Border Banking. The first meeting was a conference-call meeting in March and the second was a full meeting in London in May. The principal topics discussed at these meetings were the risk-based approach to the implementation of customer due diligence/AML guidance, the implementation of consolidated KYC risk management principles, home/host supervisor issues and developments in corporate governance issues. Home/host supervisor issues were only touched on briefly in 2005 because the Basel Committee's work in that sphere was being focused on Basel II and capital adequacy issues. The Group felt that it might be counterproductive to undertake a further review of home/host supervisor relationships during the period of the critical implementation of Basel II initiatives. The Group continued its dialogue on proposed consolidated KYC risk management principles with the Wolfsberg Group of international banks.

In November the Director attended the Banking Executive Forum Program (focusing on Basel II preparedness and corporate governance issues) run by the Toronto International Leadership Centre for Financial Supervision in Toronto. In the same month the Deputy Director attended the 11th Annual Association of Certified Fraud Examiners European Fraud Conference in Rome. As in previous years, attendance at this conference by a senior member of the Division has enabled it to stay abreast of current issues surrounding the combating of financial fraud.

Sector developments

In March, Chicago-based Northern Trust Corporation completed its acquisition of Baring Asset Management's Financial Services Group, including its Guernsey fiduciary business, from ING Group N.V. This was followed in November by Royal Bank of Canada's announcement of its acquisition of Abacus Financial Services Group Limited, with offices in London, Guernsey, Jersey, Edinburgh, Cheltenham and Amsterdam.

The Division's overview from prudential discussions, financial statements and statistical reports suggests that the fiduciary sector is in a healthy state and is positive about new business flows and the future.

This confidence was evidenced by two finance businesses, both with large fiduciary operations, centralising their functions in new office developments. MeesPierson Management (Guernsey) Limited and Kleinwort Benson (Channel Islands) Trustees Limited both relocated to Admiral Park, Guernsey during the year.

Supervision and policy

The Division has devoted considerable resources to the resolution of the remaining transitional licence applications, of which there were four at the year end (three of which were related). This has involved close monitoring of several applicants during the winding-down of their businesses, and the examination of measures put in place by others in attempts to meet the licensing criteria. The Division envisages that these applications will be determined early in 2006.

New fiduciary licences were granted during the year to four full and three personal licensees. Of the four new full licensees, two were managed trust companies established for overseas professionals, one resulted from a group restructuring and one from senior staff leaving an existing licensee to establish their own business. At the end of 2005 there were 144 full and 54 personal licences in issue. A list of current licensees and applicants for licences is available on the Commission's website at www.gfsc.gg.

Our priority in relation to existing licensees has been to continue the first cycle of on-site visits. These full-scope visits and the discussions that follow them are time-consuming but nevertheless 48 licensees have been visited during the year. Those were predominantly first visits to licensees, but included revisits to licensees to assess progress on issues identified during an earlier visit. There were also visits to transitional applicants to monitor either the winding-down of a business or its progress towards meeting the licensing criteria. We expect to conclude this first cycle of visits in the second quarter of 2006.

Our experience during the first cycle of on-site visits has been that:

- In relation to new business, licensees generally have good standards of verification of identity and know your customer work;
- In relation to existing business, licensees' retrospective verification programmes are either at an advanced stage or, in many cases, completed;
- Licensees have made significant progress over the last couple of years in developing their procedures for the control and periodic review of administered structures.

The Division has been identifying which aspects of fiduciary business should be the focus of the second cycle of on-site visits. Our experience of the first cycle of visits, together with other factors such as the subject matter of complaints about licensed fiduciaries, suggests that particular themes merit further examination. We will be discussing those areas with industry associations before the start of the second cycle.

In addition to on-site visits, we have developed our understanding of licensees' businesses through numerous prudential discussions, both at licensees' and the Commission's instigation. Common areas of discussion have been corporate restructuring, acquisitions of other fiduciary businesses, changes in senior personnel, complaints and other problem cases.

A particular area of focus during 2005 was client verification principles in the context of business introduced from fiduciaries to banks. The Division, together with the Banking and the Policy and International Affairs Divisions, worked with the Fiduciary Sector Policy Forum and the Association of Guernsey Banks to develop a common form to help simplify the introduction process. The Division has also worked with colleagues on the development of new draft anti-money laundering guidance notes.

Informal discussions have taken place with representatives of the fiduciary sector on many occasions and the Director, Deputy Director and Assistant Directors met the committee of the Guernsey Association of Trustees in June. In the same month, the Director met members of the Sark Association of Corporate Administrators.

The Director and Deputy Director participated in seminars held in January in Guernsey and in July in Alderney on preventing financial crime, providing feedback on issues arising at on-site visits.

The Director has served as a member of working groups established by the States of Guernsey's Commerce and Employment Department to make recommendations on the development of trusts law and on Guernsey's companies registry.

International developments

The Division hosted a meeting of fiduciary regulators from the Crown Dependencies and Gibraltar in March, and the Director and Deputy Director attended a further meeting in the Isle of Man in October. The agenda at both meetings covered businesses of groups licensed in more than one of the jurisdictions, as well as areas of common policy such as trends in fiduciary business and licensees' financial resources.

We have also had numerous bilateral discussions with counterparts in other jurisdictions, both about licensees of common interest and about policy matters. We have an increasing level of contact with fiduciary regulators in other jurisdictions such as the Caribbean centres.

Companies

One of the functions of the Division's Intelligence team is to scrutinise all applications for the formation of new Bailiwick companies. A number of applications were withdrawn, or refused by the Policy Council, during the year following questions being raised by the team. These included applications from a convicted fraudster, a suspected money launderer, a burglar and an individual alleged to have connections to terrorist financing. The experience within the team combined with access to helpful databases and contacts enables it to perform an important role in the prevention and disruption of crime as well as assisting in investigations after the event. Such intervention can also help prevent embarrassment for the Bailiwick and its financial institutions.

Intelligence

The Intelligence team continued to liaise closely with the Crown Officers, Guernsey Police, Guernsey Customs and the Financial Intelligence Service to further the common interest of preventing and investigating financial crime. The international nature of the Bailiwick's business also involved regular contact with regulatory bodies in the UK and elsewhere.

The Intelligence team also assists colleagues within the Commission in regulatory investigations and enforcement action. During the year the team was involved in obtaining files and conducting a compulsory interview under the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended. These were further steps in an investigation in which orders had already been served under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 as amended. The case is expected to be concluded in the first half of 2006.

Notable cases on which the Intelligence team has worked during the year include:

- Early in the year, the team liaised with overseas investors who had contacted the Commission after finding that they were unable to retrieve their investments from an overseas fund. The Commission had issued a public warning in 2002 that the fund had made false claims about a connection with Guernsey, and it subsequently appeared that the promoter had plundered the fund. The Commission alerted authorities in various other jurisdictions about the suspect's activities.
- Through information received by the team, a suspicious internet payment system was prevented from setting up in Guernsey. Approaches had been made to local institutions which reported their concerns. Further research by the team, including assistance from the authorities in the Czech Republic where the principals were based, revealed that they had been involved in fraudulent schemes in the past and a warning was circulated to Bailiwick fiduciaries in case others were approached.
- An internet-based form of a pyramid scheme came to light during the year, falsely claiming to be registered in the Bailiwick. In view of the spurious claim and the underlying activity, a warning was issued on the Commission's website. The team also liaised with the authorities in Latvia where it was suspected that the principals were based.
- The team dealt with new instances of bogus bank websites, where a website falsely claims to be that of a bank and that the bank is based in Guernsey, whereas in reality the "bank" does not exist. This is a problem experienced by many international finance centres and tends to form part of a wider fraud, with victims typically being induced to pay money over in the belief that they have won a lottery or come into an unexpected inheritance. The team's close contacts with law enforcement and crime prevention agencies internationally have led to bogus sites being brought to the Commission's attention quickly. This enables the Commission to have the offending sites closed promptly in order to minimise and if possible prevent any damage to the Bailiwick's reputation or to victims of the frauds.
- As well as dealing with the websites of fictitious banks, the team assisted a genuine Guernsey bank whose website had been cloned by fraudsters. The bank issued a warning to customers on its website and the Commission's separate efforts led to the bogus site being closed down within 24 hours.

In addition to its case-work on these and other matters, the Intelligence team continued to represent the Commission in the Financial Fraud Information Network, which promotes the sharing of intelligence to counter financial crime, and on anti-financial crime groups within the Bailiwick.

Market performance

Guernsey's international insurance market, comprising captives, protected cell companies ("PCCs") and cells continues to show high levels of activity. In 2005 a further 66 international insurers, including 25 captives and PCCs, were licensed. This is encouraging as it demonstrates the continued confidence placed in the Guernsey insurance market during 2005 by a variety of companies ranging from major international companies such as Électricité de France and Coca-Cola, to financial groups looking to expand their portfolio of offerings, such as ABN-AMRO and Standard Life. Figure 10 shows a breakdown by parent's business type of the new captives and PCCs.

As with any mature market, the net increase in licensed international insurers has grown only modestly, from 611 in 2004 to 621 in 2005. This is due to a number of licence surrenders during the year, caused principally by companies having reached the end of their useful lives as a result of changes in market conditions/strategic direction, or merger and acquisition activity at parent level. Cell surrenders form the majority of all surrenders and reflect the one-year nature of many cell transactions and lower exit costs associated with cells. In addition, 2005 saw the branch operation of a Bermudan segregated account company surrender its licence and the associated cell surrenders impacted significantly on the cell numbers. The overall net increase in the number of cells, from 232 at the end of 2004 to 239 at the end of 2005, and PCCs, from 65 to 67, demonstrates that the cell structure continues to be a popular and cost-effective vehicle for both captive insurance and other bespoke insurance transactions. During the year licences were issued for cells transacting life insurance, traditional captive insurance and reinsurance business.

