

2017



Guernsey Financial
Services Commission

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2017

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



Guernsey Financial Services Commission

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

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

CHAIRMAN'S STATEMENT

Our Ship

Towards the end of last year, Guernsey's Lieutenant Governor hosted a meeting at Government House for long-serving Commission staff. Whilst waiting for guests to arrive the Lieutenant Governor and I compared notes, he ex-Royal Navy, me ex-Merchant Navy. We were both commenting on, and were struck by, the attitude and the pride crews have for the ships they sailed on. We, in our different careers, had come across this time and time again and how the sense of belonging hugely contributed to the effectiveness, success and safety of that particular ship, almost regardless of the ship itself.

I want to hold up the concept of 'our ship' as an example of how the Bailiwick can improve its chances to get through these turbulent times and will continue to prosper well into the future. My association with Guernsey now extends to over 25 Years and over that period my experience has been mainly good, Guernsey has been a good place to do business with people who know what they are doing and are mostly good to work with.

However, over that period, the Guernsey business model has increasingly come under threat, with supra-national bodies and sovereign governments challenging the basis on which the economy of the Bailiwick operates. In modern consultancy speak, the Target Operating Model (TOM) is experiencing head winds. In 2018 this will require mobilisation of the best resources the island can muster, working closely together for the prolonged wellbeing of 'Our Ship'.

Earlier this year, I was asked to speak to a Guernsey audience about the prospects for the Economy and for financial services in particular, 25/30 years into the future. Making predictions is quite hazardous particularly when it involves the distant future, but one can have an opinion on what makes Guernsey strong and what is likely to threaten it. What we can do is prepare and make the most of the attributes we have.

In no particular order this is what I think makes us strong:

- We are in the right time zone, capable of straddling Asia, Europe and the USA market;
- We speak the preferred global language;
- There is a human scale of infrastructure;
- We have a flexible Common Law system, well equipped to deal with changing demands from new concepts and products;
- There is a skilled workforce; and
- We have an up-to-date technical infrastructure.

All powerful points, in particular when combined with strong regulation to international standards. There are, however, also things we need to do to stay competitive. It is my impression that we are not as proactive in getting business as we could be. We are handicapped by our transport links not being as effective as we need them to be and the lack of Guernsey-owned companies and firms who fight the Guernsey corner. This is where the island is currently falling short and this will need to be addressed; there are sacrifices to be made, but without them, we run the risk of the world passing us by.

If we want to continue to play in the wider market (and we do), we need to ensure speed in our law-making processes. Financial services products are increasingly behaving like perishable goods, they need to be harvested over increasingly reduced periods. If we fail to do so, the moment will pass.

However, I remain optimistic. There are big opportunities in the insurance sphere, providing cover for people and businesses in a riskier and simultaneously risk-averse world. It is expected that provisions, and therefore premiums, for pensions will need to double from the current level of 4.5% of GDP to at least 9%, as governments struggle to provide for an ever-growing part of the population entering into old age. Assets under management will have to increase substantially to reflect the low yields available and the desire to de-risk investments to protect investors, depressing returns even further. The Bank of England forward yield curve is not expected to go above 2.5% over the next 40 years!

Problems create opportunities; we do have the wherewithal to grasp these opportunities, but only if we work together with sufficient urgency to safeguard the prosperity of Our Ship.

Cees Schrauwers
Chairman



DIRECTOR GENERAL'S STATEMENT

Risks

2017 was a year in which we came to appreciate that Brexit was a marathon, if not an ultra-marathon, rather than a sprint. As I write in January 2018, it is still unclear to me whether the UK will leave the European Union to trade with it under World Trade Organisation rules; whether it will achieve something close to the Canada plus a bit deal which the Secretary of State for Brexit has said he desires following a transition period, or whether there might be an agreement containing some characteristics of the Norwegian model. Firms in the Bailiwick will have doubtless considered the implications of Brexit by now, in as much as they are affected given the Bailiwick's location outside the EU Single Market. One area which I have been consistently alerted to by credible people as being important is that of contract certainty with respect to longer term derivative instruments. Such instruments may form part of the portfolios of some entities in the Bailiwick. Whilst we might assume that there will be some deal to make sure that there is contract certainty after March 2019, given the economic interests of the UK and EU 27 are aligned in this matter, Bailiwick firms should work out if they or their counterparties would be affected if there were no agreement to guarantee contract certainty.

The Bailiwick's implementation of its version of the General Data Protection Regulation is another important risk for firms to manage properly in 2018. Across the EU, firms are working hard to work out how to implement it. The Commission conducted remedial work with its archives in 2017 (scanning and sorting more than five million pieces of paper) to help bring us into compliance with the Data Protection (Bailiwick of Guernsey) Law, 2017 by the implementation deadline but the focus on the proper use of data and its security is only likely to become stronger and firms need to think about how legally compliant and otherwise well prepared they are.

