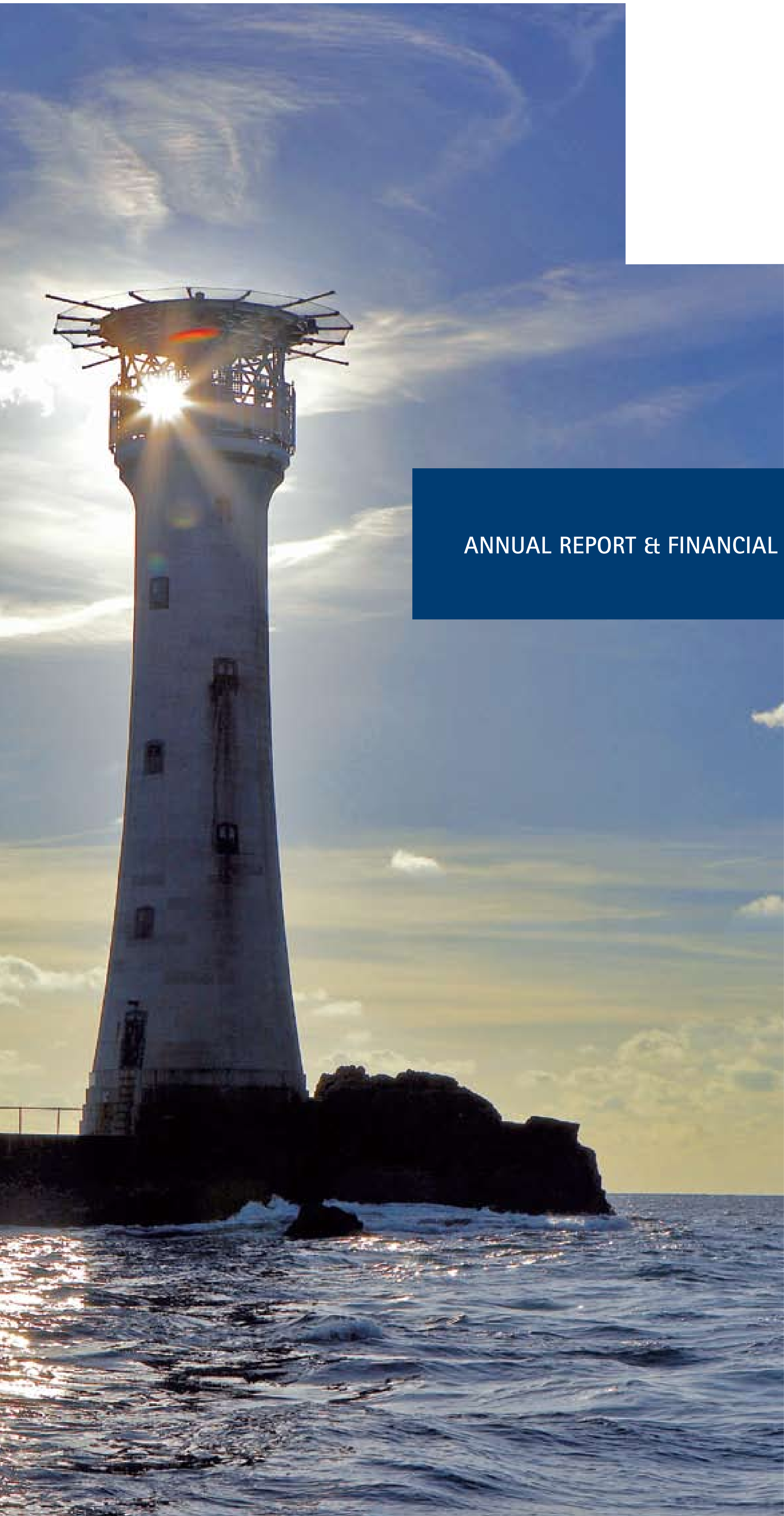

GUERNSEY FINANCIAL SERVICES COMMISSION

ANNUAL REPORT & FINANCIAL STATEMENTS 2007

GUERNSEY FINANCIAL SERVICES COMMISSION

ANNUAL REPORT & FINANCIAL STATEMENTS

For the year ended 31 December 2007

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".

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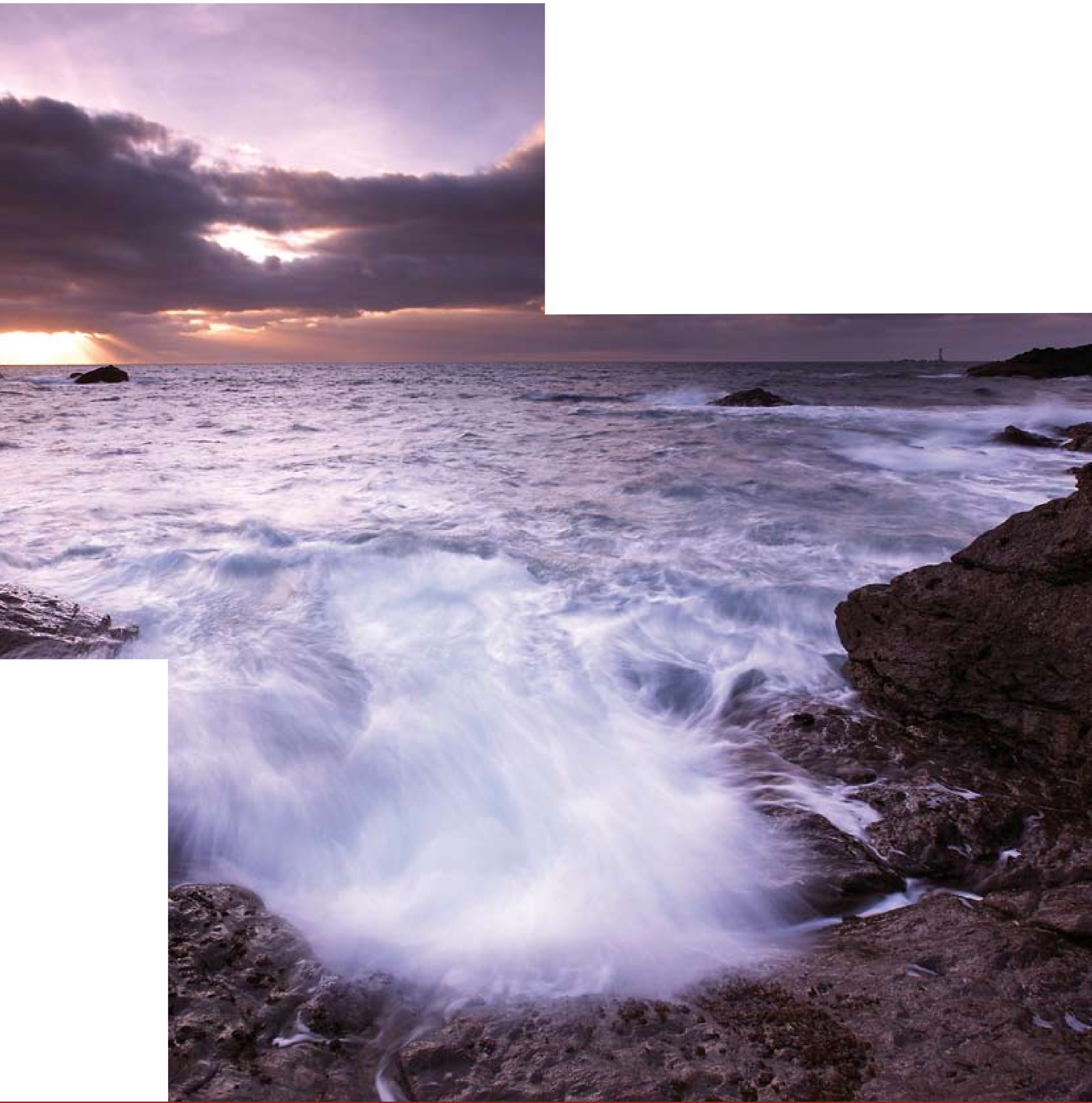
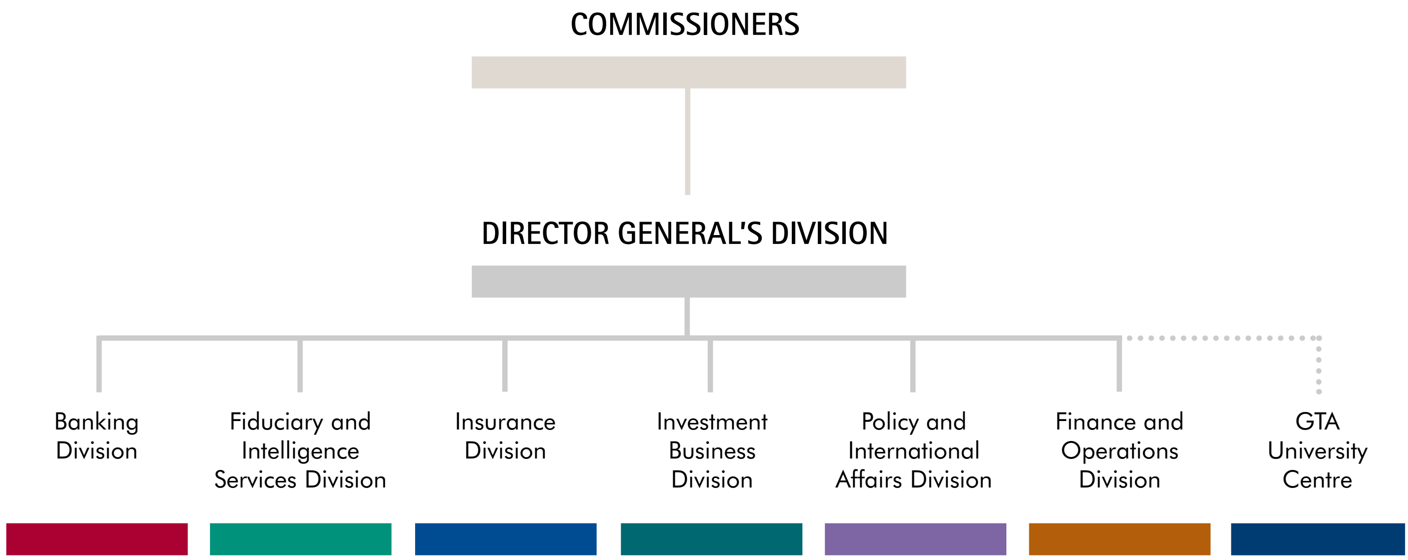
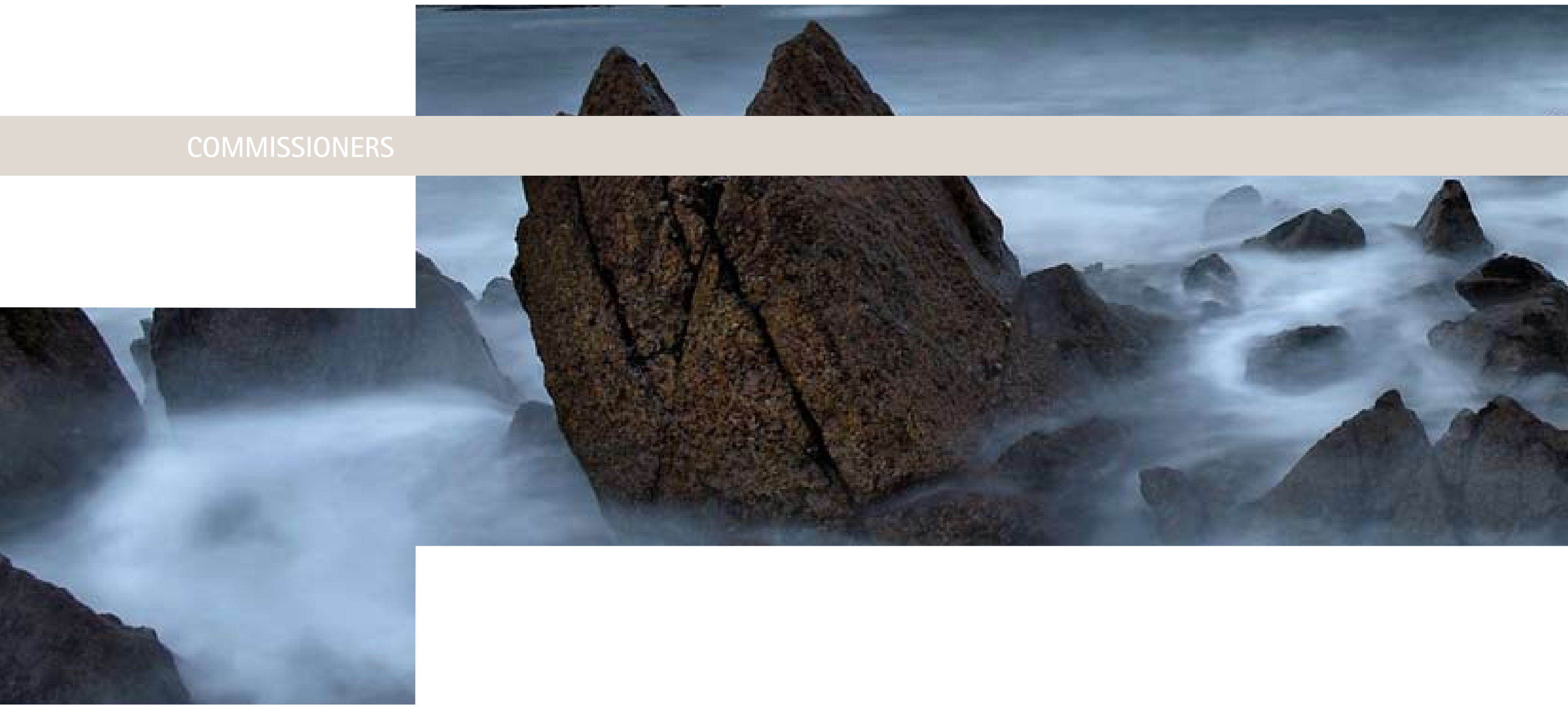
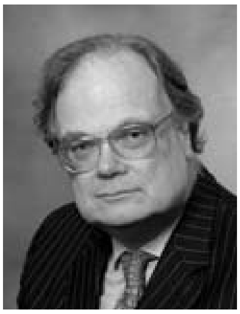


THE GUERNSEY FINANCIAL SERVICES COMMISSION IS THE REGULATORY BODY FOR THE FINANCE SECTOR IN THE BAILIWICK OF GUERNSEY. THE COMMISSION'S PRIMARY OBJECTIVE IS TO REGULATE AND SUPERVISE FINANCIAL SERVICES IN GUERNSEY, WITH INTEGRITY AND EFFICIENCY, AND IN SO DOING HELP TO UPHOLD THE INTERNATIONAL REPUTATION OF GUERNSEY AS A FINANCE CENTRE.


COMMISSIONERS
DIRECTOR GENERAL'S DIVISION
Banking Division
Fiduciary and Intelligence Services Division
Insurance Division
Investment Business Division
Policy and International Affairs Division
Finance and Operations Division
GTA University Centre



COMMISSIONERS



Peter Harwood LL.B *Chairman of the Commission*

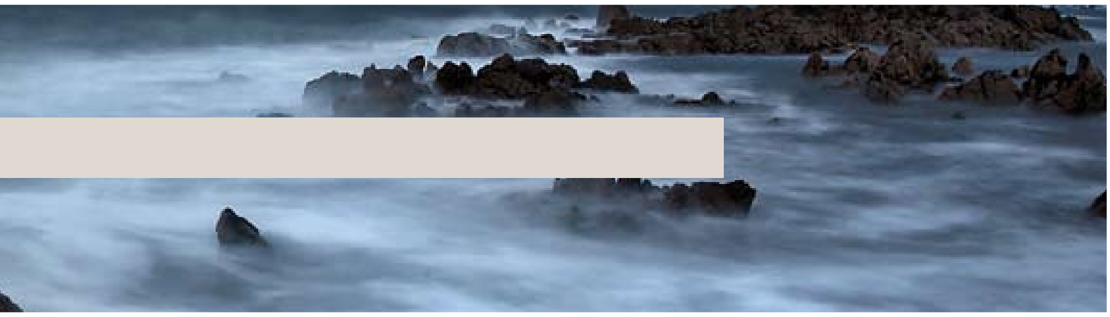
Peter Harwood was appointed as a Commissioner in 2004 and Chairman in January 2006. He was admitted as a solicitor of the Supreme Court of England and Wales in 1972 and worked with Coward Chance and Hill Samuel Bank in London, before returning to Guernsey in 1981. He was admitted as an advocate of the 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 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 2006 he completed 17 years as a member of the Financial Reporting Review Panel.

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. She is also director of a number of companies and a regulated collective investment fund.



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, Paymaster General and Chief Secretary to the Treasury. From 1999 to 2004 he had Shadow Treasury responsibilities for the Finance Acts, the financial services industry, financial regulations and pensions. He has worked for over 35 years in the financial services industry, starting his career at Rothschilds. In the second half of the 1970s he worked for HSBC's merchant bank in Hong Kong and India. In 1979 he joined Guinness Mahon and established what became Guinness Flight Global Asset Management, of which he was joint Managing Director until it was acquired by Investec. He has recently formed Flight & Partners, which is the manager of the Flight & Partners Recovery Fund, and is currently a director of Investec Asset Management Limited and a number of other companies and investment funds.

Alex Rodger MCIBS

Alex Rodger was appointed as a Commissioner in February 2008. He spent over 40 years with the Royal Bank of Scotland ("RBS") Group. Prior to moving to Guernsey in 1989 as Island Director, he occupied senior posts in relationship management and credit control in London and New York. During his time in New York he was closely involved in diligence exercises leading to RBS Group's acquisition of Citizens Bank in 1988. He was executive director of RBS International from its formation in 1996 and was appointed Managing Director of RBS International Securities Services Group in April 2002. Later that year his responsibilities were increased to that of Managing Director of RBS International Corporate Banking Division with responsibility for corporate banking operations in each of Jersey, Guernsey, the Isle of Man and Gibraltar. He led the sale of RBS International's Securities Services business to BNP Paribas in June 2007. He was also Chairman of RBS International Employees Pension Trust. Alex Rodger is a non-executive director of Cable & Wireless (Guernsey) Limited and non-executive Chairman of advocates Collas Day.