A number of major catastrophes, such as hurricanes Katrina, Rita and Wilma, have impacted the profile of the traditional markets during 2005. As a result of the changes occuring in these markets during 2005/6 it is anticipated that international insurers will continue to be used to provide a facility to cater for gaps in insurance cover or to fund

Figure 10. **Distribution of new captives and PCCs licensed in 2005 by parent's business type**

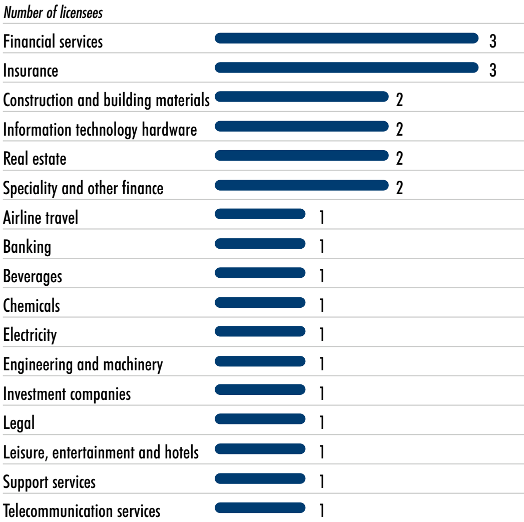
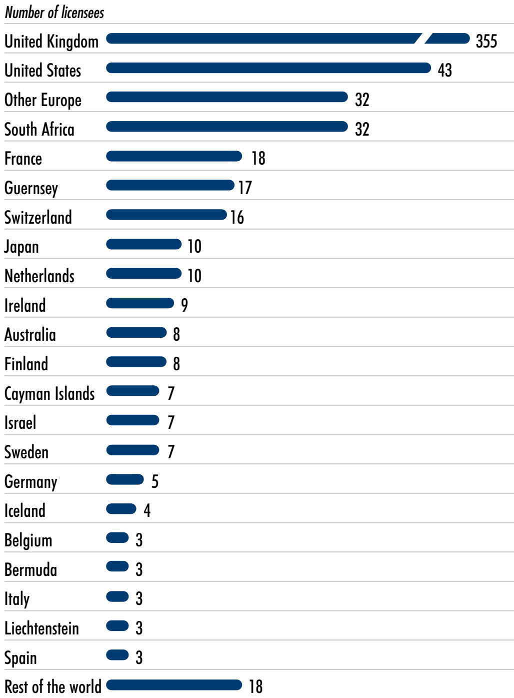


Figure 11. **Shareholder location for captives, PCCs and cells at end 2005**



increased deductibles which are likely to be imposed by the traditional market.

Guernsey's insurance market remains a truly international market, with new captives, PCCs and cells in 2005 created by companies based in countries such as the Netherlands, Saudi Arabia, Greece, Japan and Sweden, although the majority continue to originate from the UK (figure 11).

The Island's insurance market continues to see growth in both life and general insurance business, and with the help of the Island's insurance managers, companies have continued to develop new and innovative business through PCC cells and traditional company structures.

The intermediary sector in Guernsey remains stable. Although there were four new licences issued during 2005, there was a slight decrease in the total number of licensed intermediaries, from 47 at the end of 2004 to 44 at the end of 2005. Interest in the intermediary sector in Guernsey remains high, with some large insurance players either obtaining a licence or expressing interest in 2005. At the same time the domestic insurance market remains relatively stable. Whilst there were three domestic insurance licence surrenders during the year, reducing the number of licensees to 24, there has also been interest in the domestic market from some large commercial UK insurers, some of which it is anticipated will be licensed in early 2006.

Perhaps the best indicator of the growth in the insurance sector in Guernsey is not the number of international insurers which reside here, but the total premium levels and gross assets which were received. The latest figures available show total premiums of £3.3 billion and gross assets of £14.7 billion.

Despite the development of European Union domiciled jurisdictions as captive insurance markets as well as new international domiciles during 2005, Guernsey continues to lead the way in Europe for captive insurance and is well placed to grow both commercial and captive insurance and reinsurance business during 2006.

A full list of currently licensed insurance entities can be found on the Commission's website at www.gfsc.gg.

Education

The Division continues to strive for the improvement of standards within the sector and is pleased with the progress made to date. The Insurance Education Forum, which was set up by the Commission in conjunction with the Guernsey Training Agency and whose members are from a cross-section of industry, meets regularly. The stated purpose of the Forum is "to facilitate and exchange views on education and training needs of the insurance sector within the Bailiwick of Guernsey"; several training issues have been identified and action taken.

There has been a considerable amount of cooperation between the Division and the representative bodies of both the captive managers and intermediaries as well as actuaries, accountants and chartered secretaries. The Division has participated in, and hosted, a number of educational events, all of which have concentrated on enhancing regulatory knowledge across the sector. The Division also provided feedback on issues arising at on-site visits in one of the seminars on the prevention of financial crime held in January.

Mandatory minimum qualifications for authorised insurance representatives providing advice on long-term insurance products came a step nearer with the first deadline for attaining the Guernsey Insurance Certificate being reached during 2005. The Certificate forms an element of the minimum qualification requirements which become compulsory in June 2006.

The Commission actively encourages insurance managers and those working in the captive sector to complete the Certificate in Captive Management, which was launched in Guernsey in 2002. Although most delegates are Guernsey-based, more than 70 delegates, from as far afield as North Carolina, USA and Qatar have registered for the qualification to date, with over 40 already achieving the Certificate. Both the Certificate in Captive Management and the Guernsey Insurance Certificate have been granted accreditation by the Chartered Insurance Institute ("CII") and count towards CII qualifications.

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. 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 2005, the Division performed on-site visits to eight insurance intermediaries, six insurance managers, two international life companies and one domestic insurer. Additional visits were carried out to a non-life captive and two PCCs. During each of the visits to the insurance managers, several captive insurance companies were reviewed.

During the year, members of the Division also had regular meetings with insurance managers and other licensees to discuss new applications, changes in business plans and other issues such as capital requirements. Many of these meetings included owners or potential owners of captive insurance companies.

A risk-based approach to monitoring insurance companies has been adopted with a risk rating assigned to each company based on a set of standard criteria. This approach allows the Division to focus its resources on the areas of greatest risk and to prioritise regulatory intervention.

Guernsey also saw its first PCC, which is a licensed insurance company, go into administration. The Commission was closely involved in the action required to ensure the process went smoothly.

The Commission has been monitoring developments in connection with the Equitable Life Assurance Society ("Equitable Life"). Regular meetings are held with the UK Financial Services Authority and our lawyers to discuss issues and any developments that may affect the interests of policyholders of Equitable Life's Guernsey branch. In a press release on 21 February 2005 we indicated that the Commission had made a submission to Iain Ogilvie, who is conducting the investigation into the regulation of Equitable Life on behalf of the Parliamentary Ombudsman, that Guernsey policyholders should be covered by the Parliamentary Ombudsman's investigation. It is very pleasing that the uncertainty has now been clarified in favour of Guernsey policyholders and the Commission is glad to have been able to assist the Parliamentary Ombudsman on this important matter. The Parliamentary Ombudsman's investigation into the substantive issues is expected to produce its recommendations in the second half of 2006.

The Division has continued to review both the Insurance Business (Bailiwick of Guernsey) Law, 2002 and the Insurance

Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 together with the associated Regulations, Guidance Notes and Codes of Practice. 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 changes to the laws themselves. It is intended to appoint a panel of representatives from each industry sub-sector during 2006 to participate in the review process.

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

The industry continues to grapple with the issues arising from the introduction of International Financial Reporting Standards ("IFRS") for listed companies and the requirements of the first insurance standard entitled *IFRS 4 Insurance Contracts*. The Division participated in the IFRS Discussion Forum ("the Forum"), consisting of representatives from industry and the major accounting firms, which was formed in 2004 to consider the potential issues affecting the captive insurance industry in Guernsey arising from the implementation of IFRS. The Forum made a second presentation to the members of the Guernsey Insurance Company Management Association and the Guernsey Society of Chartered and Certified Accountants in December 2005, which covered the required disclosures and other practicalities for implementing IFRS and the continued convergence of United Kingdom accounting standards and IFRS. The Forum will continue to meet during 2006 to consider the impact of any revisions to existing IFRS for Guernsey-based captive insurers.

International developments

Guernsey is a leading jurisdiction for captive insurance. It is the fourth largest captive insurance domicile in the world and the leader in Europe. As a consequence of this, Guernsey has a high profile within the international and supervisory standards-setting bodies. The International Association of Insurance Supervisors ("IAIS") is the standards-setting body for the international insurance industry. The Offshore Group of Insurance Supervisors ("OGIS") represents jurisdictions concerned predominantly with cross-border captive insurance business. Over the past few years there has been considerable emphasis on the insurance industry developing and upgrading its international standards. As a consequence the IAIS has been very active in introducing and updating standards on a wide range of issues, including disclosure of financial data, accounting issues, solvency criteria, fraud and anti-money laundering. There is also a considerable effort in conjunction with other regulatory bodies, such as the Basel Committee on Banking Supervision and the International Organization of Securities Commissions, to improve practice in relation to sharing regulatory information between jurisdictions.

Particularly during this time of substantial international 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 international associations. The Director General represents OGIS on the Executive Committee of the IAIS and is playing a leading role in a working party of the IAIS committed to improving cross-border communication and transparency. The Director General also represents the IAIS on a review group of the G7 Financial Stability Forum. The Director General and the Director of Insurance attended the Triannual Working Party Meetings of the IAIS and represented the Commission and OGIS on the Technical and Executive Committee meetings of the IAIS. In addition to the Technical Committee meetings of the IAIS, the Director is a member of the Implementation, Core Curriculum and Reinsurance Subcommittees of the IAIS.