Alongside legal compliance with data protection standards is the closely related issue of cyber security. The removal and exploitation of data from Appleby's offices in Bermuda provides a clear lesson to all of us of the potential attractiveness to malign individuals of personally sensitive data held by a number of firms in the Bailiwick. Going forward the Commission will be liaising with the newly appointed Guernsey Data Protection Commissioner to ensure that we can both fulfil our regulatory objectives of helping ensure that the data of Guernsey firms is appropriately secure. The Commission retained the services of a "white hat" hacking firm in 2017 to test its own cyber defences. We would urge boards to take measures to gain assurance that the data for which they are responsible is secure. It will remain a notable risk for many Bailiwick firms.

The pace of change in financial services and technology services does not appear to decrease. We would urge all boards to take measures to examine the robustness of their business models – ensuring they understand to what changes in technology and financial services they are vulnerable. On a global basis, many financial services firms are finding business models which have provided robust shareholder returns for many years are under pressure for a variety of reasons. It is surely better to look around and work out what is threatening you so that you have some ability to plan and pre-emptively react rather than wait until you have been pushed to the ground before struggling to get back on your feet.

Looking to new EU regulations, the implementation of MiFID II on 3rd January 2018 was a major event for European markets. It has been compared by some to the Big Bang of 27th October 1986. I think it is too early to tell whether it is an event of that magnitude but firms in the Bailiwick involved in investment activity would be well advised to work out what its implementation means for them. They should not assume that the fact that Guernsey has not rushed to replicate all aspects of MiFID II does not mean that it will not affect them.

Before turning away from risks, I will mention two more which I think all financial services firms in the Bailiwick should consider – climate change and ageing. Through various conversations with informed actors from outside the Bailiwick in 2017 I have detected a strong momentum to make green finance mainstream so as to realise the trillions of Green investment required to meet the Paris Climate Agreement's goal of a much less carbon intensive global economy. At the Commission we will continue to work with the States and industry to consider how the Bailiwick can best position itself with this now widespread agenda but firms should consider it both from a defensive and a business opportunity perspective. On ageing, other regulators have pointed out that ageing generally increases customer vulnerability. In the West, we have more and more people who are over 75, an age at which vulnerability appears to markedly increase¹. All firms interacting with customers and investors should be conscious of increasing vulnerability amongst those with whom they interact commercially and the burden of care which that puts on them. The Commission has not suddenly stopped believing that caveat emptor retains some validity but we wish to ensure that overly simplistic assumptions of capability do not lead to inappropriate product sales or ongoing relationship management.

Supervision and Authorisations

On the supervisory front, we continued to utilise our PRISM methodology to guide our supervisory activities. These included publishing the results of our thematic work on:-

¹See *Understanding the financial lives of UK adults*, (Financial Conduct Authority) October 2017

- Governance, Risk and Compliance in Fund Managers and Fund Administrators;
- Pensions and their administration by Fiduciary firms; and
- Investment and long-term insurance practises.

In terms of novel developments, industry continues to make good use of our Innovation Soundbox to discuss regulatory aspects of new proposals with us to aid their well planned development within the Bailiwick. Further to discussions in 2017, we agreed the use of blockchain solutions to aid administration in the funds and insurance sectors and will be watching the evolution of this technology with interest. We also participated in two Trust and Company Service Provider (TCSP) colleges (meetings where a global TCSP is subject to discussion by all its national supervisors, enhancing supervisory effectiveness). We regularly participate in equivalent colleges for banking and insurance groups but the constitution of these new colleges is a further indication of the maturity and sophistication of our TCSP supervision.

We have also taken the opportunity to integrate and enhance our work with firms on how to apply the law through seminars and business breakfasts etc. under the “Regulatory Self-Assurance” label. We hope that, going forward, firms will continue to find these sessions helpful and that they will give material assistance to firms in determining the most appropriate way of meeting their legal obligations.

We continue to work to ensure that we meet our service standards for authorisations processes. These standards are designed to give industry and professional services firms confidence that they can rely on Guernsey to authorise well considered proposals in good time. We continue to request more information on incomplete proposals and will apply appropriate scrutiny in order to ensure that the Bailiwick’s reputation as a high quality domicile is preserved.

In terms of application volumes, 2017 saw overall applications rise by 13% relative to 2016 and by 18% relative to 2015. This positive overall figure masks a more complex picture with lower levels of investment-related applications relative to 2015 and 2016, contrasted with very high levels of insurance applications with the 2017 insurance figure 14% greater than the combined total for 2015 and 2016, perhaps helped by the clarity of the Commission’s new Special Purpose Insurer Rules.

We have seen a significant increase in online applications over the past three years with more than 8,500 online portal submissions made in 2017. Our in-house software developers worked in conjunction with the authorisations team in 2017 to further

develop our online services to enhance the capabilities of the system and the user experience.

Policy Development

A number of pieces of policy work came to fruition in 2017:-

- Special Purpose Insurance Rules – effective January 2017;
- The new code of conduct for Authorised Insurance Representatives – effective April 2017;
- Pensions regulation with the Commission becoming the Bailiwick’s pensions regulator as of July 2017; and
- Basel III liquidity reporting – effective July 2017.