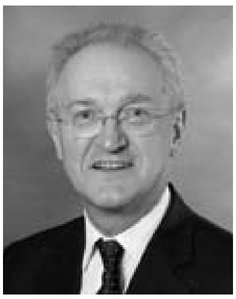
DIRECTORS

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. He is a member of the Executive Committee of the International Association of Insurance Supervisors and the Financial Stability Forum Offshore Financial Centres Review Group.

Diane Colton **FCII, Chartered Insurance Practitioner** *Director of Insurance*

Diane Colton started her career with Guardian Royal Exchange and joined the Commission in 1995. She was appointed Deputy Director of Insurance in 2001 and promoted to Director of Insurance in January 2007. She has undertaken work on behalf of the Financial Stability Institute and has worked as a member of the Financial Action Task Force Working Group on Insurance Typologies (which was set up to conduct an analysis into the money-laundering vulnerabilities in the insurance sector). She has also been involved with the Insurance Fraud Subcommittee of the International Association of Insurance Supervisors ("IAIS") in drafting various papers and at the end of 2007 was appointed Chair of that subcommittee. Early in 2007 she became the Chair of the Captive Guidance Paper Drafting Group for the IAIS, which is working to publish guidance for captive insurance supervisors.

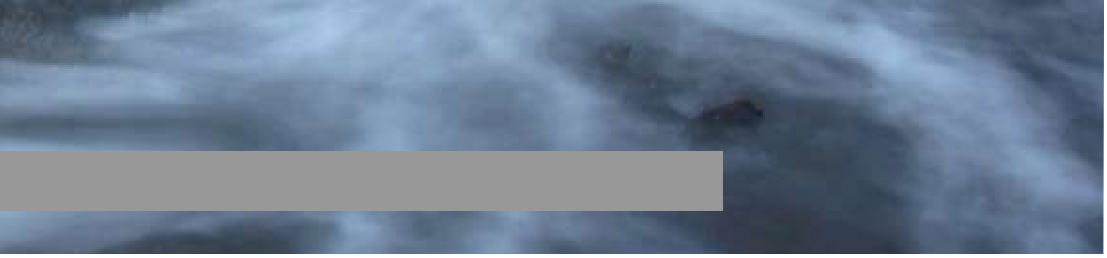


Philip Marr **MSc (Econ), CFE** *Director of Banking*

After a postgraduate degree in Economics, Philip Marr joined the Bank of England in 1968. 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 appointed Manager, On-Site Review Teams. He was appointed Senior Manager, Enforcement in 1995 and joined the Commission in June 1997. He has been a member of the Offshore Group of Banking Supervisors ("OGBS") since 1997 and was a member of the Joint OGBS/Basel Committee Working Group on Cross Border Banking from 2001 to 2007.

Peter Moffatt **MA (Oxon), FSI** *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.



Neville Roberts FCA *Director of Finance and Operations*

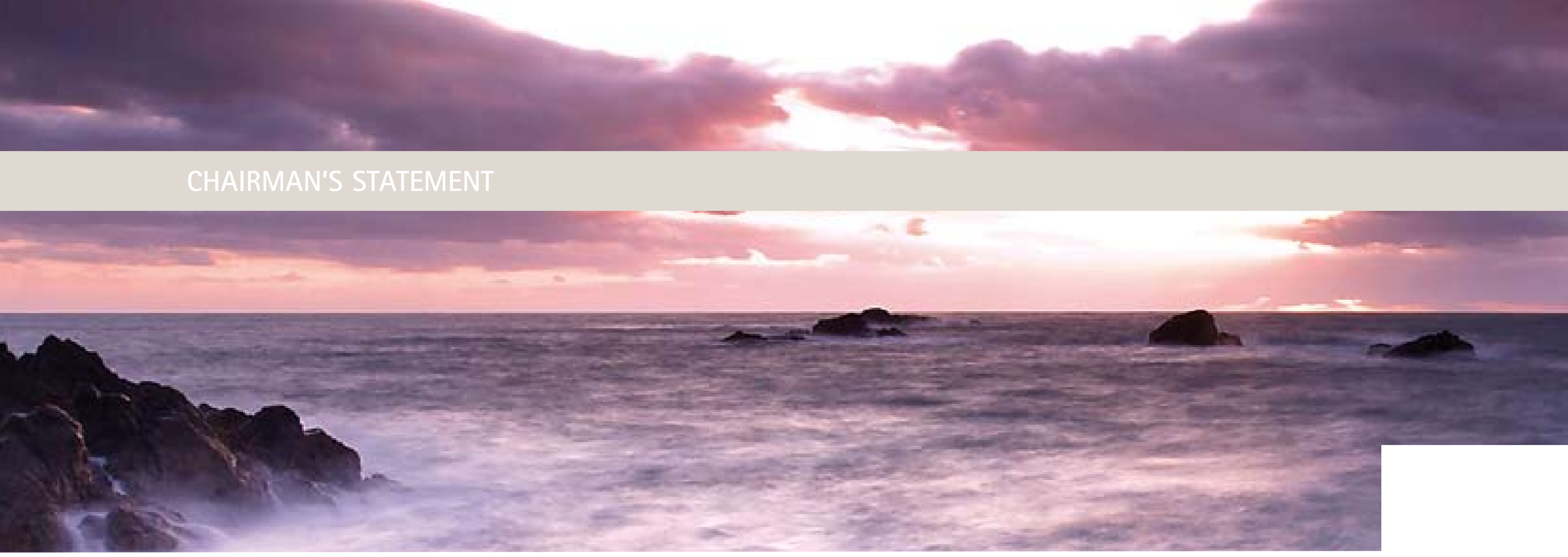
Neville Roberts is a Fellow of the Institute of Chartered Accountants. He served articles with Thomson McLintock where, following qualification, he worked in the field of receivership. In 1976 he moved to Ford Motor Co. before transferring to Schroder Life and Unit Trusts as Group Financial Accountant. 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 and in February 2007 became Director of Finance and Operations.

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

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

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.

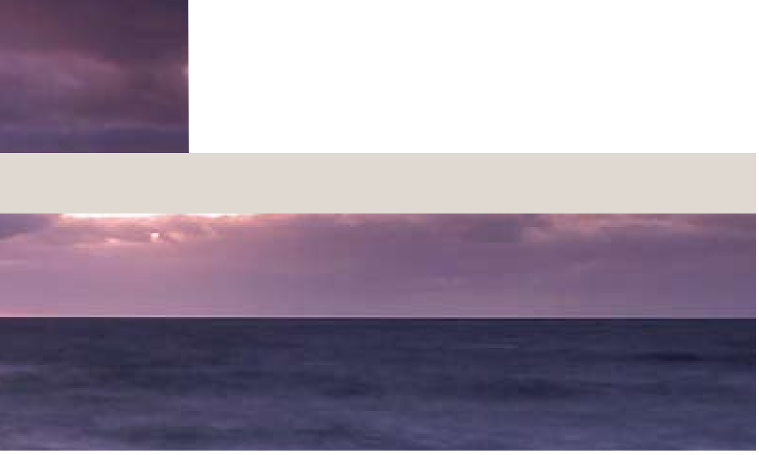


The financial information in this report is further evidence of the buoyancy of the international economy that has helped sustain the financial services industry in Guernsey throughout the current cycle that started in mid-2003. The flow of new business coming into the Bailiwick of Guernsey during 2007 exceeded budgeted expectations and, although clearly welcomed by the local business community, did place considerable additional pressures upon the resources within the Commission. I thank all the staff within the Commission for having responded to the considerable demands made upon them by that flow of new business.

Whilst all regulatory Divisions continued to experience a significant upturn in business activity, it was the Investment Business Division that saw the greatest demands upon its resources. During the early part of 2007, the Commission introduced, under the existing Control of Borrowing (Bailiwick of Guernsey) Ordinances, its new Registered Fund regime. This regime considerably assisted the processing of new closed-end fund applications and enabled the Investment Business Division to meet the expectations of the funds sector.

The level of activity throughout 2007 within the financial services sector in Guernsey was driven by external factors over which Guernsey, whether that be the politicians or the regulators or the businesses themselves, has little influence. The growth of new business within the finance sector is primarily a reflection of the buoyancy of global financial markets. Conversely, any slowdown of growth will be driven by negative sentiments within those same global markets. The sub-prime mortgage crisis that first emerged in the United States of America towards the end of 2006 began to take on an international momentum during 2007. We have yet to measure the full consequences of that crisis. The global "credit crunch" first began to manifest itself in the middle of 2007 when many financial institutions, perhaps for the first time, began to face the inevitable consequences of the exuberant lending spree that they had pursued in recent years. Uncertainty of valuation of assets and the possibility of significant write-offs drove many lending institutions to adopt a defensive stance and to cut back on the levels of inter-bank lending. One of the early casualties was Northern Rock. The difficulties associated with Northern Rock in the United Kingdom had an immediate impact upon the status of Northern Rock (Guernsey) Limited. In tandem with the Board of Northern Rock (Guernsey) Limited the Executive of the Commission played an active role in safeguarding the position of the depositors with the Guernsey bank. The Commission entered into robust negotiations with the UK Financial Services Authority, HM Treasury and the Bank of England, the outcome of which was an assurance by HM Treasury that monies that had been advanced by Northern Rock (Guernsey) Limited to the parent company in the United Kingdom would be covered as a wholesale deposit by the guarantee arrangements provided by HM Treasury. I pay tribute to the leadership shown by the Executive of the Commission by acting in such a proactive manner and by driving those negotiations to a successful conclusion.

In addition to the substantial workload borne by the Commission and its staff attributable to the growth of business of the Bailiwick's financial sector, members of the Commission staff also had to focus on the continued preparation for the forthcoming visit and appraisal by the International Monetary Fund. Staff of the Commission have continued during the year to work very closely with the States of Guernsey Policy Council, the Chief Executive of the States of Guernsey, the States of Guernsey Commerce and Employment Department, and HM Procureur and other members of the Law Officers' Chambers in preparing policy letters, legislation, regulations, rules and guidance notes



covering many aspects of the Commission's activities. We are very grateful for the cooperation that the Commission has received from the political authorities, not only in the island of Guernsey but also in the islands of Alderney and Sark, to ensure that we could meet the deadlines required for the substantial legislative programme.

The Commission continues to work closely with those international bodies that are responsible for setting international regulatory standards and continues to attempt to counter the misconceptions and prejudices that are often directed to this and other well-regulated offshore jurisdictions. Unfortunately, all too often, these misconceptions and prejudices are politically motivated, and do not reflect the views of other international regulators with whom the Commission maintains good working relations. Members of the Executive continue in their attempts to break down the artificial distinction between the "onshore" and "offshore" finance centres. To this end, it is important that we can continue to demonstrate that the standards of regulation in Guernsey are at least comparable with, and, in many respects superior to, the standards of regulation applied in many other "onshore" jurisdictions, including standards applied within Member States of the European Union and individual states within the United States of America.

I am, once again, also very grateful for the support that I have enjoyed from my fellow Commissioners. Unfortunately, in February 2008, Mel Carvill retired having served three three-year terms as a Commissioner. We have appreciated the dedication and enthusiasm that he has shown over those past nine years. We are especially grateful for the extra effort that he has made in recent years to attend meetings of the Commission, notwithstanding his extremely busy working schedule as a Global Executive within the Generali Group. In his place, the States of Guernsey has appointed Alex Rodger who, until recently, was a Senior Executive of the Royal Bank of Scotland International, and we look forward to his contributions over future years.

During 2007, Rosemary Radcliffe tendered her resignation as Commissioner. Health problems had prevented her from regular attendance at meetings of the Commission during the latter part of 2007. In its deliberations, the Commission particularly benefited from Rosemary's economic background. We wish her a speedy and full recovery. The process for appointment of her successor has been set in motion.

Peter Harwood
Chairman

Market turbulence

2007 was a very testing year for the financial services industry. The sub-prime crisis, followed by a severe contraction in bank liquidity, resulted in a serious deterioration in the markets. Although the local financial sector held up remarkably well, as the following Directors' reports explain, Guernsey was not isolated from the shocks. The difficulties experienced by the local subsidiary of Northern Rock plc were simply one manifestation of the local effects of the market turbulence.

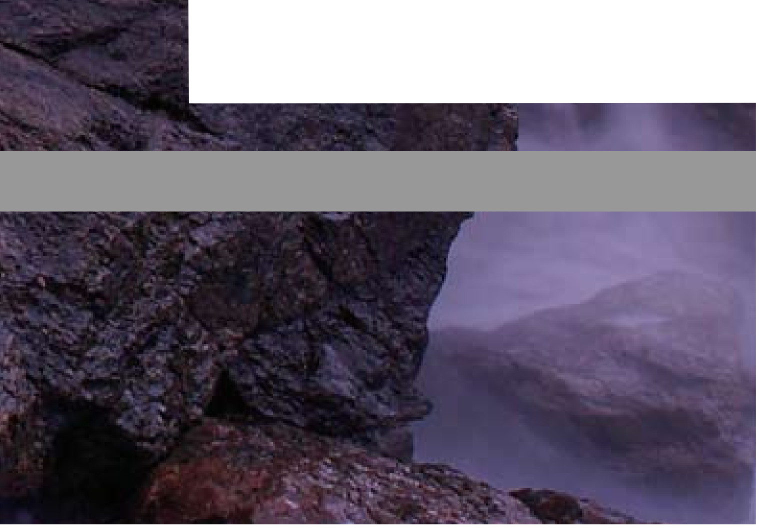
What was at first expected to be a swift correction within the international financial system has changed in nature and broadened in scope. The authorities now face the challenge of preventing the effects of the credit squeeze spreading even further and infecting the wider economy. Fundamental to achieving this is re-establishing confidence in financial institutions and the markets. It is not possible to predict the implications for Guernsey. What is certain is that the international financial environment has changed and that firms are facing even greater challenges than before.

International initiatives have been launched to identify and then address the vulnerabilities in the financial system. A number of the key challenges raised by recent events have been recognised, including the need for effective prudential risk management, the importance of controlling exposure to off-balance sheet vehicles, valuing and accounting for complex products accurately, improving customer due diligence practices, addressing the weaknesses in the originate-to-distribute business model, improving the role of credit-rating agencies in relation to structured products, and reviewing the role and effectiveness of customer compensation schemes.

At the Commission we are analysing the implications for regulation and supervision in Guernsey with a view to addressing both current and future vulnerabilities. Our initial conclusions indicate the need to consider the following matters in relation to the banking sector:

- the adequacy of the legal and regulatory powers available to the Commission to stabilise and correct matters when problems occur, in order to protect customers, the public and Guernsey's reputation;
- the effectiveness of cross-border cooperation between supervisors, and the willingness of parent supervisors, central banks and treasuries to respond to crises originating in their jurisdictions but affecting other jurisdictions. In this context we look forward to seeing the results of the deliberations being carried out to improve the workings of the system of regulation and supervision involving the Tripartite Authorities in the UK;
- the effectiveness of monitoring in a group context;
- the gathering and upstreaming of deposits to parent groups; and
- the appropriateness of introducing ombudsman and deposit protection schemes in Guernsey.

The Northern Rock crisis had a considerable impact in Guernsey because a group subsidiary is based here. The difficulties faced by Northern Rock (Guernsey) Limited were not a direct result of the liquidity shortage which caused the parent bank to seek Bank of England support, and which resulted in a UK government guarantee being provided to the parent bank's depositors. Northern Rock (Guernsey) Limited is primarily a gatherer of deposits which are then lent to its parent. Liquidity was therefore not an issue as long as its parent repaid the amounts advanced to it. The problems it faced were a result of its parent's difficulties – a case of an offshore subsidiary being adversely affected by its onshore parent. This is a salutary reminder that the



frequently cited risk to onshore financial businesses posed by offshore institutions can also occur in reverse.

International standards and the IMF assessment

It has been frustrating to witness a number of larger onshore jurisdictions pressing for all offshore centres to be subjected to special, and to some extent more rigorous, international scrutiny in respect of compliance with international regulatory standards than onshore centres. This is despite the strong arguments put forward by the majority of jurisdictions, both onshore and offshore, in favour of fair and equal treatment for all financial centres. It is difficult not to suspect that fiscal and competitive motives lie behind some of these pressures, particularly when there is resistance to applying normal international standards even to those offshore jurisdictions which have met as high, if not higher, standards than many onshore jurisdictions.

It is therefore encouraging that the Financial Stability Forum has endorsed a move by the International Monetary Fund ("IMF") to begin applying elements of the Financial Sector Assessment Programme, which so far has mainly been applied to onshore jurisdictions, when carrying out assessments of offshore centres. This new approach will apply to the assessment of Guernsey's regulatory and law enforcement regime that will be undertaken by the IMF in December 2008.

Preparations for the IMF assessment are nearing completion. These include three very important developments:

- amending the Protection of Investors (Bailiwick of Guernsey) Law, 1987 ("PoI Law") to provide the Commission with powers enabling us to sign the International Organization of Securities Commissions Multilateral Memorandum of Understanding ("IOSCO MMoU"). This is regarded as the touchstone of internationally acceptable cooperation and information exchange practices;
- introducing a new law registering non-regulated financial services businesses and bringing them more closely into the anti-money laundering and countering the financing of terrorism ("AML/CFT") regime in Guernsey;
- introducing a modern AML/CFT regime in the form of new Criminal Justice (Proceeds of Crime) Regulations and rules for lawyers, accountants and estate agents.

In addition changes have been made to update the insurance laws.

Enforcement action

The Commission's aim is to ensure that the firms we supervise comply with relevant standards by liaising closely with industry and, where necessary, by taking appropriate enforcement action. In addition, we work closely with the law enforcement authorities to seek the prosecution of criminal matters and to counter the abuse of the financial system. Our powers are used proportionately and a robust appeals process is in place.

The year 2007 saw increasingly close cooperation and coordination between the Commission, law enforcement, the Financial Intelligence Service and Her Majesty's Procureur's Chambers. This reflects the importance attached to these relations as the financial industry in Guernsey grows in size and sophistication, and as the AML/CFT regime develops to reflect this.