The Deputy Director of Insurance is an active member of the Insurance Fraud Subcommittee, which is working in conjunction with the Joint Forum and the Financial Action Task Force ("FATF"), in developing a range of guidance papers and standards in this field. The Deputy Director has attended a number of international meetings involved in drafting papers for the IAIS Fraud Subcommittee on *Fit and Proper Requirements and Combating the Misuse of Insurers for Illicit Purposes.* Together with the Deputy Director (Policy and International Affairs), who was representing the Director General, the Deputy Director of Insurance participated in a meeting of the Insurance Fraud Subcommittee during which the revised IAIS guidance notes on these matters were finalised.

The Division's Actuary is a member of the IAIS Solvency and Enhanced Disclosure Subcommittees. 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 life insurance company technical performance and risks.

The Commission liaises closely with members of OGIS and other jurisdictions to ensure that these IAIS subcommittees are aware of the specific impact of the standards that are being developed on captives and other international insurance companies. There is still a lack of understanding at senior regulatory level in some major jurisdictions of the role and benefits of captive insurance entities. The Commission therefore has been leading a working party, involving members of both captive insurance jurisdictions and other major territories, to produce a captive issues paper for the IAIS, which will help education and understanding in this field. In addition to the captive insurance work, during the year the Director made a presentation on the regulation of intermediaries to OGIS. Involvement in OGIS provides an excellent opportunity to share ideas and issues with other jurisdictions, including the Isle of Man, Mauritius, Gibraltar, Jersey, Cayman and the British Virgin Islands.

The Commission also maintains a working liaison with other international regulatory bodies. During the year the Director made presentations to a number of important captive-related conferences, including in Bahrain, Athens and the M200 Group, which is a gathering of senior multinational risk managers and insurance and reinsurance executives. The Deputy Director attended meetings in Paris for the Insurance Typologies Working Group set up by the FATF to conduct an analysis into the money laundering vulnerabilities in the insurance sector. The work of the group concluded in June 2005. In January 2005, the Deputy Director attended a United Nations special meeting in Kazakhstan and, in addition, on behalf of the Financial Stability Institute, provided training in Beirut for insurance supervisors on the supervision of intermediaries. The Division's Actuary made a presentation at the Association of Insurance and Risk Managers conference in Brighton.

Market sentiment

The Division noted last year that economic and political uncertainties around the world had not been reflected in market indices. In the main, those economic and political uncertainties remained just as pronounced in 2005 as they were in 2004 and once again market indices increased substantially.

It should therefore have been no surprise that the accelerating trend of new business applications, first seen during the last quarter of 2002, continued during 2005. As a result, more open and closed-end funds were approved last year then in any previous year.

In the open-ended sector, a total of 40 new funds and 155 new classes of existing funds were authorised, this compared with 36 new funds and 139 new classes in 2004 (table 3). The use of protected cell structures continues to be an advantage to promoters wishing to domicile their funds in Guernsey, and the trend seen in previous years has continued. By the end of 2005, for example, there were 15 Class A funds comprising 127 portfolios, 200 Class B funds comprising 922 portfolios and 18 Class Q schemes comprising 54 portfolios. The total value of open-ended funds increased by 43% during the year, from £33.7 billion to £48.2 billion. Table 4 and figures 12 to 14 provide an analysis of open-ended funds. Table 5 and figures 15 and 16 provide an analysis of closed-end funds. There was growth in the closed-end sector, with 73 new funds receiving consent in 2005, compared with 47 in 2004 and 33 in 2003. Cell structures for closed-end vehicles, relatively little used until two years ago, continued to increase. Fifteen new classes for existing closed-end funds were created in 2005 compared with 11 in 2004. The trend over time in the number of Guernsey open and closed-end 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 2005, with a total of 46 new approvals granted. The value of funds under management, administration or custody in the Bailiwick under the non-Guernsey scheme arrangements increased from £17.0 billion at the end of 2004 to £20.7 billion at the end of 2005, an increase of 22% (table 6). Overall, the total value of funds serviced in Guernsey

Table 3. **New collective investment fund business at the year end**

	2004	2005
Open-ended funds – authorised	36	40
Open-ended funds – new classes approved	139	155
Closed-end funds – approved	47	73

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

	2004	2005	Change
Number of funds	218	233	+7%
Number of investment pools	956	1,103	+15%
Value of assets (£bns)	33.70	48.23	+43%
Net new investment over year (£mns)	8,131	10,557	+30%
Number of registered shareholders (000's)	89.6	82.2	–8%
Stock exchange listed	71	72	+1%

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: geographical distribution of investments at end 2005**

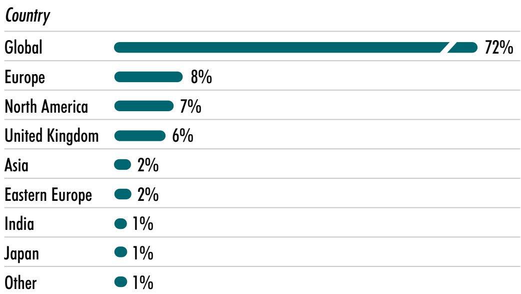
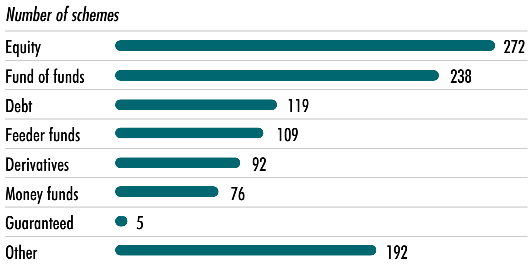


Figure 13. **Open-ended funds: analysis by type of investment pool at end 2005**

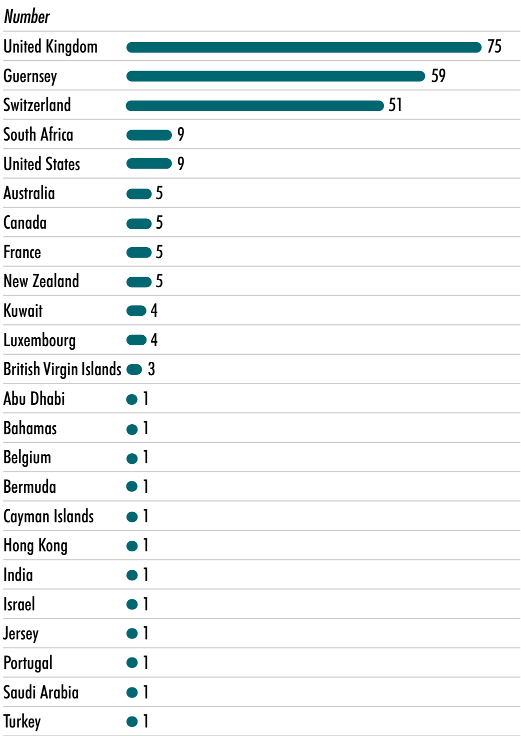


rose from £73.6 billion at the end of 2004 to £100.0 billion at the end of 2005, an increase of 36%.

As in 2004, grant of new investment business licenses showed further growth. A total of 74 new licences were granted compared with 58 during 2004. The net number of institutions licensed under the Protection of Investors (Bailiwick of Guernsey) Law 1987 ("the POI Law") increased to 486 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.

One factor contributing to the strong growth of the fund sector and the interest of new sponsors in obtaining licences here was the introduction on 7 February 2005 of the Qualifying Investor Fund ("QIF") regime. This provided an expedited approval process for both open and closed-end investment funds targeted at qualifying investors. After 12 months' operation, a review of the scheme was conducted. This resulted in the addition of a further criterion by which investors could qualify as Professional Investors, and re-emphasised applicants' responsibility for confirming that associated parties are honest, solvent and competent. As the Director General has noted in his report, the Commission was disappointed to find that certain firms participating in the QIF regime had given insufficient attention to these requirements. The revised document setting out the formal arrangements, along with the guidance to sponsors, is attached as Appendix 3 and can also be reviewed on the Commission's website. The QIF regime was taken up quickly by sponsors, and by the end of 2005 a total of 36 qualifying investor funds had been approved:

Figure 14. **Nationality of sponsors/joint sponsors of Guernsey open-ended funds at end 2005**



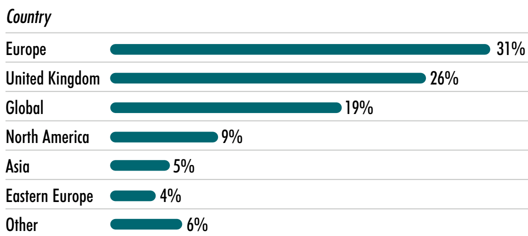
Note: Some funds may have more than one sponsor.