Work continued on many other policy projects, in conjunction with the States and the Law Officers of the Crown. A few highlights include:-

- The fine drafting of the legislation to implement the revision of the Bailiwick’s regulatory laws, further to the Policy Letter the States have approved. We hope that we may be in a position to ask the States to consider passing these laws before the end of 2018 to bring enhanced consistency, clarity and capability to the Bailiwick’s financial services legislation.
- Development of the proposed Lending, Credit and Finance law continued (designed to replace and update the Non Regulated Financial Services Business Law whilst better equipping the Bailiwick to manage some types of FinTech). The Commission plans to submit a draft Policy Letter to the States of Guernsey for further consideration early in 2018.
- The development of the new Anti-Money Laundering and Countering the Financing of Terrorism handbook. The development of the new rules and regulations within the handbook has required considerable finessing as we have worked to find the best way of implementing new important international Financial Action Task Force standards and the Recommendations of the Council of Europe’s anti-money laundering inspectorate (MONEYVAL) whilst making sure that the Bailiwick’s financial services sectors’ need for straightforward and workable processes for countering financial crime are accommodated. As I write this in January 2018, we believe that the main concerned parties have a good understanding of the best way forward and we look forward to taking this long-running project to fruition in 2018.
- The future of insurance solvency regulation taking into account the International Association of Insurance Supervisors’ 2017 Kuala Lumpur agreement on the development of an International Capital Standard for internationally active insurance groups.

Director General's Statement *(continued)*

- Work to evolve the Guernsey funds regime to ensure that it continues to offer the right combination of flexibility and quality to international investors.

We also, building on best practise from other regulators, published 'Our Regulatory Framework' – a guide to financial services regulation in the Bailiwick. Read in conjunction with our publication on 'Risk Based Supervision' in Guernsey and this annual report, we hope that interested parties will be able to gain a clear understanding of how we endeavour to perform our regulatory duties.

Enforcement

The enforcement team had a busy year, dominated by a small number of long-running complex cases, some of which have not lent themselves to early settlement. We continue to make considerable use of our Senior Decision Makers, three of whom were allocated to hearing active cases as the year ends. At the beginning of the year we had 9 open cases. At the end of the year we had 12 open cases.

We concluded enforcement actions against:-

- a fiduciary firm for serious and systematic anti-money laundering failings, the non-registration of administered businesses under the Non-Regulated Financial Services Businesses Law when those administered entities fell within the scope of the law; failing to effectively administer loan companies; failure to properly identify and verify customers, missing obvious red flags and failure to remedy failings following a Commission inspection in 2015;
- a firm involved in fund management for failure to organise and control its internal affairs in a reasonable manner, failure to retain company records for at least six years and a serious lack of understanding by directors of their legal and professional obligations;
- an unlicensed individual for illegally providing a registered office by way of business.

Fortunately these cases are not emblematic of the wider Guernsey financial services sector but we continue to uncover pockets of poor practise which require action to protect consumers and investors and to create a fair marketplace for law abiding firms.

International Work

We sought to develop our links within the European Union during 2017 as well as maintaining our existing links with the

UK regulators whilst providing technical support to the States in its interaction with the UK Government on financial services matters. This involved running a workshop with the BaFin, the Federal German financial services regulator, participating in the European Securities and Markets Authority (ESMA) Conference as well as ongoing contact with the European Commission, the European Banking Authority and the European Central Bank.

Outside Europe, a highlight of our year was signing a memorandum of understanding with the China Insurance Regulatory Commission. We now have operational MoUs with all three Chinese regulators which we believe to be helpful given they are often a prerequisite for significant financial services investment between jurisdictions. We have also provided technical expertise to support Guernsey Finance events in London, the United States and China.

We provided support to the States of Guernsey on the Global Forum on Transparency and Exchange of Information for Tax purposes's second round peer review of Guernsey as well as playing a part in the ongoing financial crime focused National Risk Assessment of the Bailiwick where Guernsey is being assisted by International Monetary Fund (IMF) consultants.

We commissioned Ian Towers (formerly a senior IMF inspector) to review the way in which we complied with international standards and shared his conclusions with senior politicians. He reached positive conclusions about the compatibility of key aspects of our regulatory regime - such as our PRISM based approach to supervision - with international standards. He highlighted the importance of the delivery of the Revision of Laws in helping to ensure that our legal powers match those required by revised international standards for financial services regulation.

We have continued to play an active role in the Financial Action Task Force, the International Association of Insurance Supervisors, the International Organisation of Pensions Supervisors, the Group of International Financial Centre Supervisors, the Group of International Insurance Centre Supervisors and the International Organisation of Securities Commissions (hosting a meeting of its Committee 4 which focuses on international co-operation between regulators in September 2017). By being an engaged international citizen we help to ensure that the Bailiwick's reputable regulation is well understood by significant international counterparts who influence whether Bailiwick entities have access to their markets. We also work to ensure that our voice is heard as new international standards are developed as these can have a positive or negative influence on the future of our financial services centre.