Industry growth

The financial services industry in Guernsey has continued its strong year-on-year growth. Total investment funds under management and administration increased by 37%

to £178 billion over the year to 31 December 2007. In the same period, total bank deposits increased by 29% to £119 billion. The Insurance Division licensed or approved 64 new entities in 2007, compared to 51 in 2006, including Guernsey's first major commercial reinsurer, Barbican Reinsurance Company Limited. Barbican will be reinsuring a new Lloyds syndicate and is funded by US investors. Also, in the fiduciary sector a number of new firms were licensed.

The Commission remains very alive to the changing needs of industry. The imminent amendment of the PoI Law, mentioned above in the context of the IOSCO MMoU, will also bring in a framework for registered open-ended funds, to complement the regime for closed-end registered funds that has been successful since its introduction during 2007.

Commission finances and staff

In 2007 the Commission benefited from a substantial increase in fee income, primarily as a result of growth in the funds sector. The accounts set out below show a surplus of £1.56 million for the year. At the same time, however, the costs of dealing with problem cases, including the costs of taking investigation and enforcement action, have become more difficult to predict. Experience shows that times of strain in the industry give rise to a greater number of regulatory issues. This means we must build up our reserves to ensure we have sufficient resources to deal with unexpected costs. Bearing this in mind, and taking account of the turmoil in the financial services industry worldwide, it has been decided that we should increase the Commission's reserves until they equal twelve months' expenditure. At the end of 2007 the reserves of £5.53 million equated to 68%, or eight months, of the 2007 total expenses figure.

In line with our approach to controlling Commission expenditure, we have established a new defined contribution pension scheme to which employees joining the Commission from 1 January 2008 will belong, thereby ending for future employees the Commission's participation in the States of Guernsey Superannuation Fund which provides final salary pension benefits to its members. This step is regarded as a prudent reaction to the uncertain and growing costs of providing such pensions.

When setting the fees for 2008 we have, as always, taken account of the commercial environment in which regulated firms operate. As a result, the majority of fees have either been held at the same level as in 2007 or have been increased at a rate equivalent to inflation.

The Commission undertakes a complex and challenging series of roles and in order to carry on doing this effectively we must recruit and retain high-quality staff. This has obvious cost implications.

As I have mentioned previously, the Commission is planning a move to new premises which will provide a better working environment for all staff. It is hoped that 2008 will see good progress being made towards that goal.

I would like to thank all my colleagues for their hard work, professional approach and dedication during 2007.

Peter Neville
Director General

BANKING

Sector trends

There is no doubt that 2007 was one of the most challenging years for banks worldwide for some time with money market conditions proving very difficult in the second half as the set of conditions which have become known as the "credit crunch" took hold. It is evident that those difficult market conditions have continued into 2008.

Developments locally in 2007 have to be seen against that background but the picture was broadly one of the interplay of positive factors reflecting the further solid growth in aggregate deposits and the continuation of the downward trend in the number of licensed banks. Overall developments reinforce the trend of recent years of fewer, larger banks doing more and more business.

Total deposits advanced strongly by 29% from the end-2006 level of £92.3 billion to reach £119.2 billion at the end of 2007 (table 1), driven mainly by corporate and institutional deposits and further growth in Swiss fiduciary deposits. With steady growth in issues of non-deposit short-term paper, total liabilities and total assets reached a new highest level of £133.1 billion (table 2 and figure 1). By the end of the year the proportion of deposits in US dollars had increased to 45% while the proportion of deposits in sterling had fallen to 28% and those in euro had slipped back to 21% (figure 2).

The growth in the deposit base and in total assets was given a major boost early in the year when a large bank participated in the funding of its group's North American private banking business, previously financed by non-group banks. Throughout the year growth in Swiss fiduciary deposits continued to underpin the increase in total deposit levels as increased nervousness about securities markets made staying liquid and holding low-risk bank deposits more attractive. Mortgage lending continued to increase, although at a

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

End	*Banks licensed*	*Deposits £mns*	*Annual change in deposits*
2007	47	119,170	+29.0%
2006	50	92,349	+14.4%
2005	50	80,728	+14.6%
2004	54	70,426	+1.0%
2003	61	69,703	–3.1%
2002	67	71,943	–6.8%
2001	72	77,211	+12.8%
2000	77	68,474	+20.0%
1999	79	57,059	+7.8%
1998	78	52,922	+7.2%

Figure 2. **Analysis of deposits with Guernsey banks by currency at end 2007**

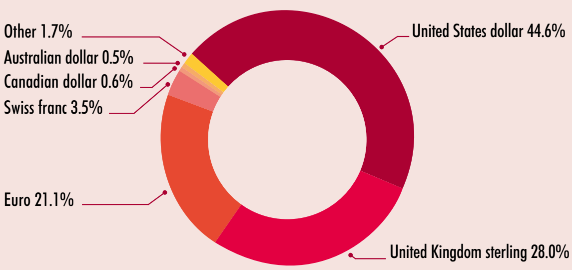
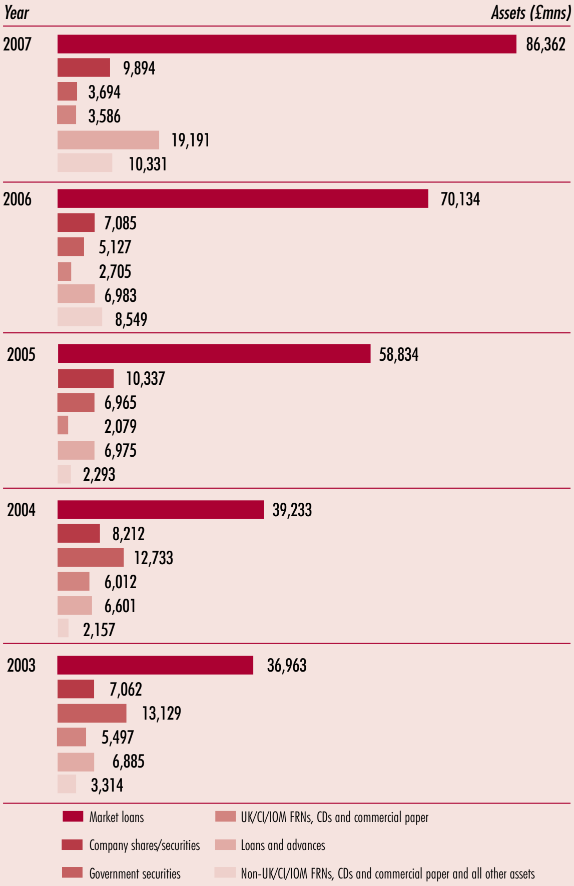


Figure 1. **Assets at the year end**



slightly slower rate than in previous years, and passed £2 billion (figure 3).

As in previous years, the largest proportion of assets (36%) were placed in treasury units and Head Offices in the United Kingdom but there has been a change in the distribution to other financial centres. The proportion placed in other European Union countries has fallen from 19% to 12% while Switzerland has increased from 10% to 14% and the United States of America has increased from 7% to 14%. This latter increase was the result of the previously mentioned increase in funding by a large Guernsey bank of its group Northern American private banking business (figure 4). The source of bank deposits was little changed from previous years, with deposits from Switzerland being slightly higher at 46% and Guernsey slightly lower at 18%. However, deposits from the United States of America rose from 1% to 8% and this is also a reflection of an increase in North American business (figure 5).

As the year progressed it was evident that decisions had been taken at group level to discontinue banking operations at several licensees in Guernsey. The German Landesbank LBBW had decided that following a recent merger it could perform its mainly corporate banking operations at its much bigger London branch much more cost-effectively. LBBW's Guernsey branch ceased operations in Guernsey at the end of March after almost 15 years in the Bailiwick.

The decision of the Portman Building Society to merge with its larger rival the Nationwide Building Society led it to put its Guernsey subsidiary Portman Channel Islands Limited up for sale. After a competitive bidding process the Guernsey bank was acquired by the Scarborough Building Society and the subsidiary now trades as Scarborough Channel Islands Limited.

The Lugano based Swiss private banking group BSI, which had latterly operated in Guernsey as BSI Generali (CI) Limited, decided it could not make a successful and cost-effective transformation from a private banking unit to a group treasury unit and undertook an orderly transfer of its book of business to other parts of the group and finally closed at the year end.

The Guernsey subsidiary of Clariden Leu, the separate private banking brand within the Credit Suisse Group, surrendered its licence at the end of the year having transferred its business to other parts of the group. The business of the Guernsey subsidiary of the Ireland based First Active Bank, which is now part of Ulster Bank and which locally traded as First

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

	2003 total £mns	*2004 total £mns*	*2005 total £mns*	*2006 total £mns*	*2007 total £mns*
Liabilities					
Tier 1 capital*	1,585	1,479	1,385	1,491	1,570
Tier 2 capital**	21	23	28	51	49
Deposits by:					
Banks, etc.	13,811	15,063	16,433	21,480	26,403
British Isles public sector	44	34	36	48	42
Companies, persons, other	55,848	55,329	64,259	70,822	92,724
Other liabilities	1,541	3,020	5,341	6,692	12,270
Total liabilities	72,850	74,948	87,482	100,584	133,058

	2003 total £mns	*2004 total £mns*	*2005 total £mns*	*2006 total £mns*	*2007 total £mns*
Assets					
Loans, advances and market loans with:					
Banks, etc.	37,654	40,077	59,731	71,177	87,896
British Isles public sector	5	5	10	10	10
Companies, persons, other	6,189	5,752	6,067	5,931	17,647
UK CDs***	5,497	6,012	2,079	2,705	3,586
Government securities	13,129	12,733	6,965	5,127	3,694
Company shares/securities	7,062	8,212	10,337	7,085	9,894
Non-UK CDs*** and all other assets	3,314	2,157	2,293	8,549	10,331
Total assets	72,850	74,948	87,482	100,584	133,058

* Paid-up share capital and disclosed reserves.

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

*** Certificates of deposit ("CDs") plus floating rate notes and commercial paper.

Active Bank Channel Islands Limited, was transferred to the Guernsey branch of its fellow group bank Royal Bank of Scotland International Limited ("RBSI") after the Guernsey company had first migrated to Jersey to become a Jersey company, which then enabled it to amalgamate with RBSI, itself a Jersey company.

A Guernsey branch of the Geneva based Swiss bank Credit Europe Bank (Suisse) S.A. was licensed in the first half of the year. Enquiries have been received from several banks wishing to set up in Guernsey and discussions are continuing with those banks. Existing Guernsey banks Investec Channel Islands Limited and EFG Private Bank Limited established deposit-taking branches in Jersey.

In September the Guernsey subsidiary of Northern Rock plc was affected by the troubles of its parent. The local bank (Northern Rock (Guernsey) Limited), whose business is essentially postal and internet-based deposit gathering, sustained very high levels of transactions in the month or so after the parent secured Bank of England funding. Activity levels stabilised after the announcement of the UK government's guarantee arrangements for retail and wholesale depositors of Northern Rock plc. Northern Rock (Guernsey) Limited's deposits with its parent are classified as wholesale deposits and so are covered by HM Treasury's guarantee arrangements. Following unsuccessful attempts to find a private-sector solution, the UK government placed Northern Rock plc into temporary public ownership on 22 February 2008 with the intention of an eventual transfer back into the private sector once market conditions made this possible. As part of the nationalisation process, the Commission approved a change of indirect controller for Northern Rock (Guernsey) Limited in favour of the UK government, with ownership vested in HM Treasury. A UK government-appointed Executive Chairman, Ron Sandler, was tasked with running Northern Rock plc on a commercial arm's-length basis whilst the bank remained in public ownership, and with producing a strategic review at an early stage.

It is evident that during the period of uncertainty following the troubles of Northern Rock, savers and investors in the offshore deposit-gathering banks adopted a cautious approach and many sought additional comfort by reallocating their

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

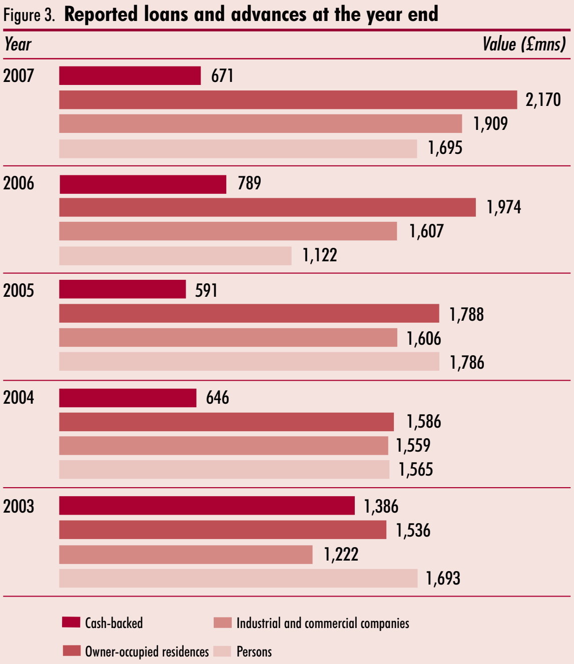


Figure 4. **Disposition of bank assets at end 2007**

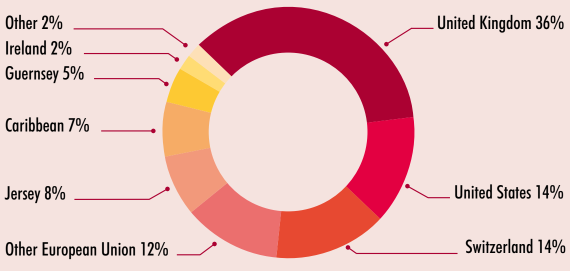
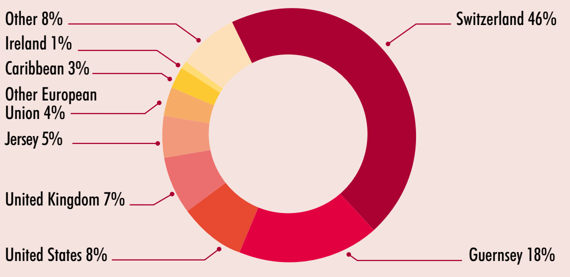


Figure 5. **Source of bank deposits at end 2007**



portfolios, spreading their funds amongst several banks which initially took the form of a "flight to quality" with funds typically being placed with UK clearing banks.

In the light of the Commission's experience in the Northern Rock story it has given considerable thought to the vulnerabilities which arise from the failure of a parent bank where funds from the local subsidiary are 100% upstreamed to the parent bank. It is currently undertaking a review of the Guernsey supervisory infrastructure for banks. This will address inter alia the issue of parental funding, information exchange with home regulators and liaison with the parent bank, group liquidity arrangements, access of the parent to lender of last-resort facilities and the feasibility of a deposit protection scheme. The Director General's statement sets out more fully the background to and the objectives of the review.

Despite the credit crunch induced difficulties in the second half, Guernsey banks overall were able to report a solid improvement in profitability in the year. As in the previous year there were more banks showing higher profits than those reporting lower profits. It was particularly encouraging that aggregate net interest income – the measure of core banking revenues – was up some 9% over the year after showing a marginal decline the previous year. It was also noteworthy that Guernsey incorporated banks' Tier 1 capital levels increased overall by £79 million even after the withdrawal of three subsidiary banks and the transfer out of the Bailiwick of their capital bases (figure 6). Most of the large subsidiary banks were able to retain their profits here to act as a foundation for future growth. The overall weighted risk asset ratio remained healthy at 17.6%. Figure 7 shows the distribution of locally incorporated banks by risk asset ratio as at the end of the year.

Figures 8 and 9 show the country of origin of the 24 bank subsidiaries and the 23 bank branches licensed at the end of 2007. A list of current licensees is available on the Commission's website at www.gfsc.gg.

Supervision and policy

Banking policy was essentially unchanged in 2007, although much preparatory work continued on the ground work for the new Basel II capital framework. As in the previous year we participated with fellow supervisors from the Jersey Financial Services Commission and the Isle of Man Financial Supervision Commission in the so-called Tri-party group with a view to achieving a broad consensus approach to Basel II for the three Crown Dependencies. Further meetings were held by the Tri-party group and further papers were issued to our respective banking sectors so that licensed banks could continue their preparation and planning processes. The Tri-party group issued papers on operational risk and this also set out the reporting format for that aspect of banking business which under Basel II requires capital support. A paper was issued on high-level principles on Pillar 2: this took forward the concepts set out in an outline of key risks provided by us to Guernsey banks in 2006 and gave a consensus approach to the relevant Pillar 2 risks which are likely to be experienced by banks operating in the Crown Dependencies. A comprehensive paper was issued later in the year on internal capital adequacy assessment process ("ICAAP") methodology, pointing out that the responsibility will be on banks to produce an ICAAP for their local subsidiaries and that they cannot rely on a group ICAAP. The paper set out

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

Year	*Tier 1 capital (£mns)*
2007	1,570
2006	1,490
2005	1,385
2004	1,479
2003	1,585

Figure 7. **Distribution of locally incorporated banks by risk asset ratio at end 2007**

Risk asset ratio	*Number of banks*
10%–13.99%	4
14% –17.99%	10
18% and over	10

what risks need to be addressed and suggested a format which will capture both the risks and the risk mitigants. Two further technical papers were issued: the market, interest and settlement risk paper and the credit risk paper. Taken together with the operational risk paper they effectively set out the reporting format for Crown Dependency banks when we move to the implementation phase. Those papers provide the foundation for the respective Commissions to produce their new Basel II reporting forms and the supporting Basel II guidance notes.

In tandem with the issue of these papers we embarked on a series of training programmes to ensure that staff were kept abreast of developments in the Tri-party papers. Training was essential to ensure that all members of staff had a comprehensive understanding of the key changes and requirements under Basel II so that they had the relevant knowledge base ahead of the implementation phase. It is important for our supervisors to understand what to expect from a local bank ICAAP submission, especially since some banks will be using group resources and formatting to produce their submissions. It also remains critical for Guernsey staff to be fully aware of the relevant risks which would apply to banks operating in the Bailiwick. We still have work to do in 2008 on the supervisory review evaluation process ("SREP"), which brings together the risks identified by both the bank and by us as supervisors and sets those against the control environment and risk management culture in the bank to form an overall view of the riskiness of the institution.