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

	2004	*2005*	*Change*
Number of funds	298	351	+18%
Value of assets (£bns)	22.86	31.10	+36%
Number of registered shareholders (000's)	38,423	37,030	–4%
Stock exchange listed	84	112	+33%

Guernsey approved closed-end 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-end funds: geographic distribution of investments at end 2005**



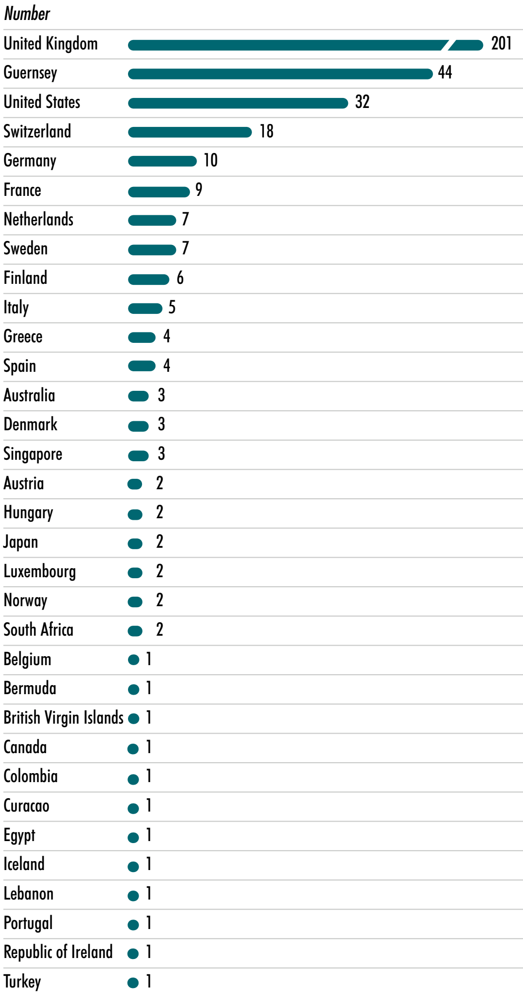
12 in the open-ended sector, 16 in the closed-end sector and eight non-Guernsey schemes.

Supervision and policy

The QIF regime referred to in the previous paragraph was a major policy development introduced in 2005. We also noted last year that a committee had been established under the chairmanship of Advocate Harwood to report jointly to the Commission and to the States Department of Commerce and Employment on the investment business sector in Guernsey. The committee's terms of reference were:

> "To consider the investment industry in the Bailiwick of Guernsey and the conditions required for its continued prosperity.
> The review will include, but not be limited to, the legal regulatory framework, aspects of public policy relating to the industry and will, where appropriate, make recommendations for change.
> Consideration will be given to the statutory objectives contained in the POI Law and rules and regulations

Figure 16. **Nationality of sponsors/joint sponsors of Guernsey closed-end funds at end 2005**



Note: Some funds may have more than one sponsor

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

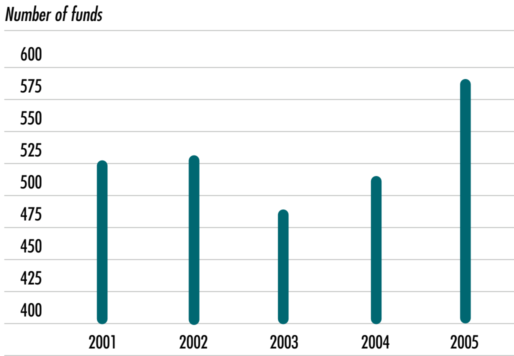
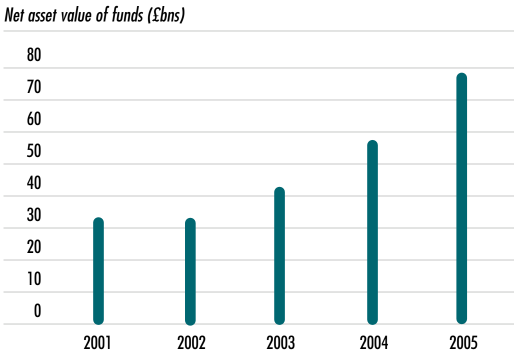


Figure 18. **Total assets under management in Guernsey domiciled funds at the year end**



> made under it, as well as the Commission's powers, duties and responsibilities. The review will also consider aspects of Company Law and other enactments which are relevant to the development of investment business. Business environment dependencies such as telecommunications will also be within the scope of the review."

The Commission was represented on the committee by the Director of Investment Business, and the Division also provided secretarial support. During the year the committee held a number of meetings during which it received evidence both from local investment business providers from the investment fund, asset management and intermediary and broking sectors and from practitioners and advisors in a number of other jurisdictions. The committee delivered its report to the Commission and to the Department of Commerce and Employment on 21 March 2006. The Division has established a small industry working group tasked with implementing those rule developments identified by Advocate Harwood's committee as desirable.

It will be recalled that, in 2002, after lengthy discussions with the UK authorities, a new set of retail collective investment scheme rules (the Class A Rules 2002) were introduced, and "designated" by means of a UK Statutory Instrument so that funds established under those rules could be freely marketed in the United Kingdom. The rules were designed to reflect the main features of the UK authorised fund regime, which in itself embodied the underlying principles of the European Union Directives on Undertakings for Collective Investment in Transferable Securities ("UCITS"). Further development in the European Union of the UCITS regime and additional developments in the United Kingdom have led the Financial Services Authority ("FSA") there to issue a revised handbook on collective investment schemes embodying both the principles of UCITS III and also setting out the principles for "non-UCITS" funds available for authorisation in the UK. The new FSA handbook will fully supersede the existing handbook from February 2007, and preliminary discussions have been held with officials of FSA, and with representatives of the regulators in the other Crown Dependencies, to consider how the regulations in the Crown Dependencies can be further developed to reflect these developments in Europe and the United Kingdom. The Commission has also made initial contact with HM Treasury on this matter.

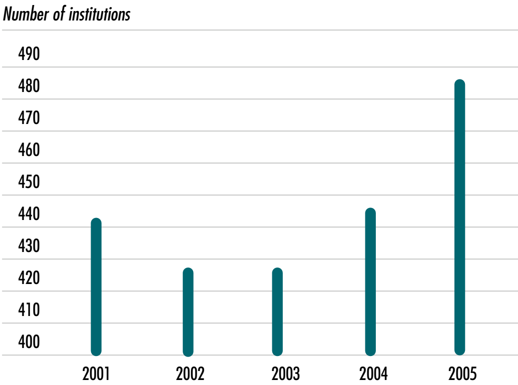
During the course of 2005, a total of 34 monitoring and inspection visits were conducted, which is similar to the number conducted in 2004. Of those visits, eight were to designated managers and three were to designated custodians of collective investment schemes. Two were to managers of closed-end investment vehicles, two were to intermediaries, and the balance were to other asset and portfolio managers. One visit was conducted in conjunction

Table 6. **Non-Guernsey schemes at the year end**

	2004	*2005*	*Change*
Number of funds	187	194	+4%
Value of assets (£mns)	17,043	20,712	+22%
Stock exchange listed	37	35	–5%

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**



with the Insurance Division and two in conjunction with the Fiduciary and Intelligence Services Division. Four of the visits were conducted in respect of QIFs; it was felt appropriate to consider, six months after the launch of the regime, whether the warranties being provided by applicants were being observed, and whether any other lessons should be learnt from the schemes' operation. A number of the visits detailed above were conducted in response to complaints or identified failings, and two of those visits were conducted at short notice. One firm which commenced 2005 with a condition imposed on its licence had that licence condition lifted early in the year. No new restrictions were imposed on any licensee during the year.

A Senior Analyst from the Division participated in seminars held in February on preventing financial crime, providing feedback on issues arising at on-site visits.

Notwithstanding the public settlement reached in respect of Split Capital Investment Trusts on 24 December 2004, significant management time and resource was devoted to that issue during the course of 2005. The Commission is a shareholder in Fund Distribution Limited ("FDL"), the company charged with ensuring fair distribution of the compensation fund agreed by certain firms involved in the split capital sector. As public statements have made clear, identifying the investors eligible to claim a distribution from FDL, and the process of calculating compensation, has proved extremely challenging. Although FDL had hoped to initiate its distribution process before the end of 2005, in the end it was not possible to achieve that before the first quarter of 2006. As a part of the overall settlement reached in December 2004, certain intermediaries in the Channel Islands agreed to set up a separate arrangement, the Channel Islands Splits Adjudication Scheme ("CISAS"), for investors in splits who had used those firms. The scheme is intended to provide, for clients of the Channel Islands firms, a dispute resolution process similar to that which would have been available to them via the Financial Ombudsman Service had the intermediaries been domiciled in the United Kingdom. CISAS commenced operations on 1 June 2005 and the formal closing date for applications was 31 December 2005, although the scheme has discretion to accept applications after the closing date.

International developments

Guernsey is very much a part of the international financial market, and international contact and protecting the Commission's, and the jurisdiction's, international reputation remains a high priority for the Division. The Director represented the Commission at meetings of the International Organization of Securities Commissions ("IOSCO") European Regional Committee, at seminars organised by the IOSCO Technical Committee, and at IOSCO's Annual General Meeting held in April. In September the Director and Deputy Director represented Guernsey at the annual meeting of the Enlarged Contact Group of Collective Investment Scheme Supervisors. The Director and Deputy Director also represented the Commission at the biennial regulatory forum organised by the Alternative Investment Management Association; the Director was a speaker at two of the panel sessions. The Division's Assistant Directors participated in seminars of the Toronto International Leadership Centre for Financial Sector Supervision, and represented the Commission at the GAIM Fund of Hedge Funds Conference in Geneva. A Senior Analyst from the Division attended the US Securities & Exchange Commission's Securities and Enforcement and Market Oversight programme. In December the Director and Deputy Director attended the annual four-way meeting with representatives of the FSA, Isle of Man and Jersey Commissions to review the designated territories' collective investment scheme arrangements. The Director and his Deputy have also maintained contact with London asset management and broking firms for whom Guernsey is a significant part of their operation.

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 countering the financing of terrorism ("AML/CFT") framework, including the Guidance Notes on the Prevention of Money Laundering and Countering the Financing of Terrorism. 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 International Monetary Fund ("IMF").

Cooperation between anti-money laundering authorities

The Crown Dependencies Anti-Money Laundering Group met in London during 2005. 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 2005. It is a forum for closer coordination at a strategic level between the Attorney General's Office, the Commission, Police, Customs and the Financial Intelligence Service ("FIS") in the prevention, detection, investigation and prosecution of economic crime and the countering of terrorist financing. The Director of 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 2005. The Terrorist Finance Team, which was established by the group to coordinate action and responsibilities relating to terrorism matters, also met three times in 2005.