Internal Operations

We made a number of process enhancements internally in 2017 – launching an intranet; reviewing and enhancing our data management in preparation for the implementation of the Data Protection (Bailiwick of Guernsey) Law, 2017; introducing Policy Governance Panels to enhance the quality of cross-Commission challenge on policy projects; and introducing regulatory focused internal assurance reviews to further quality assure our supervisory processes.

We continued to keep a close eye on headcount and made back office savings over the course of the year which allowed us to redeploy headcount to the policy, enforcement and pensions areas where our workload has been particularly taxing.

We continue to invest in cost-effective training, providing our people with development opportunities. We also work to ensure that reward is clearly linked to operational performance and collegiate teamwork.

Finances

As in 2016 we continued to live within our means. We ran an operating surplus before exceptional items of £579,000 compared with £966,000 in 2016. Stripping out the highly variable level of financial penalties imposed (down 76% in 2017), our overall operational income increased by 2% to £13.2 million. On the expenses side of the Comprehensive Income Statement, staff costs increased by 2.4%, reflecting the January 2017 pay award which averaged 1.5% and the fact that the Commission ran closer to full complement in 2017 than in 2016. Legal and professional expenses rose by £58,000, reflecting the cost of professional advice such as that contained in the Tower Review discussed above and ongoing spending on legal advice relating to enforcement matters. In summary, a story of relative continuity compared with 2016 in terms of operational income and expenditure.

The big change in our financial statements relates to the elimination of the Commission's liability for employees of the Commission who were historically members of the States of Guernsey Pension Scheme. As I discussed in my 2016 annual report, we had arrived at a position at the end of 2016 where the Commission had negative net assets because of adverse changes in the liabilities as calculated under the widely criticised FRS 102 standard. During the course of 2017, an agreement was reached which saw the States formally adopting the Commission's liabilities in relation to members of the States Pension Scheme on the basis of a realistic valuation of the liabilities. As accounting

standards require the effects of this transaction to go through the Statement of Comprehensive Income, we have to present a rather extraordinary income statement this year showing a technical surplus running into several million (effectively reflecting the difference between the FRS 102 valuation of the pension liabilities and the realistic actuarial valuation of the liabilities) which bears little relation to our operating surplus discussed above.

As the Commission, following this transaction, has a reasonable level of reserves, we intend to run our finances on an approximately break-even basis going forwards rather than having to set fees with regard to having to re-build reserves to a prudent level. We will take into account the removal of this financial pressure upon us when setting 2019 fees later in 2018. The Commissioners, Directors and I will continue to seek to run the Commission on an efficient basis, seeking best value through the continued use of the sound operational practises we have adopted over the previous five years.

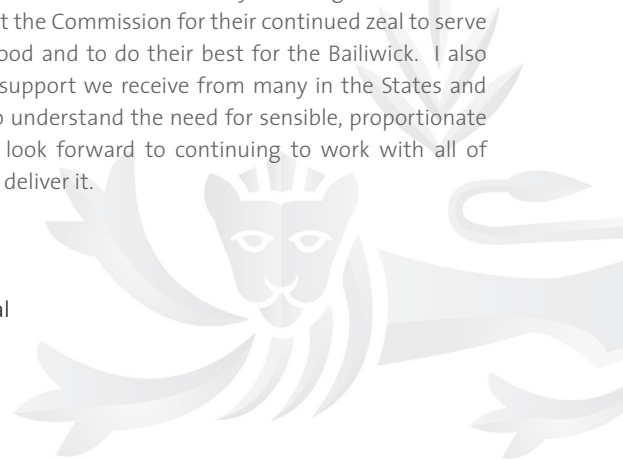
Looking Ahead

In 2018 we will continue to work to ensure that we:-

1. Execute high quality risk-based prudential, financial crime, and conduct regulation;
2. Deliver high quality regulatory policy;
3. Protect and enhance the Bailiwick's reputation and influence;
4. Manage finite resources effectively; and
5. Develop our people.

We will continue to be a risk-based, non-zero failure regulator because that approach is compatible with a free and prosperous society. We will continue to strive to do that which is good and right for the Bailiwick whilst being realistic about our limitations and cognisant of the need for focus. 2018 will doubtless bring its own set of challenges, as previous years have done, but as is customary I would like to conclude by thanking all those who work with me at the Commission for their continued zeal to serve the common good and to do their best for the Bailiwick. I also appreciate the support we receive from many in the States and in industry who understand the need for sensible, proportionate regulation and look forward to continuing to work with all of them in 2018 to deliver it.

William Mason
Director General



Supervision

During 2017, we undertook 12 full risk assessments as part of our engagement with High, Medium High and Medium Low Impact firms. In addition, we conducted 61 engagement meetings as well as a significant number of bespoke engagements with Low Impact firms the latter sitting alongside the notification regime, our work in reaction to triggers and, of course, thematic reviews.