Work was continued on the preparations for the forthcoming assessment at the end of 2008 by the International Monetary Fund ("IMF") against the international regulatory standards contained in the Revised Core Principles for Effective Banking Supervision. The Revised Core Principles were confirmed by the Basel Committee during 2007 and we needed to make an internal review against those definitive core principles. That work is continuing into 2008.

The Division undertook its annual trading book survey in the autumn to determine the extent to which banks were engaging in proprietary trading. Once again the survey confirmed that there is very little own-account trading in the Bailiwick and that there was no material increase in such business compared with the previous year – indeed, there was slightly less own-account business than previously as particular banks had exited from the very limited proprietary trading that they previously undertook.

The on-site review visit programmes continued throughout 2007. Seventeen anti-money laundering/countering the financing of terrorism ("AML/CFT") visits were conducted and some seven credit on-site reviews were also undertaken. The AML/CFT programme was undertaken under the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Regulations, 2002 and the then current guidance notes, that is, prior to the introduction of the Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 and the new *Handbook for*

Figure 8. **Country of origin of Guernsey licensed banks – subsidiaries at end 2007**

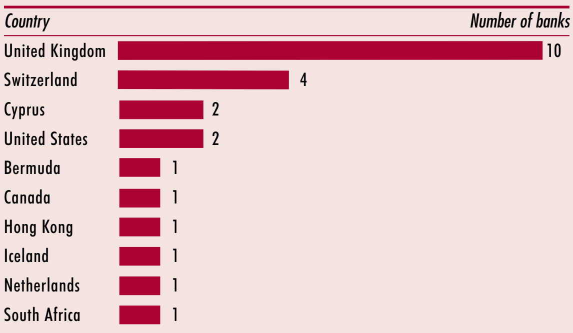
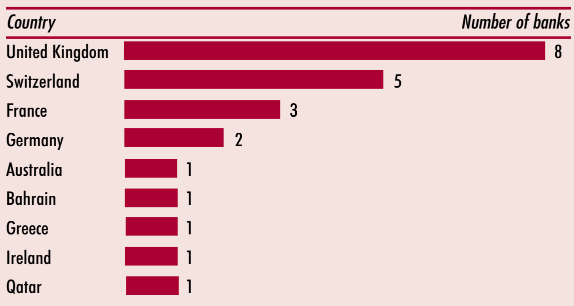


Figure 9. **Country of origin of Guernsey licensed banks – branches at end 2007**



Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("Handbook"). Credit on-site reviews involve a smaller number of the licensed population who have a material credit portfolio. The focus in the international private banks sector is typically on property lending and lending against securities portfolios. However, amongst banks providing credit locally the focus is on mortgage lending, including the bank's approach to affordability and ability to service the mortgage repayments.

During the year the Division was closely involved in the preparation of the *Handbook,* which came into force on 15 December. In November, the Director took part in a briefing to the banking sector on the requirements contained in the *Handbook*.

At the end of the year the Division was given responsibility for monitoring compliance by non-regulated financial services businesses with the AML/CFT regulations set out in the *Handbook*. These businesses include bureaux de change, money brokers and consumer credit businesses. The non-regulated financial services businesses sector will become subject to a registration framework during 2008. An additional person has been recruited to the Division to assist with the registration process.

International developments

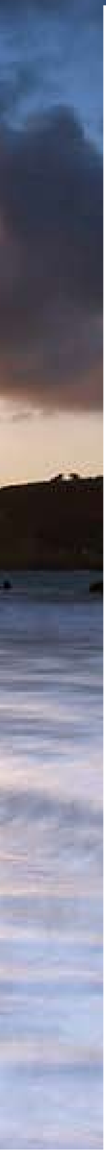
The Director and Deputy Director attended the 2007 meeting of the Offshore Group of Banking Supervisors ("OGBS") which was held in Macau, China on 29 to 31 October. The OGBS meeting was preceded by a seminar organised by the Financial Stability Institute ("FSI") which addressed Basel II implementation and the revised Basel Core Principles. The OGBS plenary meeting was addressed by representatives of the IMF, the Financial Action Task Force, the Basel Committee, the Financial Stability Forum and the Egmont Group. Consideration was given to the future role of the OGBS and there was a review of requests for membership of the group. Bilateral meetings were held with several home supervisors of institutions we supervise on a host basis. Meetings were held with executives of the UK Financial Services Authority ("FSA") in London, with officials of the Swiss Federal Banking Commission in Bern and with the Director of Banking, Trust and Investments of the Bermuda Monetary Authority in the fringes of the Macau meeting.

During the year visits to the jurisdiction were made by several overseas supervisors. The UK FSA performed an on-site review visit to a local institution in order to complete its Arrow Risk Assessment of the parent group. There was a visit by United States banking supervisors from a member bank of the Federal Reserve System and a State Superintendent of Banks to perform an on-site visit to the subsidiary of one of its banks in November. At the end of the year supervisors from the Jersey Financial Services Commission visited the island to undertake review visits of several Guernsey licensed branches of Jersey incorporated banks.

During the course of the year two members of the Division participated in the UK FSA organised residential course, Arrow Risk Based Regulation. As in previous years several members of the Division attended training seminars with wide international participation put on by the FSI in Basel, Switzerland.

Representing the Basel Committee Working Group on Cross-Border Banking, the Director was invited to make a presentation to the High-Level Meeting on Implementation of Basel II in Africa organised by the FSI in collaboration with the Institute of International Finance. This was held in Cape Town, South Africa where the specific topic delivered was current issues and developments in AML/CFT.

FIDUCIARY AND INTELLIGENCE SERVICES

Sector developments

At the year end there were 149 full and 54 personal fiduciary licensees (2006: 147 and 58 respectively). During the year, new businesses to which full licences were issued were Lancaster Trustees Limited, Liberation Management Limited, AFR Trustees (Guernsey) Limited, AO Active Corporate Services Limited, Augentius Trust Company (Guernsey) Limited and Aztec Financial Services (Guernsey) Limited. In addition there were group reorganisations leading to former joint licensees becoming lead licensees. A list of current licensees is available on the Commission's website at www.gfsc.gg.

Supervision and policy

The Division started the second cycle of visits to licensees in January 2007 and visited 31 full and nine personal licensees during the year. The visits to full fiduciary licensees focused on three areas – client take-on, investment management and corporate governance. An overview of those aspects from the second cycle of visits undertaken so far is provided below:

- Client take-on

  We have looked at aspects of client take-on beyond the areas of know your client/verification of identity already examined during the first cycle of visits. Our examinations during the second cycle have included reviews of standard literature about fiduciaries' services and of information provided to potential clients on how an administered trust or company will operate.

  The licensees visited have appreciated the value of setting out clearly to potential clients the roles of different parties to trust and company structures and agreeing fee arrangements. While fiduciaries have generally been thorough as regards fee arrangements with new structures, we have seen a sensitivity about the issues of fees and terms and conditions on older files and occasionally a reluctance to address this. A significant proportion of complaints made to the Commission about licensees originate on such files and some could be avoided by clearer discussions over fees, particularly when changes are made to charging structures.

- Investment management

  The Division has also reviewed the management of investments held by trusts and companies, for example when and how external investment advice is used and how performance is monitored.

  In the majority of cases fiduciaries have appointed professional investment managers to manage trust/company investment portfolios. However, the written recording of the terms of investment agreements has been variable.

  We have seen very few cases where the trustee fulfils the investment management function itself and, where this has occurred, it has not always been clear from the files that an investment policy and objectives have been established for the portfolio. In these cases, we are requiring licensees to document the investment policy and objectives.

  In relation to the monitoring of investment performance, where licensees have a member of staff carrying out a dedicated investment-monitoring function, the individuals have a relevant investment qualification or investment experience. A number of licensees have appointed independent investment advisers to comment on or assess for the licensee's benefit the manager's investment performance. This may either be a direct relationship on a per-case basis between the investment adviser and the trustee, or at licensee level.

  We have seen cases in which licensees have sought to secure adequate management and control where a settlor or beneficial owner attempts to control investment decisions. However, on some older cases licensees again, on occasion, have appeared reluctant to change an established pattern of behaviour and we have stressed that a modus operandi that was considered acceptable at the inception of a relationship may not be acceptable now.

- Corporate governance

  The third theme considered in these visits has been corporate governance within the licensee, for example, the content and format of board meetings and the exercise of the board's oversight generally.

  What we have seen in this area has been mixed, but where the corporate governance culture is weak those licensees have recognised this and are taking steps to address the position. For example, whilst directors may be very actively involved in the day-to-day running of the business, this has not always been evident from minutes of board and management meetings. We have also seen, in some cases, lower governance standards within managed trust company licensees, and in these cases have emphasised that the same expectations apply to managed as to stand-alone licensees. In particular, the directors of a managing licensee, when acting on the board of the managed trust company, are as much responsible for the direction of the managed business as for their own licensee.

We will continue to review these areas and, as we have done during this year, require necessary changes to be made.

Throughout the year, the Division was closely involved in the Commission's preparation of the *Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("Handbook")*. The *Handbook* became effective on 15 December 2007, and shortly before this date the Division made presentations to the fiduciary sector in Guernsey, Alderney and Sark. We have been working with other Divisions to adjust the structure of on-site visits to reflect the requirements of the new Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 and the *Handbook* in a consistent way.

The Director of Fiduciary and Intelligence Services and senior staff provided general regulatory updates to licensees in Alderney in June and Sark in July.

During the year, the transitional licence application of Old Crown Trust Limited was withdrawn and the remaining transitional application, by Claridges Trustees Limited, was refused. This marks the close of the transitional phase during which fiduciaries already in business when the legislation came into force in 2001 were permitted to continue their activities until the final determination of their licence applications.

As indicated under Sector developments, above, the Division continues to receive new licence applications for a variety of types of fiduciary activity, on both managed and stand-alone bases and also from individuals seeking a personal fiduciary licence.

The Fiduciary Services Education Forum, chaired by the Director, met twice during the year and is made up of representatives of the Guernsey Association of Trustees, the Guernsey branches of the Society of Trust and Estate Practitioners and the Institute of Chartered Secretaries and Administrators, and the Commission. The forum exists to review training needs within the sector and benefits from the support and expertise of the GTA University Centre ("GTA"). With the GTA's assistance, during the year the forum has updated the Fiduciary Industry Qualification Matrix to enable those working in the sector to chart a path through the wide range of professional qualifications available. The matrix is advisory in nature and is available at www.gta.gg.

The Division pays close attention to training on fiduciary and anti-money laundering and countering the financing of terrorism ("AML/CFT") matters within licensees and these matters are relevant to licensees' "4-eyes" arrangements and succession planning. During the year the Division has had discussions with some smaller full licensees about the proposed promotion to board level of staff whom the Division considered to have insufficient qualifications and/or experience to make up part of the licensees' "4-eyes" arrangements. The Division did not approve the proposed appointments and, in the absence of a compulsory minimum qualification requirement for directors, will continue to examine proposed appointments carefully.

The visit of an International Monetary Fund ("IMF") review team in December 2008 will examine the supervision and enforcement of the Bailiwick's AML/CFT requirements for fiduciaries and our previous focus on AML/CFT work is continuing, alongside the three non-AML/CFT themes summarised above. Although the IMF's review will not encompass the supervision of fiduciaries beyond the AML/CFT area, a self-assessment of that supervision is being undertaken against the Statement of Best Practice in relation to Trust and Company Service Providers published by the Offshore Group of Banking Supervisors in 2002.

International developments

The Director and Deputy Director met their counterparts from the Isle of Man, Jersey and Gibraltar in Jersey in March and in Gibraltar in November to discuss both policy issues and businesses licensed in more than one jurisdiction.

Legislative developments

The Director has been closely involved with the Policy and International Affairs Division in the development of rights of appeal against regulatory decisions and of the Commission's enforcement powers, and in the States of Guernsey Commerce and Employment Department's work on company law, described below.

Companies

The intelligence team handled a record number of applications for consent to register companies in Guernsey and Alderney. A total of 2,157 companies were formed in Guernsey and 58 in Alderney. However, a number of applications were refused by the States of Guernsey Policy Council or withdrawn as a result of issues raised by the team. Examples of such cases include proposals for:

- a convicted child molester's involvement in an investment-holding company;
- a Russian subject to allegations of fraud and corruption wishing to have a property-holding company;
- a restaurant-holding company for owners with connections to the drugs trade;
- an investment-holding company for a Middle Eastern owner accused of fraud and torture;
- the bulk sale of unlicensed medical products to a Third World country;
- a holding company for a non-locally licensed internet gaming business; and
- a holding company for a petrogas business in a highly corrupt jurisdiction where there were concerns that insufficient oversight could be maintained from Guernsey.

During the year the Commerce and Employment Department concluded its review of Guernsey's company law. The Director continued to participate in the Company Law Steering Group and its Legislation Sub-group, and in June took part in a presentation to the finance industry and professionals on the proposed new companies law. This law is expected to come into force in the third quarter of 2008 at the same time as the new companies registry becomes operational.

The proposed legislation brings into effect a full revision of company law including the company formation process, in which the Commission has been involved for many years on behalf of the Policy Council and, before that, the States of Guernsey Advisory and Finance Committee. Under the new legislation the Policy Council, and therefore the Commission, will cease to have a role in the formation of Guernsey companies. Instead of that role and the current restriction on formation to advocates, Guernsey companies will only be formed by full fiduciary licensees. After formation, companies need not retain a fiduciary but those which do not must identify a Guernsey-resident director who will be under a legal obligation to take reasonable steps to keep himself informed of the beneficial ownership of the company.

On an AML/CFT level, these are important safeguards and should ensure that Guernsey requirements are complied with before company formation takes place, and that necessary information is available in the Bailiwick both at and after formation. However, the changes will place heightened responsibility for the reputation of the Bailiwick on licensees who are asked to form companies for exposed individuals or sensitive activities. In the past, after consideration by the Commission, some such cases have been refused by the Policy Council whereas in future the final decision on whether a Guernsey company is formed will lie with the fiduciary licensee. The Commission will expect such decisions to be made responsibly and for the reasoning to be fully documented. Fiduciaries should be ready to bear the consequences of any future problems resulting from facts which were, or should have been, known to them when they decided to form the company in question.

The present system will continue for the formation of Alderney companies.

Intelligence

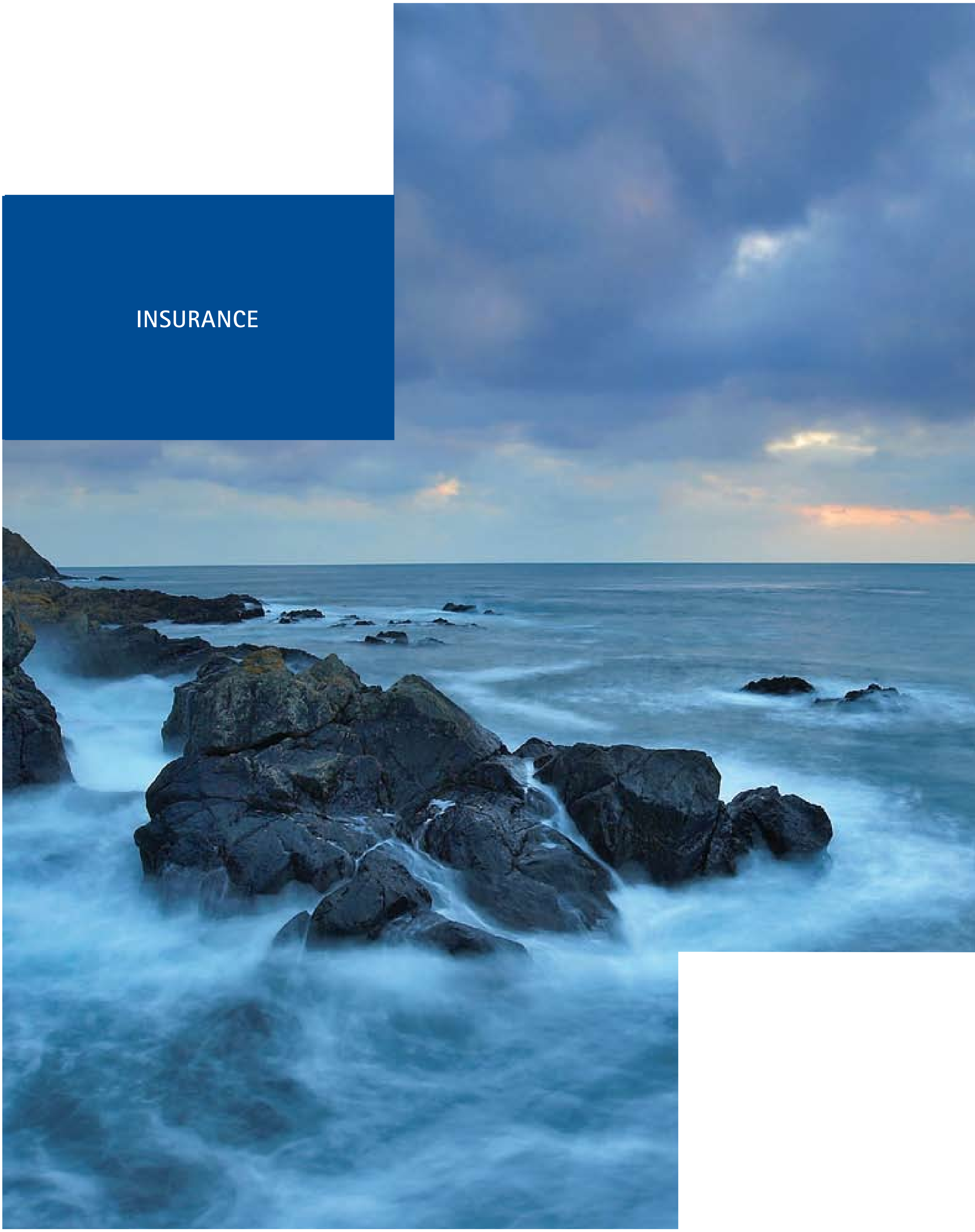
The intelligence team continued to assist in connection with a wide variety of matters involving local law enforcement and overseas regulators as well as supporting the other regulatory Divisions within the Commission. The Commission's membership of the Financial Crime Information Network continued to prove a useful method for sharing information on problem cases and assisting other member agencies with their own enquiries.