In January, February and July representatives of the Commission took part in seven 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.

AML/CFT initiatives

In order to supplement its existing statement on introduced business, issued in 2003, and following consultation with the Joint Money Laundering Steering Group, in April the Commission issued a second statement on introduced business. This statement covered technical aspects of introduced business where there are two introducers of business involved in a business relationship and where the introducers are regulated and based in Guernsey, Jersey or the Isle of Man. The aim of the statement was to confirm the requirement for the receiving financial services business to identify the ultimate customer and, where possible, to avoid the need for the duplication of documents being passed between the introducers and the receiving institution.

The Fiduciary Sector Policy Forum and the Association of Guernsey Banks worked closely with the Commission to produce an introducer certificate, in order to develop a consistent approach to the provision of information in respect of the underlying principals of business introduced by fiduciaries in the Bailiwick to local banks. This certificate was launched in May and has been adopted by licensed fiduciaries for business introduced to banks.

During the year, the Division continued to prepare revised draft guidance notes on AML/CFT to reflect the most recent changes to the international standards issued by the Financial Action Task Force ("FATF"). In this connection the Director General and representatives of the Policy and International Affairs Division and the regulatory Divisions met with the Joint Money Laundering Steering Group in December to discuss aspects of the new guidance notes. That meeting also discussed issues, particularly the risk based approach, in respect of which the FATF wished to obtain experience globally from the private sector.

In 2005 the Commission undertook 95 on-site inspections of institutions' AML/CFT frameworks. 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 participated with all of the regulatory Divisions on eight 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 International Association of Insurance Supervisors ("IAIS") and attended meetings of the IAIS in Basel in February, in Beijing in May and in Vienna in October. On behalf of the IAIS, at a conference hosted by the IMF in Sydney in November, he made presentations concerning cooperation by insurance supervisors and on finite reinsurance. On behalf of the Director General, the then Deputy Director (Policy and International Affairs), together with the Deputy Director of Insurance, participated in a meeting of the IAIS Insurance Fraud Subcommittee. This meeting was responsible for completing the revised IAIS guidance notes on fitness and propriety and the misuse of insurers for illicit purposes. The Deputy Director (Policy and International Affairs) also participated in an IMF mission to provide technical assistance on countering insurance money laundering and terrorist financing. He also made two presentations for the Financial Stability Institute on these subjects and on countering fraud.

Following on from his meeting in Beijing, in June the Director General met with the Hong Kong securities and

Table 7. **IMF Coordinated Portfolio Investment Survey 2004**
Cross-border securities* owned by institutions in the Bailiwick of Guernsey at end 2004

Sector	*Equities*	*Short-term debt*	*Long-term debt*	*Total*
	US$ mns	*US$ mns*	*US$ mns*	*US$ mns*
Banks	386	5,962	37,407	43,755
Domestic insurers	2	–	48	50
Life insurers	2,033	117	1,470	3,620
Insurance managers and captives	326	2,410	3,560	6,296
Insurance intermediaries	–	–	–	–
Open and closed-ended collective investment funds	53,352	1,776	17,075	72,203
Special purpose vehicles	–	14	147	161
States of Guernsey	14	404	263	681
Total	56,113	10,683	59,970	126,766

*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.

futures regulator, the Securities and Futures Commission ("SFC"). A Letter of Intent, which provides a framework for enhanced cooperation between the SFC and the Commission, was signed at this meeting. This Letter of Intent was the first to be signed by the SFC with a regulatory body outside Asia and provides a formal basis for strengthening regulatory cooperation, particularly with regard to the supervision of investment products and cross-border trading. This should facilitate the development of deeper and broader investment markets through the cross-border trading of investment products that are acceptable to both authorities.

As usual, the Director General spoke at the Cambridge International Symposium on Economic Crime. The theme of the presentation was the war against the misuse of the financial system for terrorist purposes.

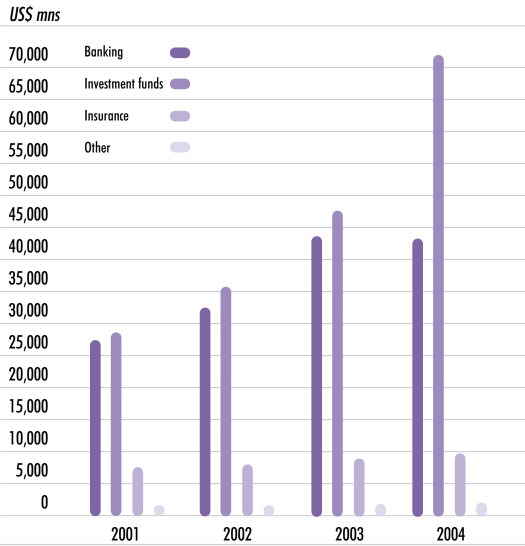
The Director General also met with the Directors General of the Jersey and the Isle of Man Commissions to discuss matters of common interest to the Crown Dependencies.

IMF survey

The Commission provides statistics from Guernsey financial institutions to the IMF for its Coordinated Portfolio Investment Survey ("CPIS") on an annual basis.

Each year, institutions are asked to provide cross-border investment statistics in respect of Guernsey banks, open-ended and closed-end collective investment funds, insurers, insurance intermediaries/brokers and special purpose vehicles. The statistics for 2004 were obtained from 130 institutions, representing 951 entities. Table 7 provides a summary of the results for 2004. The total value of assets reported for Guernsey financial institutions as at 31 December 2004 was US$126.8 billion, an increase of US$25.1 billion over the assets reported in the 2003 survey. Figure 20 shows the results from Guernsey institutions over the last four years. There has been a significant increase in the value of the assets held over this period; this is particularly noticeable in the investment funds sector in the last two years. The weakening of the US dollar also accounted for a proportion of this increase; the dollar value of a sterling asset will have increased by a third during this period. Detailed results from the CPIS are available on the

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



Commission's website at www.gfsc.gg.

In May 2005 a Senior Analyst from the Division together with a Senior Analyst from the Banking Division attended the IMF's annual workshop for small economies with international finance centres which was hosted by the government of Gibraltar. This event was also attended by representatives from Aruba, the Bahamas, Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, the Isle of Man, Jersey and the Netherlands Antilles.

Other developments

During 2005 the Policy and International Affairs Division and the regulatory Divisions commenced a formal programme of work to consider the consistency of regulatory legislation, policies, procedures and controls across its functions.

New regulations were made by the Commission which significantly open up the protected cell company ("PCC") concept in Guernsey. Previously, only certain types of financial services vehicle, such as collective investment funds, insurers, and securitisation companies could be established as PCC structures. The new regulations, which came into effect in September, permit PCCs to carry out business other than financial services business – this could include the full range of commercial activities from simple asset holding to complex financial arrangements for sophisticated corporate customers. A copy of the PCC regulations is available on the Commission's website.

The Commission also prepared new limited partnership regulations which were made by the States Commerce and Employment Department. Closed-end funds structured as limited partnerships are primarily used by professional and institutional investors, rather than retail investors, and can be innovative and complex. The regulations offer scope, in appropriate circumstances, for reducing the audit requirements for funds used by such investors. Copies of the limited partnership regulations can be obtained from the Commerce and Employment Department section of the States of Guernsey website at www.gov.gg.

During 2005 the Director General brought together representatives of the Citizens Advice Bureau, the Guernsey International Business Association ("GIBA"), the Guernsey Press, the Guernsey Training Agency and the States Eductation Department to form the Guernsey Financial Literacy Advisory Group ("G-FLAG"). The group is a catalyst for improving the ability of young people and adults in Guernsey to make informed judgements and to take effective decisions regarding the use and management of their money. The group is chaired by the Director General – the Director of Policy and International Affairs is its secretary. The first event promoted by G-FLAG was a seminar held by GIBA for educationalists – both at a political level and at an executive level (including teachers) – within the States Education Department, to provide members of the Department with a detailed picture of the finance sector and a starting point for building a framework for financial education.

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 facilities management.

Finance

The financial statements are shown on pages 50 to 61. The Commission has fully adopted the Financial Reporting Standard 17 (''FRS 17'') on Retirement Benefits for its 2005 Financial Statements. This has necessitated a change to our accounting policy for pension costs, as explained in note 1(h) of the Notes to the Financial Statements, and we have therefore restated the 2004 results to be in compliance with the standard. The deficit in the scheme at the end of the year on the FRS 17 valuation basis is £1,197,782. We have, however, had an approximate actuarial valuation of the scheme carried out as at 31 December 2005 by the scheme actuary; this valuation shows a surplus of £61,000. The reason for the variance is primarily due to the different discount rate used to determine the present value of liabilities. FRS 17 refers to the current rate of return on high-quality corporate bonds of equivalent currency and term to the liabilities. The actuarial valuation uses discount rates based on the scheme's investment in assets such as equities (in addition to bonds) that are expected to produce higher future returns than bonds, on their own, over the long term.

Fee income increased from 2004 as a result of fee-level changes and significant increases in business activity across some of the business sectors, notably in fund management. The Commission remained 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 total fee income for 2005 was £7,209,404, an 8.6% increase over 2004.

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 resulted in reduced expenses of £7,200,355 for the year ended 31 December 2005; this represents a reduction in total costs of £97,271 when compared to 2004. The overall result was a surplus of £598,500.

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, when setting fees for 2006, the Commission has once again borne in mind the difficulties faced by the finance sector and it is not anticipated that the surplus achieved for 2005 will be repeated in 2006. There are a number of other external factors that could affect the Commission's expenditure in future. These include potential developments regarding the States pension scheme and the approach to be adopted towards the accounting treatment of the retirement benefits.