We published the findings from our second thematic, entitled Governance, Risk and Compliance in November 2017. The topic was chosen because a theme to emerge from supervision had been a weakness in the application of effective compliance monitoring arrangements. Whilst conducted jointly with the Financial Crime Supervision and Policy Division, we concluded that separate reports would be more helpful for the financial services community. It was pleasing to note that the Commission overall found a good governance, risk and compliance culture amongst the licensees sampled: 35 respondents to a questionnaire, ten of which were then visited by the Commission. Notwithstanding that, the following areas for improvement were identified:

- Enhanced board oversight was required with respect to the scope, content and relevance of compliance monitoring programmes.
- Boards needing to be able to articulate their risk appetite for the taking on of new collective investment schemes.
- A few licensees not monitoring financial performance and key risk indicators.
- Some fund administrators not seeking to independently validate prices supplied by the fund manager.
- That whilst all licensees had a conflicts of interest policy in place, there was inadequate consideration of conflicts of interest by some fund administrators where they also provided directors to sit on the Board of the Scheme.

The Commission will be following up on the above thematic with fund administrators in 2018 via a series of regulatory self-assurance events on the latter two points in particular. The objective of the regulatory self-assurance events will be to engage with the sector over the Commission's expectations of their role in ensuring and facilitating the appropriate discussion by the boards of funds over matters such as best practice for fund administrators in order to obtain some assurance on the prices supplied by the fund manager. The events will also cover complaints, outsourcing and conflicts of interest.

A further regulatory self-assurance event is planned to cover the online submissions portal. The Commission hopes this will be helpful to the investment sector in identifying common errors or misunderstandings when completing the online submissions. For example, we were surprised at the number of instances over the last year that the submission of funds report and accounts incorrectly stated that there was no management letter/audit qualification when in fact there was one. The submission of correct information is something the Commission takes seriously and will monitor over the next period.

Policy

The themes arising from our supervisory work in 2017 influenced our policy work and continue to inform it into 2018. A consultation on changes to the Registered Collective Investment Scheme Rules, 2015 and the Prospectus Fund Rules received a high level of response and as I write in February 2018 the Commission is evaluating those responses.

Towards the end of the period we reflected on the Private Investment Fund and canvassed the views of a number of Managers who had signed the required declaration on a Private Investment Fund to see what mechanisms they relied upon in order to be able to do so. The results of these enquiries helped inform an amendment to the declaration which we hope will be helpful in clarifying our reasonable expectations.

Internationally, we have continued to monitor the implementation of MiFID II and will work with the asset management sector in 2018 to ensure that our approach to this important EU legislation remains appropriate.

The policy of the imposition of conditions upon the late submission of Collective Investment Scheme accounts and accounts with qualified, disclaimed or adverse audit opinions, introduced in 2016, continued to be implemented in 2017. The main reporting submission date of 30th June saw the need for 11 condition notices to be issued, however, matters about which we had concerns were regularised in short order in each case and there was no need to impose any further conditions. This area still remains a concern to the Commission and significant resource was committed to the monitoring of the receipt and subsequent review of the accounts and will be again 2018.

Risk Outlook

Emerging themes for the Commission include the transparency of management fees, cyber security and funds' risk management during what is looking like a considerably more volatile year in the markets. Other themes include the ongoing possibility of interest rates rising, and ensuing sterling and dollar volatility further catalysed by political events in the United States and ongoing Brexit negotiations between the EU and the UK.

Emma Bailey
Director



Supervision

'Pension Arrangements in the Bailiwick' was the focus of the Fiduciary Division's 2017 Thematic Review. Pension and gratuity scheme arrangements are of fundamental economic and social importance for long-term savings and adequacy of retirement income. Our thematic review formed an important part of our fact-finding activities regarding the nature and scale of operations of firms providing services to pension and gratuity schemes in advance of the introduction of pension regulation and associated rules. The thematic review included a review of the transparency of fees and charges to pension members and a review of the frequency of book keeping and recording of transactions; both essential components of pension provision and yet both areas of mixed practice at present. As a result of the thematic review the Commission issued a consumer focused help sheet which we hope is a useful resource.

In addition to the pension thematic questionnaire completed by 51 Fiduciary licensees, and 8 thematic onsite visits, the Division undertook 13 engagement visits and 8 Full Risk Assessments. Visit themes included a focus on governance, specifically the role

of dominant directors and the potential failure of other board directors to provide an adequate check and balance; a focus on operational risk, specifically with the continued trend for mergers and acquisitions the importance of the board not underestimating the integration and reporting challenges; and a focus on adequate professional indemnity insurance, specifically the need for firms to check and understand the detail of their policies and when a group policy is in place to understand the extent and limits of the particular local cover.

The Commission continues to play an active role in the Group of International Finance Centre Supervisors (GIFCS). A significant development during the year in this respect was the introduction of the concept of supervisory Colleges for Trust and Corporate Service Providers (TCSPs); Guernsey participated in both of the 2017 Colleges and found them a valuable opportunity to compare notes with other regulators regarding specific fiduciary groups.

Policy

On 30th June 2017, the Fiduciaries Law was amended to include the formation, management or administration (and the provision of advice), in respect of defined pension and gratuity schemes, as a regulated activity. This amendment, together with the introduction of pension rules, reflects a notable step in modernising the regulatory framework for private pensions in the Bailiwick.