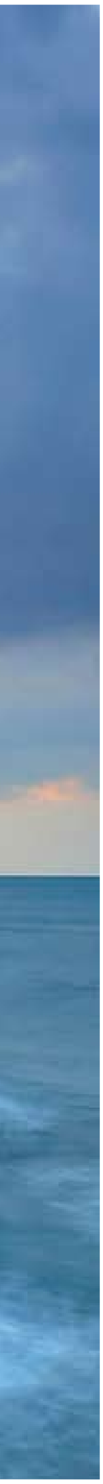
During the year the team served notices under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000, in order to assist the Central Bank of Cyprus and the Ontario Securities Commission with their investigations.

As well as working with law enforcement and other regulatory bodies, the team was involved in liaising with local financial institutions and helped to disrupt suspected fraud and potential money laundering schemes.

The perennial problem of bogus bank websites continued throughout the year and they were successfully tackled by the team, the site hosts generally being cooperative once made aware of the problem. Guidance was also given to genuine institutions whose websites had been copied by fraudsters.

INSURANCE





Market performance

International insurance market

During 2007, 64 new international insurance entities (made up of companies and protected cell company ("PCC") cells) were licensed in Guernsey. Many of the new entities are owned by well-known companies, such as ABN Amro Bank, Towergate Partnership and AIG. The Insurance Division continues to see a diverse range of insurance companies being formed from the traditional captive to large reinsurers. There were a number of firsts for Guernsey in 2007, including the world's first local authority captive for the Australian Gold Coast City Council, which after a rigorous selection process chose Guernsey in recognition of the corporate governance requirements under the Insurance Business (Bailiwick of Guernsey) Law, 2002. Guernsey's first major commercial reinsurer, Barbican Reinsurance Company Limited, will be reinsuring a new Lloyd's syndicate, which will write a diverse portfolio, initially in international property and casualty reinsurance, treaty business and other specialist lines, and is supported by a number of US private investment funds. Guernsey's first pension reinsurer, Pension Security Insurance Corporation Limited, will participate in the UK bulk annuities market by way of reinsurance of its UK sister company. The first incorporated cells in an incorporated cell company ("ICC") were licensed to conduct insurance business in 2007. Just under 40% of the new insurers were established for UK companies, with nearly 30% being established for companies based in Europe (figure 10). Although the majority of companies choosing Guernsey as the domicile for their captives are from the UK, the increasing numbers of European and US companies choosing Guernsey demonstrates the continuing attractiveness of Guernsey as a leading international insurance centre.

Despite the current soft market conditions, the number of captive insurance entities licensed or approved increased. Currently there are a total of 632 insurance entities licensed or approved to write insurance business, consisting of international insurers, PCCs, ICCs and cells. The Commission is continuing to see cells that are comparable in size to a full-blown captive. Although the number of captive insurance companies has dropped over the year due to some captives coming to the end of their useful lives, others completing the run-off of business, or mergers and acquisitions of parent companies, the reduction has been more than offset by the number of cells in PCCs and ICCs being approved. Figure 11 shows the trend over time in the total number of licensed insurers, PCCs, ICCs and cells. Forty-two new protected cells and seven incorporated cells were approved during the year, an increase from 31 protected cells and no incorporated cells in 2006.

Local insurance managers have indicated that there is continued interest in forming captive insurers in Guernsey, especially in the small to medium enterprise market, where cells are a low-cost alternative to a full captive insurance company.

Domestic market

The domestic market, which provides insurance services to the local community and consists of insurance intermediaries and domestic insurers, has remained stable over the last year. At

Figure 10. **Shareholder location for new insurers, PCCs, ICCs and cells licensed in 2007**

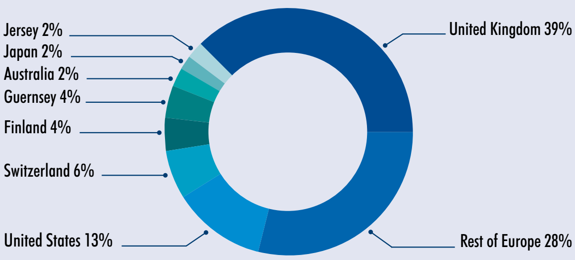
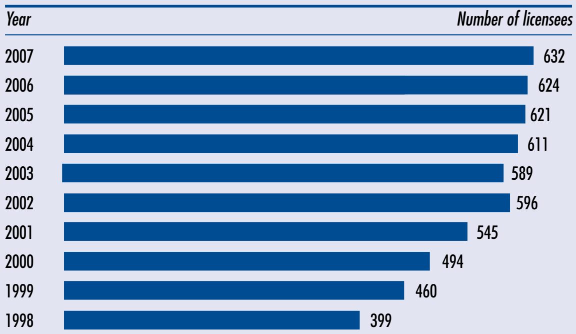


Figure 11. **Number of insurers, PCCs, ICCs and cells at the year end**



the end of 2007 there were 47 licensed intermediaries and 25 licensed domestic insurers.

During the year there was a net decrease of one insurance intermediary as a result of two new licences being issued, two licences surrendered and one revoked. The net increase of one domestic insurer resulted from two new licences being issued and one being surrendered.

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

Market condition

In light of the sub-prime crisis and the potential impact on the financial services industry, the Division conducted a survey of Guernsey's insurance sector which demonstrated that there was relatively little impact from the market conditions as the insurance market was not correlated to the economic cycle and the majority of the assets of the insurers were invested in cash or fixed interest bonds.

The main concerns for insurance supervisors are the uncertainty over the extent of crisis, financial conditions of financial conglomerates where an insurance company and a bank are in a same group, and the secondary and indirect impact of the crisis.

The IAIS is developing a principles-based solvency standard to enhance risk sensitive insurance supervision and studying issues on corporate governance to identify a role for the IAIS in encouraging sound risk assessment and risk evaluation by insurance companies.

Education

The Division continues to support initiatives to improve standards within the sector. The Insurance Education Forum, which was set up by the Commission in conjunction with the Guernsey Training Agency, now the GTA University Centre, and whose members are from a cross-section of industry, met during the course of the year. 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".

There was extensive cooperation between the Division and captive managers and intermediaries as well as actuaries, accountants and chartered secretaries. We held a number of seminars in our drive to improve compliance standards with insurance intermediaries during 2007 which will continue during 2008.

Mandatory minimum qualifications for authorised insurance representatives providing advice on long-term insurance products came into force in June 2006. These include a requirement to hold the Guernsey Insurance Certificate.

We actively encourage insurance managers and those working in the captive sector to complete the Certificate in Captive Management, which was launched in Guernsey in 2002. Nearly 60 people have been awarded the Certificate and a further 50 are currently undertaking the course with students from a variety of jurisdictions, including Guernsey, the Caribbean, the Isle of Man, Jersey, Malta, the Middle East and South Africa. 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.

The Guernsey Insurance Company Management Association generously agreed to fund the updating and review of the core material which is used by students who are studying for the Certificate. The new material, which reflects recent industry developments, will be introduced early in the new year.

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 enhance its understanding of licensees and their systems of control. In many cases, it has proved beneficial to perform a "themed" on-site visit, designed to address specific areas, in order to gain a deeper insight into a particular aspect of the licensee's operations. During 2007, we visited 13 insurance intermediaries, seven insurance managers, four international life companies, three non-life companies and one domestic insurer, covering 210 captives/PCCs.

Members of the Division also had regular meetings with insurance managers to discuss new applications, changes in business plans and other issues, such as capital requirements. Many of these meetings included the owners or potential owners of captive insurance companies. During 2007, we began a programme of annual meetings with licensed insurance intermediaries.

The Division adopts a risk-based approach to monitoring insurance companies, with a risk rating assigned to each company based on a set of standard criteria. This approach allows us to focus our resources on the areas of greatest risk and to identify where regulatory action may be required.

During 2007 regulatory action continued against a small number of insurance intermediaries. The Commission's action against St James Global Limited, a licensed insurance intermediary, was concluded. This action resulted in the revocation of St James Global Limited's licence and the disqualification of Joseph Coutts, its Managing Director, from acting as a director for 11 years following his conviction for fraud in 2006.

We continued to monitor developments concerning the Equitable Life Assurance Society ("Equitable Life"). Regular meetings were held with the United Kingdom 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. The recommendations of the Parliamentary Ombudsman, following the investigation into Equitable Life, are not now expected until the middle of 2008. This is due to her consideration of the substantial representations which she received from the public bodies whose actions are subject to investigation. In addition, an enquiry into Equitable Life has been conducted by a special committee of the European Parliament and a report has been sent to the UK government.

During 2007, the Division completed its consultation with the insurance sector regarding the proposed revisions to the Insurance Business (Bailiwick of Guernsey) Law, 2002 and the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 and their associated rules, regulations and codes (together "the Regulations"). The amended Laws and the Regulations will take effect in March 2008. The amendments have been made as part of our preparations for the scheduled visit by the International Monetary Fund ("IMF") in December 2008 and to ensure that the Bailiwick's insurance laws remain up to date and continue to meet international requirements by enabling regulation of the sector in an appropriate and efficient manner.

Senior members of the Division provided input to discussions regarding the preparation of the new *Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("Handbook")*, which came into force on 15 December 2007, and have been liaising with other Divisions in order to revise the structure of on-site visits to reflect the requirements of the new Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 and the *Handbook* in a consistent way. In November the Deputy Director of Insurance took part in a briefing to the insurance sector on the requirements contained in the *Handbook*.

The Director of Insurance chairs the Insurance Advisory Group (formerly the Forum for Insurance Development). This body provides an opportunity for representatives of the industry and the Commission to discuss and explore solutions to technical and regulatory challenges facing the Bailiwick's insurance sector with a view to improving the insurance supervisory framework.

International developments

The Commission has continued to ensure that Guernsey maintains its high profile within the international insurance standard-setting body, the IAIS. Guernsey is a member of the Offshore Group of Insurance Supervisors ("OGIS") and the Director General represents that body as a member of the IAIS Executive Committee.

The insurance core principles, standards and guidance developed by the IAIS are used by the IMF and other international bodies to assess the quality of individual jurisdictions' regulatory and supervisory regimes. In order to monitor, and where necessary influence, the development of these principles, standards and guidance, the Director General and Insurance Division staff play a very active role in the work of the IAIS. The Director General represents the IAIS on the Financial Stability Forum Offshore Financial Centres Review Group and, together with the Director of Insurance, attended the IAIS Triannual Working Party Meetings and Executive and Technical Committee Meetings.

The Director of Insurance chairs the IAIS Captive Guidance Paper Drafting Group which was formed at the start of 2007 to progress a guidance paper on the supervision of captives; the Division's Actuary also assists with the work of the group. The group is a sub-group of the IAIS Reinsurance Subcommittee and reports to that subcommittee. Five meetings were held during the year, four in London and one in South Carolina in order to obtain input from US captive insurance regulators. The membership of the drafting group is as follows: Bermuda, the British Virgin Islands, Cayman, France, Germany, Gibraltar, Guernsey, Ireland, the Isle of Man, Jersey, Luxembourg, Singapore and the United Kingdom. The paper will be released for formal consultation in 2008 and the intention is for it to be adopted at the IAIS annual general meeting in October 2008. The guidance paper will provide a valuable source of reference on issues specific to captives for insurance supervisors worldwide.

At the end of 2007, the Director of Insurance was appointed Chair of the Insurance Fraud Subcommittee. During 2007 the subcommittee worked on the preparation of training material for the recently published guidance paper on preventing, detecting and remedying fraud in insurance. In addition, Guernsey is a member of the Implementation Committee, the Insurance Laws Subcommittee, the Regional Coordination Subcommittee and the Reinsurance Subcommittee of the IAIS.

Guernsey is also a member of the IAIS Corporate Governance Task Force and the Financial Conglomerates Subcommittee which during 2007 drafted a paper on the principles of group-wide supervision. Input from the Commission during the drafting process helped to ensure that non-financial groups that owned more than one captive insurance company would not fall under the definition of financial conglomerate.

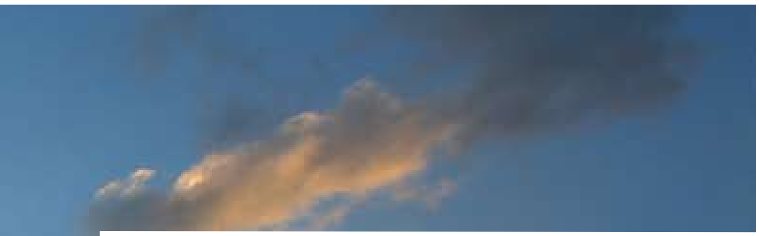
The Solvency and Actuarial Issues Subcommittee, of which Guernsey is also a member, is currently working on the development of a number of solvency-related standards and guidance papers, including the structure of regulatory capital requirements, capital resources, risk management and the use of internal models.

During 2008, a task force will review the existing IAIS insurance core principles which were last reviewed in 2003. Guernsey has been selected as a member of this group and should be in a good position to influence the development of the revised principles taking into account the specific features of the regulatory environment of the insurance business supervised by OGIS Members and our experience in assisting in the earlier work of the IAIS on the Insurance Core Principles.

In May 2007 the Commission hosted the annual working meeting of OGIS. In September members of the Division assisted with a training course for captive insurance supervisors organised by OGIS and supported by the IAIS.

During 2007, the Director and other Commission staff made presentations to several insurance-related conferences, including the annual conference of the Risk and Insurance Management Society in May, the Association of Insurance and Risk Managers conference in June, the Guernsey Insurance Forum in March and, in November, Thomas Miller's Conference on Captives and the World Captive Forum.

INVESTMENT BUSINESS



Market conditions

Although markets generally began 2007 on a positive note, the mood changed significantly from August onwards as the sub-prime credit crisis in the United States of America began to have international ramifications. Market conditions deteriorated as the overall impact on commercial and investment banks became clearer, and as liquidity declined in the inter-bank markets.

Against that background, it might have been expected that demand for new Guernsey domiciled investment vehicles would diminish significantly. In the event fund consents and licence approvals granted by the Division once again exceeded previous records. In the open-ended sector, a total of 367 new investment pools were authorised (27 new funds and 340 new classes of existing funds) compared with 317 investment pools (48 funds and 269 new classes) in 2006 (table 3). The preponderance of new classes added to existing funds, rather than the creation of new stand-alone funds, emphasised once again the attractions of umbrella and protected cell structures, and continues the trends seen in previous years. The total value of open-ended funds increased by 22% during the year from £56.7 billion to £69.3 billion. Table 4 and figures 12 to 14 provide an analysis of open-ended funds.

In the closed-end sector, 154 new funds received consent, compared with 127 in 2006 (table 3). The Registered Closed-end Fund regime, introduced in February 2007, had a significant impact on these results, with 82 closed-end funds being approved under that regime. In addition, 33 closed-end funds were approved under the existing Qualifying Investor Fund ("QIF") regime introduced in February 2005. A further nine open-ended funds were also launched under the QIF regime. The total value of closed-end funds increased over the year by 57% from £48.5 billion to £ 76.4 billion. Table 5 and figures 15 and 16 provide an analysis of closed-end funds.

Consents for the administration in Guernsey of funds domiciled in other jurisdictions increased markedly, to 75, compared with 40 in 2006 and 46 in 2005; of those approvals, 38 were

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

	2006	*2007*
Open-ended funds – authorised	48	27
Open-ended funds – new classes approved	269	340
Closed-end funds – approved	127	154

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

	2006	*2007*	*Change*
Number of funds	270	277	+2.6%
Number of investment pools	1,508	1,804	+19.6%
Value of assets (£bns)	56.67	69.25	+22.2%
Net new investment over year (£mns)	8,017	5,201	–35.1%
Number of registered holders ('000s)	76.2	75.5	–0.9%
Stock exchange listed	87	96	+10.3%

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.

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

	2006	*2007*	*Change*
Number of funds	454	574	+26.4%
Value of assets (£bns)	48.47	76.36	+57.4%
Number of registered holders ('000s)	64.50	74.69	+15.8%
Stock exchange listed	161	195	+21.1%

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 12. **Open-ended funds: geographical distribution of investments at end 2007**

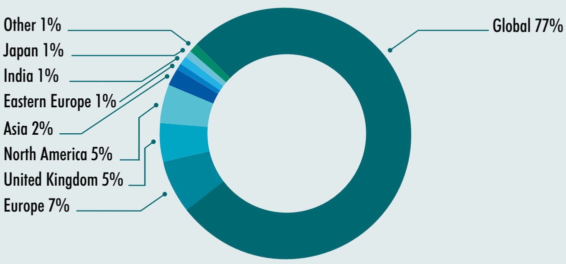
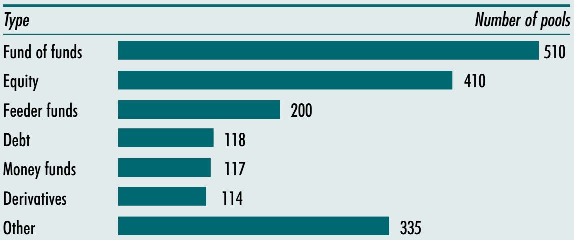


Figure 13. **Open-ended funds: analysis by type of investment pool at end 2007**



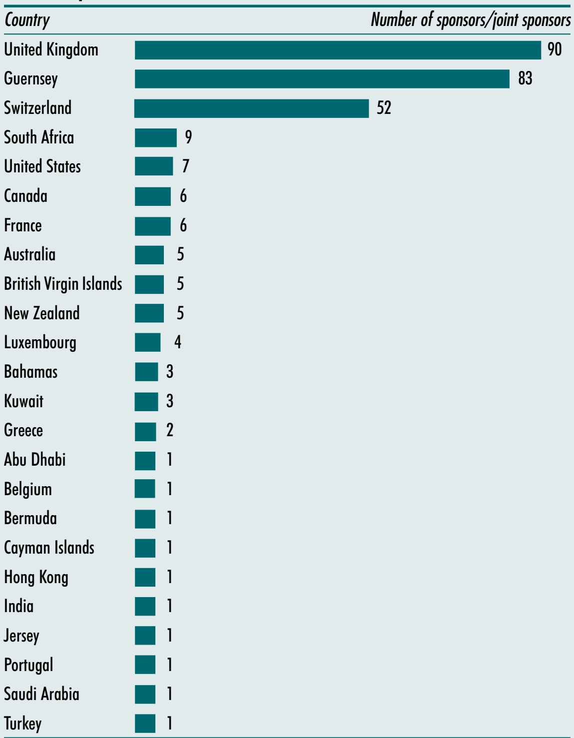
for QIFs, compared with six in 2006 and seven in 2005. The total value of non-Guernsey schemes under administration here increased by 30% from £25.1 billion to £32.6 billion (table 6). The trend over time in the number and total value of Guernsey open and closed-end funds and non-Guernsey open-ended funds administered here is shown in figures 17 and 18. Demand for new investment business licences also increased. A total of 102 new licences were granted during the year, compared with 94 in 2006; by contrast the number of new promoters seeking to establish investment vehicles in the Bailiwick was 20 in 2007, compared with 80 in 2006 and 21 in 2005. The net number of institutions licensed under the Protection of Investors (Bailiwick of Guernsey) Law 1987 ("the PoI Law") increased to 636 during the year (figure 19). A list of institutions currently licensed under the PoI Law can be found on the Commission's website at www.gfsc.gg.