The Commission continues its close relationship with the Guernsey Training Agency. It contributed 50% of the Agency's budgeted net operating expenditure in 2005 (£399,781) and has committed to do so again in 2006 (£411,000).

Fee legislation

Revised fee regulations came into effect on 1 January 2006. The following regulations apply to fees payable by the finance sector in Guernsey:

The Financial Services Commission (Fees) Regulations, 2005
The Protected Cell Companies (Fees for Insurers) Regulations, 2005

The Regulation of Fiduciaries (Fees) Regulations, 2005
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 enhancements have once again been made to its central regulatory database during the year. In 2006 we will review all current and future requirements as part of our business process review. This will include the investigation of an integrated document imaging system to increase efficiency.

The production of fee invoices to all licensees was completed during the year by extending the system to the fiduciary sector in time for the annual licence renewals from 1 July.

The website was relaunched to make it more effective in providing information about the work of the Commission. It has a more efficient search engine and a crisper, more contemporary look.

Human resources

At the beginning of 2005, the Commission's permanent headcount including vacancies was 85. A further analyst was recruited at the end of the year to assist with the increased workload in the Investment Business Division. 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 Guernsey Training Agency employs its Chief Executive directly.

There were a number of staff changes in 2005, including the appointment of Assistant Directors in the Fiduciary and Intelligence Services Division, the Insurance Division and the Investment Business Division. Two of these were internal promotions. In March 2006 the Deputy Director (Policy and International Affairs) was promoted to Director of that Division.

The Commission is keen to support its employees with their continuing professional education and we are pleased to announce that six staff attained relevant professional qualifications in the year, with a further 13 currently undertaking professional studies. The Commission remains committed to the development and training of staff, to maintain the quality of the Commission's work and to further each individual's career development.

Commissioners

With effect from January 2006 the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 ("the Commission Law") was amended to change the number of Commissioners to a minimum of five and a maximum of seven.

During the year, John Hallam gave notice that he wished to resign as a Commissioner with effect from 1 February 2006, on which date his term of office as Chairman expired. In August 2005 Leslie Priestley reached the age of 72 and, in accordance with the Commission Law, retired from office.

In January 2006 the States of Guernsey elected Peter Harwood as Chairman of the Commission for a one-year term commencing on 2 February 2006 and elected David Mallett as a Commissioner for a further three-year period from the same date. David Mallett was also appointed as Vice-Chairman of the Commission. The States elected Susie Farnon as a Commissioner to complete the unexpired portion of the term of office of John Hallam, that is, to 1 February 2007, and Howard Flight to complete the unexpired term of office of Leslie Priestley, that is, to 1 February 2006 and for a further three-year period from 2 February. The States elected a sixth Commissioner, Rosemary Radcliffe CBE, for a three-year period commencing on 1 February 2006.

Facilities management

The premises at La Plaiderie Chambers and Le Marchant House are at full capacity and it remains a long-term objective of the Commission to move to a more efficient, single location when circumstances allow.

The existing business continuity arrangements were revised during the year and a successful simulation exercise carried out. The Commission has also arranged for dedicated business continuity facilities to be made available in case an unforeseen event results in the need to vacate our existing premises.

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

We have audited the financial statements of the Guernsey Financial Services Commission for the year ended 31 December 2005 which comprise the income and expenditure account, the balance sheet, the statement of total recognised gains and losses, the cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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 which 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 International Standards on Auditing (UK and Ireland). 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 International Standards on Auditing (UK and Ireland) 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 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 2005 and of its income and expenditure, total recognised losses 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
7 April 2006

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 2005

	Note	2005	2004
			As restated
		£	£
Income	2		
Fees receivable		**7,209,404**	6,635,438
Contributions from the States of Guernsey for services provided on behalf of government		**300,000**	300,000
Interest on deposits with States Treasury		**162,249**	125,503
Miscellaneous income, including bank interest		**23,421**	10,852
Other finance income	7d	**103,781**	126,640
		7,798,855	7,198,433
Expenses			
Salaries, pension costs, staff recruitment and training		**5,045,024**	5,074,064
Commissioners' fees		**73,500**	78,000
Legal and professional fees		**445,675**	581,608
Premises and equipment, including depreciation	4,11	**810,257**	740,013
Other operating expenses		**416,118**	435,941
Auditors' remuneration		**10,000**	10,000
		6,800,574	6,919,626
Commission's contribution to expenses of Guernsey Training Agency Limited	10	**399,781**	378,000
		7,200,355	7,297,626
Surplus/(deficit) of income over expenditure	2	**£598,500**	£(99,193)

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

The 2004 comparison figures have been restated following the adoption in full of FRS 17 – "Retirement Benefits" (see Note 9)

The notes on pages 54 to 61 form an integral part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Note	**2005**	2004 As restated
		£	£
Surplus/(deficit) for the year		**598,500**	(99,193)
Actuarial loss	7e	**(1,008,717)**	(479,827)
Total recognised loss for the year		**(410,217)**	(579,020)
Prior-year adjustment	9	**(25,975)**	
Total recognised gains and losses since last annual report		**£(436,192)**	

The 2004 comparison figures have been restated following the adoption in full of FRS 17 – "Retirement Benefits" (see Note 9)

The notes on pages 54 to 61 form an integral part of these financial statements.

BALANCE SHEET

as at 31 December 2005

	Note	2005	2004
			As restated
		£	£
Fixed assets			
Tangible assets	4	**210,949**	319,011
Current assets			
Debtors	5	**225,230**	221,735
Deposits with States Treasury		**2,802,876**	2,090,626
Cash at bank and in hand		**214,529**	75,745
		3,242,635	2,388,106
Creditors – amounts falling due within one year	6	**(1,249,387)**	(1,264,510)
Net current assets		**1,993,248**	1,123,596
Net assets before post-retirement liability		**2,204,197**	1,442,607
Post-retirement liability	7b	**(1,197,782)**	(25,975)
Net assets		**£1,006,415**	£1,416,632
Reserves	8	**£1,006,415**	£ 1,416,632

The financial statements on pages 50 to 61 were approved by the Commissioners and signed on their behalf on 7 April 2006 by:

P A Harwood	D J Mallett	P J Neville
Chairman	Vice-Chairman	Director General

The 2004 comparison figures have been restated following the adoption in full of FRS 17 – "Retirement Benefits" (see Note 9)

The notes on pages 54 to 61 form an integral part of these financial statements.

CASH FLOW STATEMENT

for the year ended 31 December 2005

	Note	2005	2004
			As restated
		£	£
Reconciliation of surplus/(deficit) of income over expenditure to net cash outflow from operating activities			
Surplus/(deficit) of income over expenditure		**598,500**	(99,193)
Other finance income		**(103,781)**	(126,640)
Current pension service costs	7f	**637,749**	521,541
Contributions made to pension scheme	7f	**(370,878)**	(373,515)
Depreciation on tangible fixed assets	4	**183,136**	193,801
Interest receivable		**(174,987)**	(135,590)
Increase in debtors		**(3,495)**	(27,184)
(Decrease)/increase in creditors		**(15,123)**	21,906
Net cash inflow/(outflow) from operating activities		**£751,121**	£(24,874)

Cash flow statement

	Note	2005	2004
Net cash inflow/(outflow) from operating activities		**751,121**	(24,874)
Returns on investments and servicing of finance	16	**174,987**	135,590
Capital expenditure and financial investment	16	**(75,074)**	(100,462)
Increase in cash in the year		**£851,034**	£10,254

Reconciliation of net cash flow to movements in net cash

	Note	2005	2004
Increase in cash in the year		**851,034**	10,254
Net cash at 1 January	17	**2,166,371**	2,156,117
Net cash at 31 December	17	**£3,017,405**	£2,166,371

The 2004 comparison figures have been restated following the adoption in full of FRS 17 – “Retirement Benefits” (see Note 9).

The notes on pages 54 to 61 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2005

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) Investigation 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	33⅓% 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) Pensions

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

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

Following the full adoption of FRS 17, the regular service costs of providing retirement benefits to employees during the year, together with any past service costs, are charged to the income and expenditure account in the year.

A credit is included within other finance income, representing the expected return on the scheme's assets less the interest cost on the scheme's liabilities.

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

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

2. Income and surplus/(deficit) of income over expenditure

Income and surplus/(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 2005	78,727	685,231	586,019	1,349,977
Additions	4,986	12,741	57,347	75,074
At 31 December 2005	83,713	697,972	643,366	1,425,051
Depreciation				
At 1 January 2005	25,786	549,601	455,579	1,030,966
Charge for the year	9,629	79,017	94,490	183,136
At 31 December 2005	35,415	628,618	550,069	1,214,102
Net book value at 31 December 2004	£52,941	£135,630	£130,440	£319,011
Net book value at 31 December 2005	£48,298	£69,354	£93,297	£210,949

5. Debtors

	2005	2004
	£	£
Fees receivable due but not paid	**36,776**	43,473
Other debtors	**6,539**	14,962
Amount due from Guernsey Training Agency Limited	**38,977**	34,277
Prepayments	**142,938**	129,023
	£225,230	£221,735

6. Creditors – amounts falling due within one year

	2005	2004
	£	£
Expense creditors and accruals	**604,572**	658,105
Fees received in advance	**644,815**	606,405
	£1,249,387	£1,264,510

7. Superannuation

FRS 17 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 benefit 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 meet the cost of benefit accrual over the next year of pensionable service.

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

A full actuarial valuation of the scheme was carried out at 31 December 2004 by the scheme's actuary. The valuation was updated to 31 December 2005 by means of an approximate actuarial valuation and shows a surplus of £61,000 at that date. The scheme's actuary also completed the valuation as at 31 December 2005 for the purposes of FRS 17.