Licensed pension providers within scope of the legislation will be aware of the new obligations that they must adhere to within the pension rules. These obligations include providing details of the scheme to the Commission, assessing the suitability and competence of any service provider to the scheme, providing details of complaints procedures, ensuring that the responsibilities of all relevant parties are understood and that all member-borne changes are reasonable.

Pension regulation is still in its infancy in the Bailiwick: it is restricted to schemes within scope of the Law; the transition period for firms to comply with the rules runs until 30th September 2018; the Commission will start receiving annual scheme data from June 2019; and the Commission does not have powers to direct funding of a pension scheme. Nevertheless, in 2017 we laid the foundations for improving standards of investor protection – establishing Guernsey as a jurisdiction which has formal regulation of private pensions.

Risk Outlook

The Commission is conscious that key risks for 2017 and 2018 relate to data breaches and cyber security. As a reminder, we expect directors to be able to demonstrate how they have assessed the cyber risks to their business and clients, and clearly explain the ways that risk is monitored, mitigated and controlled. We anticipate that data hacks will continue to be a major threat in the year ahead, and recommend licensees plan and prepare (build and test contingency response plans) for when, rather than if, such an event occurs. As a reminder, any serious or significant incident involving data loss, financial loss or denial of service type attacks, whether actual or prevented, should be reported to the Commission in a timely manner.

The volume of global data reporting initiatives such as Beneficial Ownership, Common Reporting Standard (CRS), Base Erosion and Profit Shifting (BEPS) and the General Data Protection Regulation (GDPR), present immediate challenges of an operational nature to fiduciary firms who need to ensure their systems are adequate to cope with the requirements for onboarding and maintaining clients. The joint Financial Crime and Fiduciary 2018 thematic review

will focus on the Beneficial Ownership of Guernsey and Alderney legal persons, in recognition of the essential, substantial, role fiduciary licensees play in understanding the Beneficial Ownership of Bailiwick companies.

Furthermore, the Bailiwick's fiduciary firms will doubtless wish to be conscious of their tax obligations.

Innovation

The Innovation Sandbox continued to welcome all conversations and engagement during 2017. The Sandbox seeks to provide a forum through which less conventional financial services propositions, often containing a technological element, can be discussed with the Commission before an application is formally submitted. We find this allows us to get a better grasp of the entrepreneur's intent whilst allowing us to offer guidance to the entrepreneur as to how to ensure that he or she applies for the right licences in an appropriate manner.

Gillian Browning
Director

Alongside our continued support for the Innovation Sandbox, we prioritised resource to progress the Lending Credit and Finance (LCF) project, issuing a consultation paper between July and September, and building analysis of responses into a Policy Letter for consideration by the States of Guernsey.



Supervision

As a global insurance centre, the Bailiwick in 2017 continued to be affected by several global events. Perhaps most significantly, severe weather, in particular in the southern states of the United States, certain Caribbean islands, and parts of Asia, meant that trigger events for the Insurance Linked Securities (ILS) catastrophe sector were activated in Guernsey as elsewhere. Nevertheless, in terms of the alternative reinsurance market in general, premiums and capacity appear so far to have been largely unaffected; demonstrating the strength of global supply in this market.

Outside the ILS catastrophe sector, the Bailiwick's life insurers continue to face global low interest rates, together with the attendant challenges; with most long-term insurance products now transferring investment risk to the policyholder rather than the insurer.

Globally, entities with long-term longevity obligations continue to seek mitigation in this area; and the Bailiwick as a jurisdiction continues to play its part in this process; not least through the use of the Incorporated Cell Company (ICC).

More locally, the issues uncovered by the Commission during its day-to-day supervision tend to be idiosyncratic as opposed to representing global trends, as they depend on the particular firms examined in any one year. Nevertheless, certain general supervisory themes emerged in 2017, these being:

- the need to protect clients and the business from cyber-attacks;
- the need to ensure that mind and management for insurance entities remain in Guernsey; and that outsourcing is adequately overseen; and
- the continuing debate around changing technology and its potential impact on current insurance business models.

In addition to the above, there were three innovations in 2017. One was the arrival of a general re-insurer covering Chinese business – the first of its kind in Guernsey. Another was the initiation by the Commission of a closer examination of insurance managers as part of a long-term plan to intensify supervision in this sector. The latter reflects a desire by the Commission to supervise this sector more closely given its pivotal local role. The last was the first use of distributed ledger technology by an ILS insurer in Guernsey.

2017 aggregate figures are unavailable, given that many insurers have an end-December year-end and do not report until the end of the first quarter of 2018. Nevertheless, in 2016 gross assets stood at £28.8bn (up on £23.9bn in 2015), net worth at £12.9bn (up on £11.5bn in 2015), and premiums at £5.5bn (unchanged on £5.5bn in 2015). These figures reflect a hybrid local industry and can be materially influenced by business at the larger firms. However, they generally indicate business growth in the areas of catastrophic ILS, life, longevity and reinsurance.