Policy

A number of developments took place during 2007. As we noted in last year's report, the Registered Fund regime for closed-end funds – as recommended in the report of the committee set up under the chairmanship of Advocate Harwood – was brought into force in February 2007. We have noted above the very rapid take-up of that new regime.

At the same time, steps were taken to draft amendments to the PoI Law. Those amendments fell into two categories: revision of the definition of investment fund so as to bring closed-end funds within the ambit of the law and to treat them in a similar fashion to open-ended funds; and amendments designed to ensure that the Commission's regulatory powers reflected a recent development in international norms, including information-gathering and sharing powers, specific powers to make public statements and to impose discretionary fines. Those developments, although falling into two categories, are not in themselves separate: the Commission, recognising that the investment fund industry has reached a level of maturity allowing a reduced prior vetting role by Commission staff, needs a broader set of disciplinary powers to allow an enhanced response where licensees are found to have breached the Commission's rules and guidance.

Figure 14. **Nationality of sponsors/joint sponsors of Guernsey open-ended funds at end 2007**



Note: Some funds may have more than one sponsor.

Figure 15. **Closed-end funds: geographical distribution of investments at end 2007**

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

	2006	2007	Change
Number of funds	217	271	+24.9%
Value of assets (£bns)	25.09	32.61	+30.0%
Stock exchange listed	38	42	+10.5%

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 16. **Nationality of sponsors/joint sponsors of Guernsey closed-end funds at end 2007**

Note: Some funds may have more than one sponsor.

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

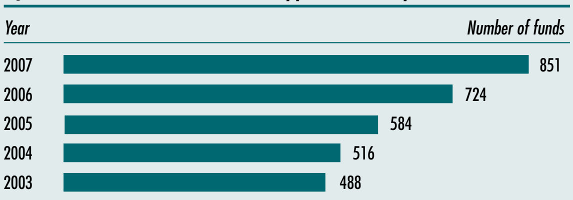


Figure 18. **Total assets under management in Guernsey domiciled funds at the year end**

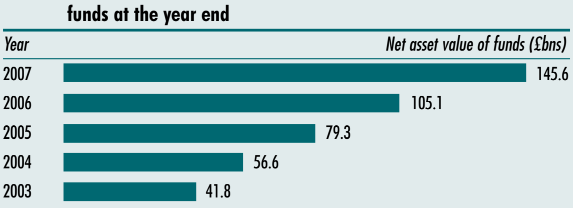
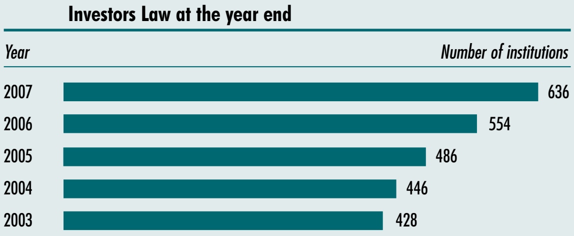


Figure 19. **Number of institutions licensed under the Protection of Investors Law at the year end**



We also reported last year on steps we were taking to revise the existing Guernsey Class A open-ended fund rules to bring them in line with more liberal developments in the United Kingdom and the European Union. During 2007, the revised rules were drafted, reviewed by an industry working group, and finally issued for public consultation towards the end of 2007. They have now been submitted to the United Kingdom Financial Services Authority ("FSA") for confirmation that the new rules provide equivalent protections to those afforded by UK provisions. The Guernsey rules and the regulatory system are now being considered by the UK FSA and assessed for equivalence against the UK framework, as a precursor to our requesting the UK government to issue a revised Statutory Instrument designating the new rules so that funds operating in accordance with them may be freely marketed in the United Kingdom. It is expected that the UK will remove the restriction in the existing Statutory Instrument preventing a Guernsey protected cell company established as a Class A fund from achieving UK recognition, so as to ensure equivalent treatment to other Crown Dependencies.

Further work was also undertaken by a Commission/industry working group to merge the existing Designated Persons Rules with the Licensees rules. A combined draft has now been developed by the Commission staff and the working party reconvened in March 2008 to continue the process.

During the year the Division was involved in discussions relating to the preparation of the new *Handbook for Financial Services on Countering Financial Crime and Terrorist Financing ("Handbook")* which came into force on 15 December 2007. We have also been working with other Divisions to revise the content of on-site visits to reflect the new Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 and the *Handbook* in a consistent way. In November the Director of Investment Business and his Deputy took part in a briefing to the investment business sector on the requirements contained in the *Handbook*.

Supervision

During 2007 the team conducted 24 monitoring and inspection visits to licensees. Of those visits, five were to designated managers, three to designated custodians, three to closed-end fund administrators, five to independent financial advisers/intermediaries, four to asset managers and two to distributors. These visits covered 84 funds and 34 administered licensees. Visits were also made to the Channel Islands Stock Exchange and to one broking firm. Of those visits, six were conducted jointly with the Commission's Insurance Division, three with the Fiduciary and Intelligence Services Division, one with the UK FSA and one in conjunction with US Federal and State Banking Regulators. One visit was a follow-up, to a firm where significant issues had been identified in an earlier visit.

In addition, themed reviews were undertaken of QIF and Registered Closed-end Fund submissions to assure the Commission that firms were adhering to the Commission's guidance on the necessary due diligence to be undertaken before submitting applications of those types. The reviews covered 24 firms.

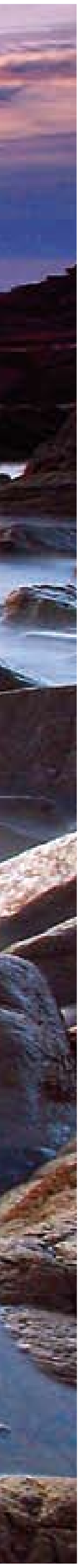
Fund Distribution Limited, the company set up to pay compensation to certain class of investors in split capital investment trusts, began to close down in 2007, having distributed all of the compensation made available to it by contributing firms. The final liquidation was completed in November 2007. The Channel Islands Splits Adjudication Scheme is dealing with the final few cases still to be determined.

International developments

Guernsey's continuing development as an international financial centre has highlighted the importance of maintaining international contacts. During the year the Director represented the Commission at the annual meeting of the International Organization of Securities Commissions ("IOSCO"), at the IOSCO Technical Committee's annual policy seminar, at a meeting of the IOSCO European Regional Committee, and a further technical seminar on accounting and regulation, also organised by IOSCO. The Committee of European Securities Regulators invited representatives of the Crown Dependencies to make presentations on cooperation and exchange of information; the Director represented Guernsey at that event. The Deputy Director attended the annual meeting of the

Enlarged Contact Group of Collective Investment Schemes Supervisors, and one of the Assistant Directors attended the annual conference on Globalisation of Mutual Funds. The Director and Deputy Director represented Guernsey at the biennial Hedge Fund regulators' conference organised by the Alternative Investment Management Association. Senior staff also attended seminars organised by the US Securities and Exchange Commission and the UK FSA. The Division was also represented at a number of industry-focused conferences – on private equity, on hedge funds and alternative investments, and on investment funds more generally.

POLICY AND INTERNATIONAL AFFAIRS



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 responsibility for the Commission's policies on anti-money laundering and countering the financing of terrorism ("AML/CFT") framework, including the *Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing ("Handbook")*. Together with the Director General, it is the Commission's main link with the Attorney General's Office, the States of Guernsey Policy Council and certain international bodies, including the International Monetary Fund ("IMF"). In addition, the Division coordinates a number of cross-divisional matters such as the preparation of the fees regulations and the production of this annual report, together with the annual report on internal control and corporate governance, referred to in Appendix 1.

Cooperation

The Bailiwick Financial Crime Committee met three times in 2007. This committee 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 to provide practical assistance to interested parties. The group met four times in 2007. The Terrorist Finance Team, which was established by the group to coordinate action and responsibilities relating to terrorism matters, also met four times in 2007.

In November and December representatives of the Commission took part in seven industry-specific half-day briefings for financial services businesses on preventing financial crime and terrorist financing. The briefings were sponsored jointly by the Commission, the FIS, the Law Officers' Chambers and the Financial Crime Service Authority. Each briefing covered a discrete section of the finance industry, namely banks, the fiduciary sector, the insurance sector, the investment sector and non-regulated businesses, businesses in Alderney and businesses in Sark. The aim was to provide businesses with information on new money laundering and terrorist financing offences introduced by primary legislation in December, the coming into force of legislation on wire transfers, the new Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 ("2007 Regulations") (see below), the *Handbook* (see below) and new cash controls legislation on the declaration of significant cash sums entering or leaving Guernsey. Non-regulated businesses were also provided with information on the registration framework expected to be introduced in the spring of 2008. Over 500 representatives of financial services businesses attended the briefings.

In addition, at the request of the Division in December, a representative of the Charity Commission of England and Wales made a presentation to representatives of members of the Association of Guernsey Charities and the finance sector on countering money laundering, terrorist financing and fraud.

AML/CFT initiatives

During the year, the Division completed its work on the replacements for the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Regulations, 2002 and the Guidance Notes on the Prevention of Money Laundering and Countering the Financing of Terrorism to reflect the most recent changes to the international standards issued by the Financial Action Task Force on Money Laundering ("FATF"). The Director General, together with representatives of the Policy and International Affairs Division and the regulatory Divisions, met with the Joint Money Laundering Steering Group three times during the year. In addition, consultation was held with the finance industry as a whole in April and May. In September the Commission issued the 2007 Regulations and the *Handbook* in final draft form so that financial services businesses had three months to put in place the necessary policies, procedures and controls for when the 2007 Regulations and *Handbook* were issued formally and came into force in December.

The 2007 Regulations and the *Handbook* effectively require financial services businesses to adopt a risk-based approach to their policies, procedures and controls in relation to AML/CFT, taking into account their customers, products and services and the provision of those services. They provide that financial services businesses should take risk into account when determining the extent of their customer due diligence measures. The 2007 Regulations and the *Handbook* allow financial services businesses to reduce or simplify the measures they take for low-risk customers. Conversely, the regulations and the *Handbook* require financial services businesses to carry out enhanced customer due diligence for high-risk categories of customer, product or transaction. The 2007 Regulations and the *Handbook* also contain provisions for the ongoing monitoring of business relationships – high-risk customers, products and transactions are subject to a higher level and frequency of monitoring.

Also, in December, the Commission issued Business From Sensitive Sources Notice No. 5, which advised financial services businesses to undertake enhanced customer due diligence when dealing with specified countries in north-west Africa. The notice also highlighted the concern of the FATF about the Islamic Republic of Iran's lack of a comprehensive AML/CFT regime and advised businesses to give special consideration to business relationships and transactions with the Islamic Republic of Iran.

The consultation referred to above also included proposals to introduce a new law requiring non-regulated financial services businesses, such as non-bank bureaux de change and non-bank lenders, to register with the Commission. The proposals were refined following the consultation and the States of Guernsey and Alderney and the Chief Pleas of Sark have approved the legislation. It is expected to come into force in the spring of 2008. The law will include sanctions for failure to comply with the rules in the *Handbook*.

Towards the end of the year the Division began preparing AML/CFT regulations and a handbook for firms of lawyers, accountants and estate agents for consultation in the first half of 2008. A steering group of practitioners and the Director of the FIS was formed in early 2008 and met twice in March to consider the draft regulations and handbook.

In 2007 the Commission undertook 97 on-site inspections of institutions' AML/CFT frameworks. These inspections covered 425 entities. While all of the on-site inspections which review AML/CFT are undertaken by the regulatory Divisions, the Assistant Director (Policy and International Affairs Division) participated with the regulatory Divisions on four 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 AML/CFT standards. At the beginning of 2008 the Commission commenced on-site visits in connection with the 2007 Regulations and the *Handbook*. The inspection programme in 2008 also began to consider compliance by non-regulated businesses with these regulations and the *Handbook*.

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 Dubai in February, in Brussels in April and in Basel in May/June.

Also in May the Director General, together with HM Procureur, visited the IMF in Washington. In July the Director General, HM Procureur, the Chief Executive of the States of Guernsey and the Minister of the States Treasury and Resources Department visited Washington. Meetings were held with the IMF, the US Department of the Treasury and with advisers to senior politicians.

As usual, the Director General was invited to speak at the Cambridge International Symposium on Economic Crime in September.

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.

In 2007, the Director of Policy and International Affairs represented the Director General on an aspect of the work of the IAIS. He attended two meetings in Basel of the G7 Financial Stability Forum Offshore Financial Centres Review Group. He also participated as a member of the IAIS multilateral memorandum of understanding ("MMoU") working group at a workshop for Asia/Pacific insurance supervisors on how to complete an application to be a signatory to the MMoU. Also on behalf of the IAIS, he led a case study at the International Association of Insurance Fraud Agencies' annual plenary on countering fraud. The Director participated in AML/CFT technical assistance missions for the IMF in China in May and Tunisia in June. In August as a member of the joint Asia/Pacific Group ("APG") and Offshore Group of Banking Supervisors evaluation team, the Director presented the AML/CFT evaluation of Macau to the APG plenary and in September/October participated in the AML/CFT element of the IMF/World Bank Financial Sector Assessment Programme of Mauritius.

IMF surveys

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 statistics in respect of Guernsey banks, open and closed-end collective investment funds, insurers, insurance intermediaries/brokers and special purpose vehicles. The statistics for 2006 were obtained in respect of 125 institutions, representing 1,091 entities. Table 7 provides a summary of the results for 2006. The total value of assets reported for Guernsey financial institutions as at 31 December 2006 was US$183.7 billion, an increase of US$46.5 billion over the assets reported in the 2005 survey. Figure 20 shows the results from Guernsey institutions over the last five years. There has been a significant increase in the total value of assets held over this period which is predominantly due to the increase in assets held by the investment funds sector. This reflects the increase in the number of Guernsey domiciled funds over that period, together with the increase in the exchange rate from sterling to the US dollar.

During the year the Commission participated for the third time in the IMF's information dissemination and monitoring framework initiative ("Information Framework"). The information provided will help improve transparency in the activities of finance centres around the world and aid the IMF and policymakers in the major countries in formulating a view as to the size, type and global impact of particular finance centres.

Participating jurisdictions provide the IMF with statistics relating to banks, insurers, collective investment funds and company and trust service providers, together with high-level data for the finance sector and the jurisdiction as a whole.

Table 7. **IMF Coordinated Portfolio Investment Survey 2006**
Cross-border securities* owned by institutions in the Bailiwick of Guernsey at end 2006

Sector	*Equities US$mns*	*Short-term debt US$mns*	*Long-term debt US$mns*	*Total US$mns*
Banks	9	15,020	23,237	38,266
Domestic insurers	3	–	50	53
Life insurers	2,793	105	1,444	4,342
Insurance managers and captives	724	2,195	2,965	5,884
Insurance intermediaries	–	–	–	–
Open and closed-end collective investment funds	91,900	10,073	32,256	134,229
Special purpose vehicles	–	13	118	131
States of Guernsey	66	382	377	825
Total	95,495	27,788	60,447	183,730

*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.

The IMF is undertaking an evaluation of this initiative. The Commission along with regulatory bodies in other jurisdictions has provided feedback to the IMF regarding its data collection and dissemination practices, together with comments regarding any difficulties encountered in collating the information requested.

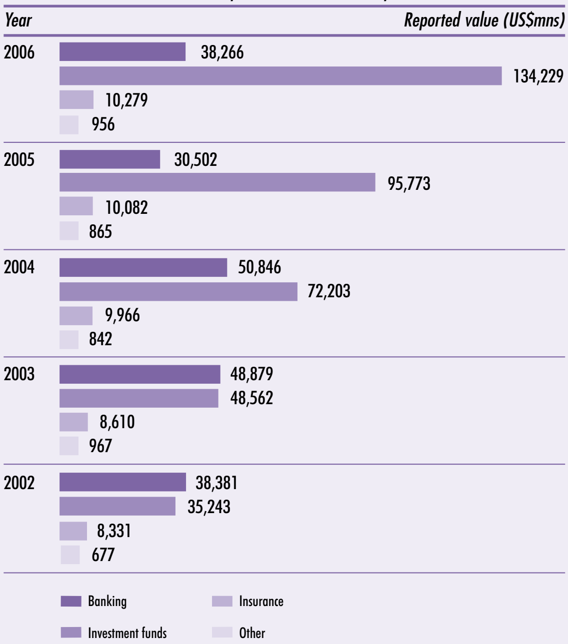
Other developments

In April and August the Director General and the Director of Policy and International Affairs met with the Council of the Guernsey International Business Association in order to discuss the preparations for the next IMF assessment of Guernsey's criminal justice and regulatory framework, including the new legislation and the *Handbook*. The Policy and International Affairs Division is coordinating the Commission's preparations for the IMF assessment.

A significant part of the preparations for the IMF is the changes to the AML/CFT framework referred to above. The Division also contributed to other legislative changes being taken forward. Following consultation by the Commission, the three parliaments in the Bailiwick have approved amendments to the Protection of Investors (Bailiwick of Guernsey) Law 1987 ("PoI Law"), which await Privy Council consent (a summary of the changes to this law is included under the Policy subsection of the Investment Business section of this report). The amendment law is expected to come into force in the spring of 2008 and will enhance the development of the finance sector, increase investor protection, assist Guernsey's finance sector to be fair, efficient and transparent, and reduce systemic risk.