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

a) The major assumptions used by the actuary in calculating the FRS 17 disclosures were:

	At 31 December 2005	At 31 December 2004	At 31 December 2003
Rate of increase in salaries	**4.40%**	4.40%	4.30%
Rate of increase in pensions in payment	**2.90%**	3.00%	2.90%
Discount rate	**4.70%**	5.30%	5.40%
Inflation assumption	**2.90%**	2.90%	2.80%

7. Superannuation continued

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

	Long-term rate of return expected at 31 December 2005	**Value at 31 December 2005 £**	Long-term rate of return expected at 31 December 2004	Value at 31 December 2004 £
Equities	**8.00%**	**5,657,011**	7.50%	4,281,057
Bonds	**4.30%**	**1,390,025**	4.70%	1,141,787
Cash	**4.50%**	**133,335**	4.75%	161,327
Total market value of assets		**7,180,371**		5,584,171
Present value of scheme liabilities		**(8,378,153)**		(5,610,146)
Net pension liability		**£(1,197,782)**		£(25,975)

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.

c) Analysis of the amount charged to income and expenditure account

	2005 £	2004 £
Current service cost	**637,749**	521,541
Past service cost	**–**	–
Total operating charge	**£637,749**	£521,541

d) Analysis of the amount credited to other finance income

	2005 £	2004 £
Expected return on pension scheme assets	**398,441**	349,002
Interest on pension scheme liabilities	**(294,660)**	(222,362)
Net return	**£103,781**	£126,640

7. Superannuation continued

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

	2005	2004
	£	£
Actual return less expected return on pension scheme assets	**660,170**	65,610
Experience gains and losses arising on the scheme liabilities	**265,220**	(307,859)
Changes in assumptions underlying the present value of the scheme liabilities	**(1,934,107)**	(237,578)
Actuarial gain/(loss) recognised in STRGL	**£(1,008,717)**	£(479,827)

f) Movement in pension liability during the year

	2005	2004
	£	£
(Deficit)/surplus in scheme at beginning of the year	**(25,975)**	475,238
Movement in year:		
Current service costs	**(637,749)**	(521,541)
Contributions	**370,878**	373,515
Other finance income	**103,781**	126,640
Actuarial loss	**(1,008,717)**	(479,827)
Deficit in scheme at end of the year	**£(1,197,782)**	£(25,975)

Following the actuarial valuation of the Fund as at 31 December 2004, the actuary recommended that the employer contribution rate be increased from 10.4% to 15.5% with effect from 1 January 2006. However, as the Fund is currently under review, the decision was taken not to increase the rate pending the outcome of that review. The employee contribution remains unchanged at 6%.

g) History of experience gains and losses

	2005	2004
Difference between the actual and expected return on scheme assets		
Amount	**£660,170**	£65,610
Percentage of scheme assets	**9%**	1%
Experience gains and losses on scheme liabilities		
Amount	**£265,220**	£(307,859)
Percentage of the present value of the scheme liabilities	**3%**	(5)%
Total amount recognised in statement of total recognised gains and losses		
Amount	**£(1,008,717)**	£(479,827)
Percentage of the present value of the scheme liabilities	**(12)%**	(9)%

7. Superannuation continued

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. Reconciliation of movements in reserves

	Note	2005	2004 As restated
		£	£
Reserves brought forward as originally stated		**1,442,607**	1,520,414
Prior-year adjustment	9	**(25,975)**	475,238
Reserves brought forward as restated		**1,416,632**	1,995,652
Profit/(loss) for the year		**598,500**	(99,193)
Actuarial loss on post-retirement liability		**(1,008,717)**	(479,827)
Reserves carried forward		**£1,006,415**	£1,416,632

Included in the reserves is a pension liability of £1,197,782 (2004 £25,975) which equates to the post-retirement liability under FRS 17 (see note 7).

9. Prior-year adjustment

The following adjustments have been made to opening reserves as a result of the full adoption of FRS 17 – "Retirement Benefits":

	2005	2004
	£	£
Post-retirement (liability)/asset	**(25,975)**	475,238

10. Guernsey Training Agency Limited

The 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 £399,781 in 2005 (2004: £378,000) 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.

11. 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 2005 under the terms of the leases amount to £292,300 (2004: £290,954).

11. Financial commitments continued

Operating lease commitments

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

Land and buildings	2006	2005
Lease which expires more than five years after balance sheet date	£292,300	£296,497

12. 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.

13. Contingent liability

On 22 December 2004, the Commission became a member of Fund Distribution Ltd ("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.

14. 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 arm's-length basis and are not considered to be significant in the context of the business of the parties.

15. 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.

16. Notes to the cash flow statement

	2005	2004
	£	£
Returns on investments and servicing of finance		
Interest received	**174,987**	135,590
Capital expenditure and financial investment		
Payments to acquire tangible fixed assets	**(75,074)**	(100,462)

17. Analysis of net cash

	At 1 January 2005	Cash flow	At 31 December 2005
	£	£	£
Deposits with States Treasury	2,090,626	712,250	2,802,876
Cash at bank and in hand	75,745	138,784	214,529
	£ 2,166,371	£ 851,034	£ 3,017,405

General

The Guernsey Training Agency Limited ("the Training Agency") 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 Training Agency is pleased to note that there were no changes in the Board of Directors in 2005, which lends to the continuity of governance. The Training 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 Training 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 broaden the skills base whilst adding value to all Bailiwick businesses. The Training Agency's work covers all sectors of the Bailiwick's economy – only those initiatives pertinent to the finance sector are outlined below. During 2005 the Training Agency has once again proved to be very successful in facilitating high-quality training and development initiatives for the workforce.

During 2005 the Training Agency underwent an audit of its quality assurance process carried out by Alan Hunt, Head of Academic Development and Quality, Bournemouth University an experienced Quality Assurance Agency ("QAA") auditor. The audit was based broadly on the QAA Institutional Audit model and included meetings with all members of staff, a representative group of past and present students, and senior representatives of client organisations. The Training Agency was very pleased with the outcome of the audit, which concluded that there was a clear focus on quality enhancement and that responsibilities for quality assurance were clearly understood by staff. The auditor described the Training Agency as a learning organisation which constantly sought to improve its performance and take up new opportunities.

During the year the Training Agency continued to work with local finance associations, professional institutes, the Guernsey International Business Association and the Commission to maintain the accuracy of the qualifications matrices for each of the four sectors of the finance industry. These matrices are published on the Training Agency's website, www.guernseytrainingagency.com. In parallel, and in support of the furtherance of training and development in each of these sectors, the Training Agency continues to work with local finance associations, the Commission and the professional institutions utilising sector based meetings defined as education forums. These groups are important in providing strategic direction for the development of finance education and training within the Bailiwick.

The strategic relationship between the College of Further Education and the Training Agency continues to be maintained through the Senior Management Forum. The members of the forum are the Principal and Vice-Principal of the College of Further Education and the Chief Executive and the Deputy Chief Executive of the Training Agency. The forum meets monthly.

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

At the end of 2005 the Agency had 1,003 registered students who made 2,572 study visits to the centre. A total of

5,253 delegates attended the 386 training events that were held. Additionally 199 examinations took place, during which 757 candidates were examined on a range of award-bearing programmes (table 8).

Award-bearing programmes

In September, 10 delegates commenced the second cohort of the Masters in Business Administration run by Southampton University and are due to graduate in 2008. The 12 delegates currently undertaking the first cohort are due to graduate in June 2006.

A new postgraduate programme, the Postgraduate Certificate in Intellectual Property, offered through Bournemouth University, commenced with six delegates in September 2005. This one-year programme provides a key foundation to the subject and the opportunity to progress to a Masters qualification.

The 10 delegates undertaking the two-year Postgraduate Diploma in Personnel Management through the University of Portsmouth all successfully graduated in July 2005. One of the students was awarded the Guernsey Training Agency Student of the Year award – a presentation that is made by the University of Portsmouth. Four delegates have successfully graduated with an MA in Strategic Human Resource Management delivered by the University of East London.

The fifth cohort of the two-year MSc Corporate Governance/Grad ICSA gained five further students in September, making a total of 14 students commencing the second year of the programme. Following the dissertation stage it is planned that the students will graduate early in 2007.

The prestigious Institute of Directors Company Direction Programme commenced in October with 17 delegates; this is the sixth 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 the Society of Trust and Estate Practitioners ("STEP"). Twenty-nine students completed the Foundation Programme with a further 27 students completing the Diploma Programme.

The International Compliance Association was established during 2002 offering diplomas for anti-money laundering and compliance. In 2005, 23 students undertook the Diploma in Compliance and eight took the Diploma in Anti-Money Laundering Reporting and Prevention.

Table 8. **Training event/delegate numbers at the year end**

Key statistics	*2001*	*2002*	*2003*	*2004*	*2005*
Registered number of students	715	818	887	951	1,003
Recorded number of study sessions	2,731	1,971	2,341	2,731	2,572
Number of training events	254	295	322	321	386
Number of delegates attending	2,549	2,811	4,463	4,695	5,253
Number of examination days	53	69	92	113	114
Number of examinations	140	158	194	236	199
Number of examination candidates	599	686	793	874	757

Eight delegates successfully completed the Professional Certificate in Marketing which is run by the Chartered Institute of Marketing and it is expected that a further six delegates will sit the course in 2006.

Three delegates have successfully completed the Certificate in Training Practice programme, leading to Associate Membership of the Chartered Institute of Personnel and Development ("CIPD"). A further five delegates are due to complete the programme in 2006.

During 2005 some 47 students undertook the Introductory Certificate in Team Leading, a three-day programme delivered by the staff from the Guernsey Business School. A further 13 students enrolled for the Introductory Certificate in First Line Management. This five-day programme is delivered by the Guernsey Business School and involves the completion of a 1,000 word work-based assignment.