International insurer licences increased from 835 in 2016 to 853 in 2017; largely due to new Protected Cell Company (PCC) cells. This increase both reflected a re-structuring of current business and continued growth in ILS catastrophe business.

Policy

In 2017, the Commission issued Special Purpose Insurer Rules to provide additional clarity to this sector around ILS and has since followed this up by allowing the use of contingent capital in certain defined circumstances. Further, the Commission revised its ILS fee structure.

The Commission also issued a Discussion Paper on “Global and European Insurance Capital Standards”. This paper considered the Bailiwick’s position in relation to the emerging International Association of Insurance Supervisors (IAIS) International Capital Standard and the European Union’s Solvency II Directive. Several issues and questions emerged and these will continue to be considered into 2018.

As Katherine Jane discusses in more detail in the Risk section of this report, in 2017 the Commission initiated a self-assessment process against regulatory standards, including the IAIS’ Insurance Core Principles. As a result of this, the Commission in 2018 intends to develop policy further around, for example, stress-testing, reporting and disclosure.

The Commission continued to contribute to IAIS through membership of IAIS’s ExCo (on behalf of the IAIS offshore constituency), IAIS’ Financial Stability and Technical Committee (FSTC) and the Reinsurance Task Force. Late in 2017, the FSTC was bifurcated and the Commission is now a member of one of its successors, the Policy Development Committee. In addition, the Commission was an active contributor to IAIS’ developing approach to its own assessment of the Insurance Core Principles.

The Commission continued to chair the Group of International Insurance Centre Supervisors (GIICS), benefiting in 2017 from its mid-level training event in Bermuda.

Risk Outlook

In 2018, long-running but still key risks continue to exist around low interest rates and the search for yield, especially for life companies. All insurers - though again in particular life companies - need to strengthen controls against cyber risk. More specifically, captives should continue to take measures against the attendant risks of Base Erosion and Profit Shifting (BEPS); whilst alternative catastrophic reinsurers should ensure prompt pay-out where appropriate.

Jeremy Quick
Director



Supervision

As at January 2018, the IMF estimated global GDP growth for 2017 at 3.7% - a strong and broadly based outturn. UK growth is estimated to have been more subdued at 1.5%.

As at end December 2017, total liabilities of Guernsey banks stood at £119bn compared to £120bn a year earlier. Third party deposits, that is deposits other than from banks, as at end December 2017, stood at £41bn compared to £46bn a year previously. The latter figures reflect a structural change in third party deposits in the wake of a re-positioning of some private bank business in the Bailiwick.

Two licences were surrendered in 2017 bringing the number of banks in Guernsey to 23 at end-year. The two groups that surrendered their respective licences continue to be present in Guernsey through other bank licences. Full time equivalent staff was more-or-less static at 1,472 at end-2017.

In 2017, the topics generally preoccupying the Guernsey banking sector were the supply of mortgage finance, fintech, and ring-fencing and resolution.

As in the UK, mortgage supply continues to be limited in Guernsey due to tight affordability criteria; but in Guernsey this is accentuated by structural barriers to cross-border lending. Guernsey retail banks were preparing themselves in 2017 for the future potential impact of Open Banking as well as continuing to adapt their business models to technological developments. Private banks similarly are preparing to face the challenge presented by robo-advice. Ring-fencing plans came close to conclusion in 2017 whilst resolution continued to be discussed in depth. Several of these themes remain relevant for 2018 and beyond.

Policy

As part of its continuing implementation of Basel III, the Commission's approach to the Liquidity Coverage Ratio and the Net Stable Funding Ratio went live in 2017 with all subsidiary banks adhering to the new requirements. This means that Guernsey is now broadly compliant with all relevant Basel III requirements.

The Commission also undertook, on behalf of the States of Guernsey, a data gathering exercise on dormant accounts.

In 2017, the Commission continued to be active internationally; attending regulatory colleges and meetings of the Group of International Finance Centre Supervisors (GIFCS).

As the Chief Risk officer discusses in more detail in the Risk section of this report, in 2017 the Commission undertook an assessment process against regulatory standards, including the Basel Core Principles. Over 2018-2020, the Commission accordingly intends to develop policy on, for example, stress-testing, large exposures and disclosure.

Risk Outlook

The outlook for banks looks better than it has for several years though profit margins in a low interest environment remain tight, not least for private banks.

Nevertheless, some risks might still upset this benign scenario. These risks include a failure by the authorities to bring about a return to a normal interest rate environment without undue market disruption, a sudden fall in UK commercial property prices and a continuing erosion in central London residential value. If a hardening in the arteries of cross-border finance (upon which the Guernsey banking industry largely depends) continues, then this will also adversely affect the local banking sector.

Operational risk continues to be an area of risk for Guernsey banks where continued diligence is especially required. This is in particular around AML/CFT controls, cyber crime and outsourcing.

Jeremy Quick
Director



CONDUCT UNIT

In 2017, the Conduct Unit continued to evolve especially in supporting the Commission's approach to retail consumer issues. This evolution attests to the importance attached by the Commission to conduct as well as prudential regulation.