During the year, the Policy and International Affairs Division, together with the regulatory Divisions, completed the legislative elements of the programme of work on the consistency and appropriateness of regulatory legislation, policies, procedures and controls across the Commission. In the spring of 2007, the Division issued a consultation document on revised appeals processes, enhanced enforcement powers and modifications to the minimum criteria for licensing in the regulatory laws. New appeals processes are included in the amendment to the PoI Law. Revised processes are also included in amendments to the Banking Supervision (Bailiwick of Guernsey) Law, 1994 ("Banking Supervision Law") and the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 ("Regulation of Fiduciaries Law") which have been approved by the three parliaments in the Bailiwick and await Privy Council consent. This is expected in the spring of 2008. An amendment to the

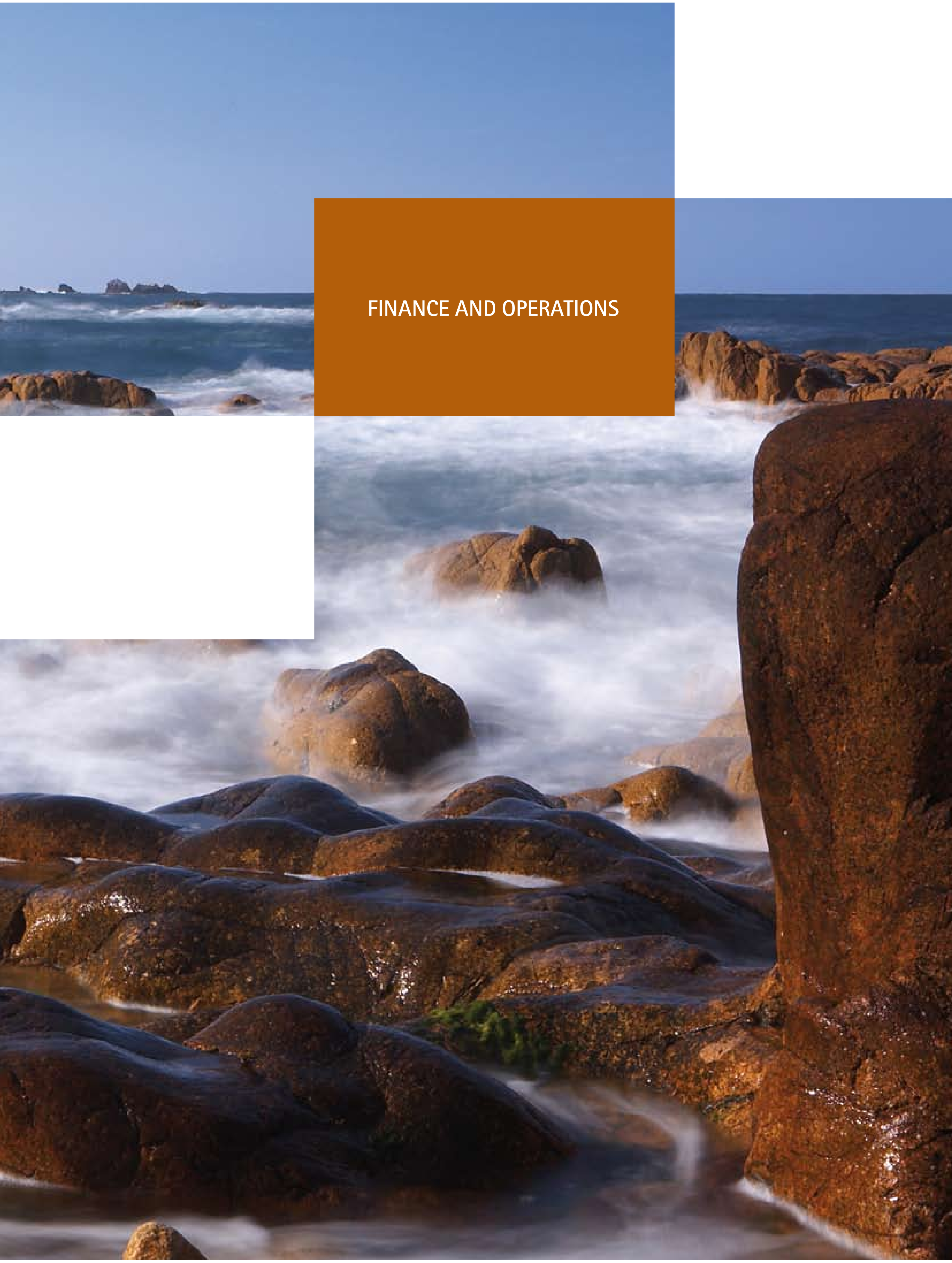
Figure 20. **IMF Coordinated Portfolio Investment Survey**
Cross-border securities by business sector at the year end

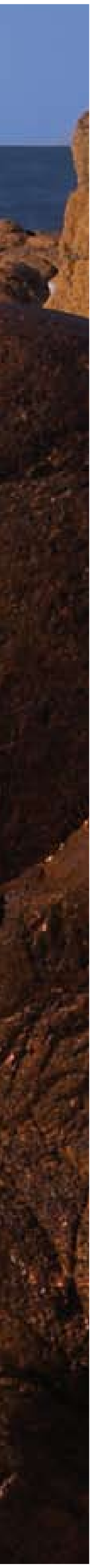


Financial Services Commission (Bailiwick of Guernsey) Law, 1987, which provides for enhanced enforcement powers, has reached the same stage of the legislative process. Revised minimum criteria for licensing are included in the amendment to the PoI Law and have been incorporated in the Banking Supervision Law, the Regulation of Fiduciaries Law, the Insurance Business (Bailiwick of Guernsey) Law, 2002 and the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 by regulations.

In light of the seriousness of the problems at the Northern Rock group, the Director of Policy and International Affairs worked closely with the Banking Division on mitigating the effects of those problems in Guernsey.

FINANCE AND OPERATIONS





General

The Division is responsible for key support services to the Commission, including finance, information and communication systems, human resources and facilities management.

Finance

The financial statements are shown on pages 54 to 65.

The overall surplus for the year is £1,564,093, a significant increase compared to 2006. This is primarily a result of increased fee income due to a substantial growth in business activity across some of the business sectors, notably in fund administration. The total fee income for 2007 was £8,838,199, a 10.6% increase over 2006.

The Commission continued to incur significant legal and professional costs in respect of investigative and enforcement activity. These costs, together with the impact of the Financial Reporting Standard 17 ("FRS 17") valuation of employer contributions to the pension scheme, offset by robust cost control elsewhere, resulted in expenses for the year ended 31 December 2007 being £8,161,504, an increase of 5.4% compared to 2006.

The deficit in the pension scheme at December 2007 reported under FRS 17 is £1,565,851, an increase of £367,859 compared to 2006. This defined benefit pension scheme is part of the States of Guernsey Superannuation Fund ("the Fund''). The States have made changes to the Fund rules which should over time help to reduce the deficit that the Commission is currently carrying on its balance sheet. However, we have taken the decision that we can no longer accept the ongoing uncertainties associated with all defined benefit schemes which arise from the increasing levels of life expectancy and the varying investment performance of the funds. The Commission has therefore adopted a new defined contribution scheme for staff joining from 1 January 2008 onwards. Those staff who were already members of the defined benefit scheme at that date continue to be eligible for membership of that scheme.

The Commission's policy to retain reserves at a sum equivalent to a minimum of six months' expenditure has now been reviewed in the light of its aim to be able to absorb unexpected or exceptional costs without putting its solvency at risk. We have therefore decided to amend this policy with the objective of retaining reserves equivalent to 12 months' worth of expenditure.

When setting fees for 2008, we have once again borne in mind the commercial environment in which regulated firms operate. The majority of fees have either been held at the same level as in 2007 or have been increased at a rate to reflect inflation.

The Commission continues its close relationship with the GTA University Centre ("GTA"). It contributed 50% of the GTA's budgeted net operating expenditure in 2007 (£411,000) and has committed to provide funding of £425,500, an increase of 3.5%, in 2008.

Fee legislation

Revised fee regulations came into effect on 1 January 2008. The following regulations apply to fees payable by the finance sector in Guernsey:

- The Financial Services Commission (Fees) Regulations, 2007
- The Protected Cell Companies and Incorporated Cell Companies (Fees for Insurers) Regulations, 2007
- The Regulation of Fiduciaries (Fees) Regulations, 2007
- 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 and communication 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. We also improved our back-up processes so that files are now saved in real time and are available at our business recovery site.

The Commission has also reviewed its future requirements for information and communication systems and expects to implement further significant enhancements in 2008.

Human resources

At the beginning of 2007, Neville Roberts was made Director of Finance and Operations. Following the retirement of Alan Fleming at the end of 2006, Diane Colton was promoted to Director of Insurance and in January 2007 Michael Graham was appointed Deputy Director of Insurance in her stead. At the end of March 2007 Chris le Marchant left the Commission as Deputy Director of Banking; his position has been filled by Dr Jeremy Quick. During 2007 two staff were promoted to Assistant Director – one in the Investment Business Division and the other in the Policy and International Affairs Division.

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

During 2007 Rosemary Radcliffe resigned as Commissioner. In addition, Mel Carvill gave notice that he wished to retire with effect from 1 February 2008, on which date he completed his third three-year term of office. In January 2008 the States of Guernsey elected Alex Rodger as a Commissioner for a three-year period from 2 February 2008 and re-elected Peter Harwood as Chairman of the Commission for a further one-year term from the same date.

Facilities management

The premises at La Plaiderie Chambers and Le Marchant House are at full capacity and it is a medium-term objective of the Commission to move to a more efficient, single location. We have signed Heads of Terms with Comprop (C.I.) Limited and Glategny Holdings Limited to take space in their proposed new building at Glategny Esplanade.

The Commission continues to maintain dedicated business recovery facilities for use in the event that our primary premises should become unusable.

INDEPENDENT AUDITOR'S REPORT TO THE COMMISSIONERS OF THE GUERNSEY FINANCIAL SERVICES COMMISSION

We have audited the financial statements of the Guernsey Financial Services Commission ("the Commission") for the year ended 31 December 2007 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.

This report is made solely to the Commissioners, as a body, in accordance with our Terms of Engagement as detailed in our letter dated 26 March 2008. Our audit work has been undertaken so that we might state to the Commissioners those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Commission and the Commissioners as a body, for our audit work, for this report, or for the opinions we have formed.

Statement of Commissioners' responsibilities

The Commissioners are required by the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended to prepare financial statements for each accounting period which give a true and fair view, in accordance with applicable Guernsey law and UK Accounting Standards, of the state of affairs of the Commission and of the surplus or deficit for that 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 are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Commission and to enable them to ensure that the financial statements have been prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. They are also responsible for safeguarding the assets of the Commission and hence for taking reasonable steps for the prevention and detection of fraud, error and other irregularities.

Respective responsibilities of Commissioners and auditors

The Commissioners are responsible for preparing the annual report and the financial statements in accordance with applicable Guernsey law and UK 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).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. We also report to you if, in our opinion, the Commission has 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 accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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, in accordance with UK Accounting Standards, of the state of the Commission's affairs as at 31 December 2007 and of its surplus for the year then ended; and
- have been properly prepared in accordance with the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.

KPMG Channel Islands Limited
Chartered Accountants
Guernsey, Channel Islands
4 April 2008

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

INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 December 2007

	Note	**2007**	2006
		£	£
Income	2		
Fees receivable		**8,838,199**	7,988,020
Contributions from the States of Guernsey for services provided on behalf of government		**200,000**	300,000
Interest on deposits with States Treasury		**477,436**	214,678
Miscellaneous income, including bank interest		**16,067**	7,379
Other finance income	7(d)	**193,895**	152,154
		9,725,597	8,662,231
Expenses			
Salaries, pension costs, staff recruitment and training		**6,015,977**	5,586,517
Commissioners' fees		**94,500**	95,420
Legal and professional fees		**395,286**	399,073
Premises and equipment, including depreciation	4,11	**719,875**	768,194
Other operating expenses		**514,866**	470,555
Auditor's remuneration		**10,000**	10,000
		7,750,504	7,329,759
Commission's contribution to expenses of GTA University Centre	10	**411,000**	411,000
		8,161,504	7,740,759
Surplus of income over expenditure	2	**£1,564,093**	£921,472

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

The notes on pages 58 to 65 form an integral part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

for the year ended 31 December 2007

	Note	**2007**	2006
		£	£
Surplus for the year		**1,564,093**	921,472
Actuarial (loss)/gain	7(e)	**(68,118)**	478,994
Total recognised gains for the year		**1,495,975**	1,400,466
Prior-year adjustment	9	**–**	1,628,038
Total recognised gains since last annual report		**£1,495,975**	£3,028,504

The notes on pages 58 to 65 form an integral part of these financial statements.

BALANCE SHEET

as at 31 December 2007

	Note	2007	2006
		£	£
Fixed assets			
Tangible assets	4	**242,601**	231,233
Current assets			
Debtors	5	**324,553**	1,823,423
Deposits with States Treasury		**7,239,990**	3,617,554
Cash at bank and in hand		**198,321**	242,487
		7,762,864	5,683,464
Creditors – amounts falling due within one year	6	**(908,720)**	(681,786)
Net current assets		**6,854,144**	5,001,678
Net assets before post-retirement liability		**7,096,745**	5,232,911
Post-retirement liability	7(b), (f)	**(1,565,851)**	(1,197,992)
Net assets		**£5,530,894**	£4,034,919
Reserves	8	**£5,530,894**	£4,034,919

The financial statements on pages 54 to 65 were approved by the Commissioners and signed on their behalf on 4 April 2008 by:

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

The notes on pages 58 to 65 form an integral part of these financial statements.

CASH FLOW STATEMENT

for the year ended 31 December 2007

	Note	**2007**	2006
		£	£
Reconciliation of surplus of income over expenditure to net cash inflow from operating activities			
Surplus of income over expenditure		**1,564,093**	921,472
Other finance income		**(193,895)**	(152,154)
Current and past pension service costs	7(c)	**918,707**	1,019,529
Contributions made to pension scheme	7(f)	**(425,071)**	(388,171)
Depreciation on tangible fixed assets	4	**133,231**	149,154
Interest receivable		**(493,503)**	(222,057)
Decrease in debtors		**1,498,870**	29,845
Increase/(decrease) in creditors		**226,934**	(567,601)
Net cash inflow from operating activities		**£3,229,366**	£790,017
Cash flow statement			
Net cash inflow from operating activities		**3,229,366**	790,017
Returns on investments and servicing of finance	16	**493,503**	222,057
Capital expenditure and financial investment	4, 16	**(144,599)**	(169,438)
Increase in cash in the year		**£3,578,270**	£842,636
Reconciliation of net cash flow to movements in net cash			
Increase in cash in the year		**3,578,270**	£842,636
Net cash at 1 January	17	**3,860,041**	3,017,405
Net cash at 31 December	17	**£7,438,311**	£3,860,041

The notes on pages 58 to 65 form an integral part of these financial statements.

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 accounted for on an accruals basis.

(c) Interest

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

(d) Investigation and litigation

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

(e) Tangible fixed assets and depreciation

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

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

(f) Leases

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

(g) Pensions

Employees of the Commission 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 Financial Reporting Standard 17 ("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.

The Commission has adopted a new defined contribution scheme for staff joining from 1 January 2008 onwards. Those staff who were already members of the States of Guernsey Superannuation Fund continue to be eligible for membership of that scheme, as could certain new staff, in exceptional circumstances, at the discretion of the Commission.

2. Income and surplus of income over expenditure
Income and surplus 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 2007	108,129	737,512	748,848	1,594,489
Additions	–	32,749	111,850	144,599
Disposals at nil value	–	(133,732)	–	(133,732)
At 31 December 2007	108,129	636,529	860,698	1,605,356
Depreciation				
At 1 January 2007	45,056	688,982	629,218	1,363,256
Charge for the year	11,030	30,807	91,394	133,231
Disposals at nil value	–	(133,732)	–	(133,732)
At 31 December 2007	56,086	586,057	720,612	1,362,755
Net book value at 31 December 2006	£63,073	£48,530	£119,630	£231,233
Net book value at 31 December 2007	£52,043	£50,472	£140,086	£242,601

5. Debtors

	2007 **£**	2006 £
Fees receivable due but not paid (see note 9)	**–**	1,611,296
Other debtors	**25,844**	11,231
Amount due from GTA University Centre	**109,022**	48,323
Prepayments	**189,687**	152,573
	£324,553	£1,823,423

6. Creditors – amounts falling due within one year

	2007	2006
	£	£
Expense creditors and accruals	**680,244**	620,517
Fees received in advance	**228,476**	61,269
	£908,720	£681,786

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") was established with effect from 1 January 2004 within the Fund following an instruction from the former States Advisory and Finance Committee. The Actuarial Account is used solely for the purpose of determining the contributions payable to the Fund by the Commission and to avoid the possibility of inappropriate subsidisation of one 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 scheme's actuary also completed valuations as at 31 December 2005, 2006 and 2007 for the purposes of FRS 17.