Fourteen delegates undertook Information Systems Examinations Board courses in information security, security management principles, and service management.

Forty-two students have now successfully completed the Captive Insurance Certificate since the introduction of this qualification. This locally designed programme is awarded 20 points under the Chartered Insurance Qualifications framework. Twenty-five students successfully completed the locally examined Guernsey Insurance Certificate Qualification during 2005. This programme is awarded 16 points under the Chartered Insurance Qualifications framework.

Short courses and conferences

During 2005 the Training Agency facilitated four conferences on behalf of CIPD, STEP, the Confederation of Guernsey Industries and the Commerce and Employment Department. On behalf of the Commerce and Employment Department and MeesPierson Reads, the Training Agency facilitated the Island's first conference on intellectual property which attracted 60 delegates. The STEP conference, which was held at St James in June, was attended by 120 delegates. The CIPD conference Facing the Future and the Challenge of Leadership conference attracted 85 and 80 delegates respectively.

Over 37 lunchtime seminars and short courses for managers covering subjects such as brain fitness at work, counselling skills and personal development were held during 2005, with 454 delegates attending in total.

The continuation series of seminars on the prevention of financial crime run by the Commission at the beginning of the year attracted 197 delegates in Guernsey.

Eighteen delegates attended a series of six law seminars run in conjunction with the Guernsey Bar in the lead-up to the Guernsey Bar exams.

A winter series of seminars on intellectual property run in conjunction with the Commerce and Employment Department and Bournemouth University was attended by 157 delegates.

A number of short courses pertaining to the finance sector were held in 2005; these covered topics such as multi-national pooling, retirement annuity trust schemes, asset recovery in offshore jurisdictions, and terrorism and identity theft and attracted 565 delegates.

In conjunction with BakerPlatt, the Training Agency offered a six-month programme for senior managers on compliance and risk management, which 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 one more organisation achieved recognition during 2005 and two companies were re-recognised under the standard, making 21 local companies currently holding IIP status.

Other initiatives

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

On behalf of the Commerce and Employment Department, the Training Agency has been commissioned to produce a Workforce Development Plan. The purpose of the plan is to lay out the skills and level of education required by the Island's workforce in five years' time and to recommend how resources should be employed to provide them. The Training Agency has just commenced this important project and is currently involved in collecting and analysing data to establish a clear picture of Guernsey's current workforce.

A further two personal development programmes commenced during 2005 with 22 delegates. In conjunction with the Learning Company, two more sessions of the Management Development Programme were offered, attracting 21 delegates.

Working with the Law Officers of the Crown, the Training Agency continues to assist in the administration of the Guernsey Bar examinations. The Training Agency is assisting the Guernsey Bar in identifying events for continuous professional development purposes.

e-Business and information technology

The IT and e-Commerce Advisory Group met four times during 2005 to discuss a number of training and development needs within the sector. The group is comprised of representatives from the Commission, the Data Protection Office, the College of Further Education, and the finance and commercial sectors. The group has provided relevant and useful information advice on the types of courses to facilitate. The Training Agency is particularly pleased with the continuing growth in information technology ("IT") training that it has facilitated during 2005.

During the year 23 seminars and short course programmes were held on topics such as voice over internet protocol, mail merge in a flash, and designing a website, and were attended by 349 delegates.

The Training Agency continues to work closely with the British Computer Society ("BCS") and is represented on the committee of the Guernsey sub-branch. The Training Agency jointly badged a number of BCS seminars during 2005.

Following the successful IT Conference in June 2004, a second conference is being planned for June 2006.

APPENDIX 1
FUNCTIONS, STRUCTURE AND CORPORATE GOVERNANCE AND OTHER CONTROL SYSTEMS OF THE COMMISSION

Functions of the Commission

The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended ("the Commission Law") established the Commission with both general and statutory functions. The general functions include the taking of "such steps as the Commission considers necessary or expedient for the 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.

Relationship with the States of Guernsey

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

The Commissioners

The activities of the Commission's executive are overseen by the members of the Commission (Commissioners).

With effect from 1 January 2006, the Commission Law was amended to change the number of Commissioners. The Law provides that the Commission shall consist of a minimum of five members and a maximum of seven members 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 for a period of one year from amongst the Commissioners and is elected by the States following nomination by the Policy Council. The Vice-Chairman is appointed for a period of one year by the Commissioners. Each member is appointed as a Commissioner for a period not exceeding three years. A member whose term of office has come to an end is eligible for re-election. The Chairman and Vice-Chairman are also eligible for re-election to their positions. A member of the Commission must retire on reaching the age of 72 years.

The number of appointed Commissioners was increased from five to six with effect from 2 February 2006. A brief resumé for each of the current members is provided on pages 6 and 7. All of the Commissioners are non-executive – three reside in the UK with the remainder living in Guernsey.

There were 15 meetings of the Commissioners in 2005. The attendance of the individual Commissioners at these meetings was as follows: John Hallam – 15, Leslie Priestley – 12 (retired August 2005), Mel Carvill – 13, Peter Harwood – 14, David Mallett – 15. Prior to each meeting, Commissioners are provided with a full information pack to support the meeting's agenda.

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

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

Delegation of functions to executive staff

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

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

Annual report and financial statements

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

The Commission Law also provides that the Commission shall:

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

and that the accounts of the Commission shall be:

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

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

Report on internal control and corporate governance

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

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

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

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

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

Audit and Risk Committee

The Commission's Audit and Risk Committee covers oversight of the management of risk – it reviews corporate governance and the systems of internal control and makes reports routinely to meetings of the Commissioners as a whole. Until August 2005 the committee comprised Leslie Priestley (who was the committee's Chairman until he retired), David Mallett and Mel Carvill. The Committee now comprises David Mallett (Chairman), Mel Carvill and Susie Farnon. Meetings are usually attended by the Director General, the Head of Finance and Operations and the Director of Policy and International Affairs (who is the committee's secretary). The committee met five times in 2005.

Review systems

Rather than appoint its own internal auditor to monitor the Commission's non-regulatory internal audit standards, the Commission has retained specialist external consultants to ensure that the Commission is up to date with current expectations. The corporate governance standards of the Commission have been reviewed by the Audit and Risk Committee and by the Commission's officers. The Commission is satisfied that it meets expectations in connection with internal audit and corporate governance. A programme of assessment against international regulatory standards has also been put in place and is undertaken by the Commission's officers and reviewed by the Commissioners. An assessment of compliance with international regulatory standards was carried out by the International Monetary Fund ("IMF") in 2002 – the Commission and the other authorities in Guernsey were found by the IMF to have a high level of compliance with these standards. The IMF is expected to undertake another assessment in 2008.

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

Forum for Insurance Development

Mark Colton	Channel Islands Actuarial Society
John Copeland	Marsh Management Services Guernsey Ltd
Paul Cutter	Association of Guernsey Insurers
Dean De La Rue	Association of Guernsey Insurance Brokers
Richard Falla	Guernsey Insurance Company Management Association
Tony Mancini	PricewaterhouseCoopers
Peter Niven	Financial Industry Policy Advisory Group
Paul Wakefield	Insurance Institute of Guernsey
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

Guernsey Reinsurance Market Project

Tony Mancini	PricewaterhouseCoopers
Peter Walpole	Insurance Corporation of the Channel Islands Ltd
Nick Wild	JLT Risk Solutions (Guernsey) Ltd

Joint Money Laundering Steering Group

Antonia Bligh	Financial Intelligence Service
Anna Burgess	Collins Stewart (C. I.) Limited
Ian Burns	Guernsey Association of Trustees
Adv. Paul Christopher	Guernsey Bar
Mike De Haaff	Guernsey Investment Fund Association
Dean De La Rue	Association of Guernsey Insurance Brokers
Richard Falla	Guernsey Insurance Company Management Association
Jim Gilligan	Association of Guernsey Banks
Steve Hogg	Association of Guernsey Banks
Steve Le Page	Guernsey Society of Chartered and Certified Accountants
John Le Prevost	Guernsey Investment Fund Association
Gary Miller	HSBC Private Bank (Guernsey) Limited
Robert Moore	Guernsey International Business Association
Julian Parker	Guernsey Association of Compliance Officers
Linda Warner	Old Mutual International (Guernsey) Limited

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.

GUIDANCE ON APPLICATIONS IN RESPECT OF QUALIFYING INVESTOR FUNDS

The purpose of this document 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) would 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:

      1. a Government, local authority, public authority or supra-national body (in the Bailiwick or elsewhere); or

      2. a person, partnership or other unincorporated association or body corporate, (whether incorporated, listed or regulated in an 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

      3. 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).

      4. an individual investor who makes an initial investment of not less than US$100,000 or equivalent in the fund in question. Provided the initial test has been met, subsequent investments by the same investor may be of lower amounts.

(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:

1. open-ended collective investment schemes and/or

2. 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-end 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:

1. 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

2. any employee, director, partner or consultant to or of any person referred to at 4(a)2 above or anyone who has fulfilled such a role in respect of any person referred to at 4(a)2 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 suitable only for those investors who satisfy the definition of a Qualified Investor as published by the Guernsey Financial Services Commission as being either 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 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 5 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) Warranties 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.

The Commission attaches great importance to these warranties. It expects applicants to be able to demonstrate that they have documentary evidence to support the warranties given, and to be able to produce that evidence immediately should the Commission request it. Applicants who cannot substantiate their applications may, as noted in paragraph 9 of this guidance, find themselves excluded from participation in the Qualifying Investor Fund self-certification programme.

(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 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.

2. 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 (f) above, together with a certificate covering the issues referred to under 1(a) of "Authorisation of the Fund" above.

March 2006