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

	At 31 December 2007	At 31 December 2006	At 31 December 2005	At 31 December 2004
Rate of increase in salaries	**4.90%**	4.60%	4.40%	4.40%
Rate of increase in pensions in payment	**3.40%**	3.10%	2.90%	3.00%
Discount rate	**5.80%**	5.10%	4.70%	5.30%
Inflation assumption	**3.40%**	3.10%	2.90%	2.90%

7. Superannuation continued

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

	Expected long-term rate of return				**Value**			
	2007	2006	2005	2004	**2007**	2006	2005	2004
Equities	**8.00%**	8.50%	8.00%	7.50%	**7,232,742**	6,796,550	5,657,011	4,281,057
Bonds	**4.60%**	4.70%	4.30%	4.70%	**1,837,794**	1,560,970	1,390,025	1,141,787
Cash	**6.00%**	5.00%	4.50%	4.75%	**631,348**	187,678	133,335	161,327
Total market value of assets					**9,701,884**	8,545,198	7,180,371	5,584,171
Present value of scheme liabilities					**(11,267,735)**	(9,743,190)	(8,378,153)	(5,610,146)
Net pension liability					**£(1,565,851)**	£(1,197,992)	£(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. The Commissioners have decided to adopt more up-to-date mortality tables than were used for the previous year's disclosures.

c) Analysis of the amount included in salaries, pension costs, staff recruitment and training charged to income and expenditure account

	2007	2006
	£	£
Current service cost	**918,707**	880,878
Past service cost	**–**	138,651
Total operating charge	**£918,707**	£1,019,529

d) Analysis of the amount credited to other finance income

	2007	2006
	£	£
Expected return on pension scheme assets	**688,525**	543,332
Interest on pension scheme liabilities	**(494,630)**	(391,178)
Net return	**£193,895**	£152,154

7. Superannuation continued

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

	2007	2006
	£	£
Actual return less expected return on pension scheme assets	**(125,434)**	111,851
Experience (losses) arising on the scheme liabilities	**(650,024)**	(117,666)
Changes in assumptions underlying the present value of the scheme liabilities	**707,340**	484,809
Actuarial (loss)/gain recognised in STRGL	**£(68,118)**	£478,994

f) Movement in pension liability during the year

	2007	2006
	£	£
Deficit in scheme at beginning of the year	**(1,197,992)**	(1,197,782)
Movement in year:		
Current service costs	**(918,707)**	(880,878)
Contributions	**425,071**	388,171
Past service costs	**–**	(138,651)
Other finance income	**193,895**	152,154
Actuarial (loss)/gain	**(68,118)**	478,994
Deficit in scheme at end of the year	**£(1,565,851)**	£(1,197,992)

Following the actuarial valuation of the Fund as at 31 December 2004, the actuary recommended that the Commission's contribution rate payable to the Fund be increased from 10.4% to 15.5%. This contribution rate was calculated using funding assumptions determined by the States Treasury and Resources Department which are different to those adopted by the Commissioners for the purpose of financial reporting in accordance with FRS 17. As a result of this difference and the amount of the current service cost calculated in accordance with FRS 17 and the fact that a benefit review was due to be carried out, the Commissioners decided not to increase the contribution rate payable to the Fund at this stage until the results of the next funding valuation are available. However the current service cost represents the cost to the Commission of the benefits accrued to active members of the scheme during the financial year ended 31 December 2007. This amount is calculated in accordance with the FRS 17 standard and as a result this figure has been reflected in the Commission's income and expenditure account. The employee contribution remains unchanged at 6%.

7. Superannuation continued

g) History of experience gains and losses

	2007	2006	2005	2004
Difference between the actual and expected return on scheme assets				
Amount	**£(125,434)**	£111,851	£660,170	£65,610
Percentage of scheme assets	**(1)%**	1%	9%	1%
Experience gains and losses on scheme liabilities				
Amount of (losses)/gains	**£(650,024)**	£(117,666)	£265,220	£(307,859)
Percentage of the present value of the scheme liabilities	**(6)%**	(1)%	3%	(5)%
Total amount recognised in statement of total recognised gains and losses				
Amount of (losses)/gains	**£(68,118)**	£478,994	£(1,008,717)	£(479,827)
Percentage of the present value of the scheme liabilities	**(1)%**	5%	(12)%	(9)%

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 to meet the five years' data as required by FRS 17.

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	**2007**	2006
		£	£
Reserves brought forward as originally stated		**4,034,919**	1,006,415
Prior-year adjustment	9	**–**	1,628,038
Reserves brought forward as restated		**4,034,919**	2,634,453
Surplus of income over expenditure for the year		**1,564,093**	921,472
Actuarial (loss)/gain on post-retirement liability	7(e)	**(68,118)**	478,994
Reserves carried forward		**£5,530,894**	£4,034,919

Included in the reserves is a pension liability of £1,565,851 (2006 £1,197,992) which equates to the post-retirement liability under FRS 17 (see note 7).

9. Prior-year adjustment

During 2006 the Commission's Insurance Division moved from invoicing in arrears to invoicing in advance for regulatory services for the coming year. This resulted in a change in accounting policy in the Insurance Division and led to there being additional income of £1,628,038 of which £16,742 was received in 2006 and the balance of £1,611,296 was received in 2007.

	2007	2006
	£	£
Insurance fee income	**–**	1,628,038
Reserves carried forward	**–**	£1,628,038

10. GTA University Centre

The GTA University Centre ("GTA") arranges training for the finance industry and for other industry sectors. The company's staff, excluding its Chief Executive, were employed by the Commission and permanently seconded to the company. However, during the year the GTA took the decision that new staff would have a GTA contract of employment. The Commission provided a grant of £411,000 in 2007 (2006: £411,000) 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 lease for the car park expires on 21 November 2009 and the underlease for Le Marchant House on 10 December 2011. The rentals payable in 2007 under the terms of the leases amount to £316,700 (2006: £303,700).

Operating lease commitments

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

Land and buildings

	2007	2006
Leases which expire less than two years after balance sheet date	**£11,400**	–
Leases which expire more than two years but less than five years after balance sheet date	**£40,300**	£51,700
Leases which expire more than five years after balance sheet date	**£265,000**	£252,000

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. 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. On 25 January 2007, FDL, having distributed some £143.5 million to claimants, was put into members voluntary solvent liquidation. As a part of that process the Commission has made a commitment to pay up to £10,000 to FDL in the event that its remaining assets are insufficient to meet its liabilities.

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.

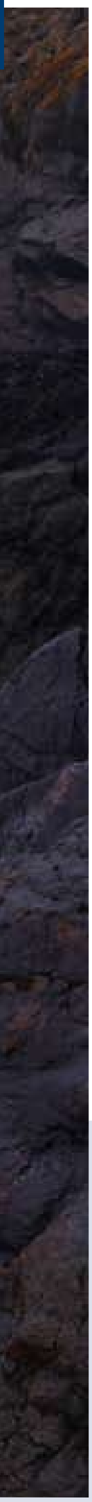
16. Notes to the cash flow statement

	2007 **£**	2006 £
Returns on investments and servicing of finance		
Interest received	**£493,503**	£222,057
Capital expenditure and financial investment		
Payments to acquire tangible fixed assets	**£(144,599)**	£(169,438)

17. Analysis of net cash

	At 1 January 2007 £	Cash flow £	**At 31 December** **2007** **£**
Deposits with States Treasury	3,617,554	3,622,436	**7,239,990**
Cash at bank and in hand	242,487	(44,166)	**198,321**
	£3,860,041	£3,578,270	**£7,438,311**

GTA UNIVERSITY CENTRE



General

The long-term objective of the GTA University Centre ("GTA") is to engender a training and development culture within all organisations throughout the Bailiwick, and procure and facilitate high-quality training and development programmes within all business sectors. The culture is expected to generate a highly qualified, knowledge-based workforce enabling all organisations to compete in a global marketplace and to broaden the Bailiwick's skills base whilst adding value to all Bailiwick businesses. During 2007 the GTA has once again proved to be very successful in facilitating high-quality training and development initiatives for the Bailiwick workforce.

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

At the end of 2007 students registered with the GTA had made 1,719 study visits to the centre. Over 440 training events took place, attracting over 6,191 delegates, a substantial 25% increase on last year. The increasing trend towards online examinations continued during the year. In addition to the online examinations, a further 125 examinations took place through the GTA examinations office during which 575 candidates were examined on a range of award-bearing programmes (table 8).

In July 2007 Nigel Lewis, Chief Officer of the States of Guernsey Commerce and Employment Department, tendered his resignation from the Board of the GTA advising that he would be taking up a new role at the States of Guernsey Policy Council from September 2007. The Board and staff are grateful to Mr Lewis for his important contribution to the work and success of the GTA. Overall, the GTA is pleased to note the stability of the Board for the calendar year, which sustains the continuity of its governance. The GTA continues to be funded jointly by the Commission and the Commerce and Employment Department.

Early in 2007 discussions were held between the senior officers of the Policy Council and the GTA regarding the future of the training and development section of the Policy Council's human resources unit. The section comprised one full-time and two part-time members of staff who facilitated the training programme for the States of Guernsey. It was agreed that for a period of 18 months from 1 July 2007 this section would merge with the GTA. At the end of this period, the assimilation would be evaluated and a decision made as to whether the arrangement should be permanent. The project is funded via a block grant payment.

This merger of the Policy Council's training and development section with the GTA represents an increase in the activity levels of the GTA, potentially introducing an additional 150 courses and circa 1,800 additional delegates. It is also an obvious rationalisation of training provision across the Bailiwick and has already realised significant economies of scale and revenue savings for the States of Guernsey.

At its meeting in December 2006 the GTA Board, aware of the intention of the States of Guernsey to dispose of Nelson

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

Key statistics	*2003*	*2004*	*2005*	*2006*	*2007*
Recorded number of study sessions	2,341	2,731	2,572	1,676	1,719
Number of training events	322	321	386	400	440
Number of delegates attending	4,463	4,695	5,253	5,968	6,191
Number of examination days	92	113	114	71	78
Number of examinations	194	236	199	147	125
Number of examination candidates	793	874	757	636	575
Total hits on website	*	*	2,315	2,846	3,655

* Hits on the website were not recorded before 2005.

Place, agreed to proceed with the acquisition of a 13 year lease on St Peter Port House and to undertake the necessary refurbishment to provide four modern training rooms, including an information technology suite. The refurbishment programme was completed to a high standard in six months and the resulting facility has met with a positive response from both tutors and students.

During 2007 the GTA continued to work with local branches of finance associations and professional institutes, such as 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 GTA's website at www.gta.gg. In parallel, and in support of the furtherance of training and development in each of these sectors, the GTA continues to work with the on-island finance associations, the Commission and the professional institutions within education fora. These groups are important in providing strategic direction for the development of finance education and training within the Bailiwick.

The strategic relationship between the Guernsey College of Further Education and the GTA 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 GTA. The forum meets monthly.

The GTA's work covers all sectors of the Bailiwick's economy – only those initiatives pertinent to the finance sector are outlined below.

Award-bearing programmes

The GTA, working in partnership with the Bailiff, the University of Southampton and the Guernsey Bar Association, launched a series of law lectures in the summer of 2007 entitled the Bailiff's Royal Court Lectures. The first of these was delivered on Thursday 7 June with Professor Brenda Hannigan, University of Southampton, who was instrumental in contributing to the new UK Company Law Act 2008. The lecture was extremely well received and attended by 110 delegates.

The GTA continues to work closely with local branches of professional organisations. It worked with the local branch of the Chartered Institute of Personnel and Development ("CIPD") in managing and facilitating its annual conference which this year was entitled "Employee Engagement" and was held in May at St Pierre Park Hotel in front of 80 delegates. The GTA also assisted the local branch of the Society of Trust and Estate Practitioners ("STEP") to organise its annual conference which was held in June at St James and attracted 120 delegates.

Ten students from the second cohort of the MBA degree, run by Southampton University, completed the taught part of the programme in June 2007 and are due to graduate in summer 2008. A third cohort of 10 students commenced in September 2007 and are due to graduate in 2010.

The cohort of 10 students sitting the Masters programme in Strategic Human Resource Management, delivered by Bournemouth University, successfully passed the first year of the programme and are due to complete the course in 2008.

The sixth cohort of the MSc Corporate Governance/Graduate ICSA programme which commenced in September 2006 with eight students, entered the second year of the course with a further three students taking the "fast-track" option, and another two students taking specified modules. The cohort are due to complete the programme in 2008.

The prestigious Institute of Directors Company Direction programme commenced in October with 14 delegates; this is the eighth time the programme has been offered in Guernsey.

Central Law Training once again delivered the Foundation and Diploma programmes in Offshore Trust Management on behalf of STEP. Twenty-seven students completed the Foundation programme with a further 24 students completing the Diploma programme.

The International Compliance Association was established during 2002 offering diplomas in anti-money laundering and compliance. Fifteen students undertook the International

Diploma in Compliance and five sat the International Diploma in Anti-Money Laundering examination.

The Professional Certificate in Marketing was successfully launched during the year with nine delegates. Fourteen delegates signed up for the Professional Diploma in Marketing. Both programmes are run by the Chartered Institute of Marketing and it is expected they will be run again in 2008.

During 2007 some 25 students undertook the Institute of Leadership and Management ("ILM") Introductory Certificate in Team Leading, a three-day programme delivered by staff from the Guernsey Business School. A further six students enrolled for the ILM Introductory Certificate in First Line Management. This five-day programme is delivered by the Guernsey Business School.

The GTA was pleased to offer tutorials leading to the Private Client and Investment module of the Securities and Investment Institute Diploma. Four students participated in the tutorials and sat the examination in June 2007.

Thirteen students sat the Captive Insurance Certificate during 2007, making a total of 64 students who have now successfully completed this qualification since its introduction. This locally designed programme is awarded 20 points under the Chartered Insurance Qualifications framework. Ten students successfully completed the locally examined Guernsey Insurance Certificate during 2007, bringing the total number who have gained this qualification to 133 since its inception in 2003. This programme is awarded 16 points under the Chartered Insurance Qualifications framework.

The GTA was also pleased to launch the Institute of Legal Secretaries and PAs Legal Secretaries Diploma course. This course comprises five modules and was taught to nine delegates by a number of local advocates. The delegates are due to complete the course in 2008.

Short courses and conferences

During 2007 the GTA facilitated five major speaking events: two conferences on behalf of STEP and CIPD, as mentioned above; two Captive Insurance Education Days on behalf of the Guernsey Insurance Company Management Association; and a Leadership Update. The Captive Insurance Education Days, run with local speakers, attracted nearly 100 delegates between them and covered the latest topics within the captive insurance industry. The STEP conference included nine seminars from a variety of local and UK speakers and attracted 120 delegates from the fiduciary sector. The GTA was very pleased to secure Allan Leighton, Chairman of the Royal Mail, for the Leadership Update conference, which was held in front of 80 delegates.

Forty-two delegates attended a series of short courses offering an introduction to Islamic finance and Sukuk (Islamic bonds). These courses were run in advance of the launch of the Securities and Investment Institute Islamic finance qualification scheduled to run in 2008.

A total of 110 delegates attended a series of seven law seminars run in conjunction with the Guernsey Bar in the lead-up to the Guernsey Bar examinations, which continue to be administered by the GTA. Ninety delegates attended a series of three law seminars held by professors from Exeter University, who provided useful updates to the local profession on tort, contract and criminal law.

In association with the States of Guernsey Commerce and Employment, Treasury and Resources and Income Tax departments, the GTA facilitated a series of short seminars on the impact of Zero-10, which was delivered to a total of 568 delegates through 12 seminars, including two seminars held in Alderney.

In total over 1,500 delegates have attended short courses pertaining to the finance sector during 2007 covering topics such as demystifying limited partnerships, human factors in risk management, tax computations and corporate governance.

Investors in People

The GTA has continued to be approached for assistance with undertaking benchmarking interviews under the Investors in People ("IiP") standard. Whilst this assistance is provided purely in an advisory capacity, organisations have found the exercise extremely helpful in positioning themselves against the IiP standard and identifying what further work still needs to be done. The GTA was pleased to invite Stephen Burrows from CAR North West to host two seminars on advising companies of the benefits of IiP and criteria for the new standard.

Other initiatives

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

Three further personal development programmes commenced during 2007, each with the maximum of 12 delegates, reflecting the popularity of the programme. In conjunction with The Learning Company, three more management development programmes were offered, attracting 34 delegates.

Working with the Law Officers of the Crown the GTA is assisting with the administration of the Guernsey Bar examinations. The GTA is continuing to work with the Guernsey Bar in identifying events for continuous professional development purposes. During 2007 a series of "update" lectures were held on English criminal, tort and contract law.

e-Business and information technology

The IT and e-Commerce Advisory Group met twice during 2007 to discuss training and development needs relating to information technology. The group is comprised of representatives from the Commission, the Data Protection Office, the Guernsey College of Further Education and the finance, public and commercial sectors. The group has provided relevant and useful information on the types of courses to facilitate and the GTA is particularly pleased with the continuing growth in information technology training that it has facilitated over recent years.

During the year a number of seminars and short course programmes were held on topics such as achieving world-class information management, implementing a document management solution and system business analysis, and were attended by 298 delegates.

The GTA continues to work closely with the British Computer Society ("BCS") and is represented on the committee of the Guernsey sub-branch. The GTA jointly facilitated a number of BCS seminars during 2007.

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).

The Commission Law provides that the Commission shall consist of a minimum of five members and a maximum of seven members elected by the States 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 Commission currently has five Commissioners: Peter Harwood, David Mallett, Susie Farnon, Howard Flight and Alex Rodger. A brief résumé for each Commissioner is provided on pages 6 and 7 of this report. All of the Commissioners are non-executive – three reside in the Guernsey, with the remainder living in the United Kingdom.

At the beginning of 2007 there were six Commissioners. During the year Rosemary Radcliffe tendered her resignation on health grounds and Mel Carvill gave notice that he wished to retire as Commissioner on completion of his third three-year term of office on 1 February 2008. There were 12 meetings of the Commissioners in 2007. The attendance of the individual Commissioners at these meetings was as follows: Peter Harwood – 12, David Mallett – 12, Mel Carvill – 11, Susie Farnon – 11, Howard Flight – 10, Rosemary Radcliffe (resigned November 2007) – 8. 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, chaired by David Mallett, 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. During 2007 the committee comprised David Mallett, 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 twice in 2007. The attendance of the individual members at these meetings was as follows: David Mallett – 2, Mel Carvill – 2, Susie Farnon – 2. Following the retirement from office of Mel Carvill in February 2008, Alex Rodger was appointed to the committee.

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 December 2008.

APPENDIX 2
COMMITTEES AND WORKING PARTIES

A number of advisory groups and committees have assisted the Commission in the various aspects of its work. The Director General of the Commission and his colleagues take this opportunity of acknowledging the contribution made by the members of the following groups and of thanking them for their support and assistance:

Class A Rules Working Party

Insurance Advisory Group, formerly the Forum for Insurance Development

Insurance Business Law Steering Group

Insurance Managers and Insurance Intermediaries Law Steering Group

Joint Money Laundering Steering Group

Licensee Rules Working Party

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