Examples of the Conduct Unit's activities in 2017 are as follows:

- acting as the prime interface between the Commission, the Channel Islands Financial Ombudsman and, where appropriate, complainants;
- supporting the Commission's ongoing initiatives around regulation of defined contribution pensions and consumer credit;
- acting as the focus point for external bodies connected to consumer interests such as the local Citizens Advice Bureau and Guernsey Trading Standards;
- developing the Commission's website on consumer affairs including Frequently Asked Questions; and
- contributing to the Commission's and the industry's approach to vulnerable customers.

Outside these ongoing activities, in 2017 the Conduct Unit spearheaded the Commission's thematic on long-term insurance and controlled investments. This thematic took the form of a questionnaire and onsite visits to selected firms. In summary, the thematic demonstrated that, although most firms displayed general compliance, there were still indications of a need to improve standards further for some firms in certain areas. These areas were for example:

- explaining to policyholders the benefits that would be lost in a surrender of a life policy;
- ensuring that policyholders understand their capacity for loss and how this differs from their risk appetite;

- being transparent around fees, charges and remuneration; and
- ensuring adequate staff training and competence levels.

Feedback and learning points on the thematic were delivered by the Commission to the industry through both written and oral means – at, for example, the Commission's 2017 annual Industry Presentations.

Turning to general insurance intermediation, in 2017 the Commission issued a new Code of Conduct for Authorised Insurance Representatives (AIRs), following extensive consultation and outreach with the industry. Several workshops were held for AIRs and compliance personnel after the introduction of the Code, attended by around 150 people, to highlight significant areas and the role of the Conduct Unit. The purpose of the Code is to assist AIRs to deliver good and reasonable advice to the customer.

The Commission has decided that it will undertake a general insurance intermediaries thematic in 2018. This will look at, for instance, whether firms make clear the previous year's premium and that firms have no opt-out add-ons.

As part of the Commission's regulatory self-assurance programme, the Conduct Unit held another one-day seminar in 2017. This was attended by around 50 people and feedback was positive. It also took part in the local roll-out of World Investor Week and participated on conduct issues at the annual meeting of the Group of International Insurance Centre Supervisors in London.

There were 36 licensed insurance intermediaries in 2017 (34 in 2016) and 20 insurance managers (19 in 2016).

Risk Outlook

In strictly local terms, intermediaries need to continue to improve their businesses around long-term insurance and collective investments along the lines indicated in the Commission's 2017 thematic. General insurance intermediaries need to be prepared for the Commission's general insurance intermediaries thematic in 2018.

In terms of wider issues, technological changes have the potential to affect, sometimes in a short timeline, current business models – for example through insurance comparison websites and robo-advice. Firms need therefore to think about how their business might change in relation to these developments. Cyber-risk is another technology challenge; especially for client data security.

Jeremy Quick
Director

Supervision

During 2017, the Financial Crime Supervision and Policy Division undertook onsite visits to 44 firms, 20 of which were carried out under its thematic review of the fiduciary sector which focused on firms' financial crime governance, risk and compliance frameworks. This topic had also formed the basis of the previous year's thematic review of fund managers and fund administrators, the report of which was published in the second half of 2017. We intend to publish the report on the fiduciary sector in the first half of 2018.

Both thematic reviews focussed on smaller firms and the topic was chosen as weaknesses in compliance monitoring arrangements had been a theme to emerge from the Division's supervision. With regard to the funds sector, we found that firms generally had a culture of compliance, with compliance monitoring programmes covering a broad range of tests with regular reporting to the Board on the outcomes. However, the principal theme to emerge from the review of the fund sector was a disconnect between the risks identified by the firm's Board and the mitigation of those risks, which was most noticeable with compliance monitoring programmes that failed to take into account the money laundering and terrorist financing risks identified by the Board in the Business Risk Assessment.

There were also several instances within firms which had outsourced compliance functions to a third party compliance consultant using generic compliance monitoring programmes which had not been tailored to the firm's business model and the financial crime risks associated with that firm. It would therefore be advisable for Boards to periodically check that their monitoring arrangements focus on the areas identified as presenting higher money laundering and terrorist financing risks.

It was also encouraging to note that within the fund sector there is increasing use of automated systems as part of a firm's monitoring controls which can enhance the firm's capabilities for detecting suspicious activity or transactions as well as any connections with sanctioned parties. This trend has also been identified in the thematic review of the fiduciary sector, indicating that many smaller firms across the sectors are investing in IT resources to strengthen their control environment.

Such investment in automated systems to monitor transactions and to screen against sanction lists is welcome, but it is crucial that, regardless of the sector, the firm's compliance function understands how a system works and periodically tests its effectiveness. There have been incidents when these controls failed, sometimes for long periods, because data was being pulled from corrupted or outdated data files or because rules or protocols had been deactivated or could be circumvented as a result of the way the system had been configured.

Where multiple systems are deployed within the processing of activities, such as payments, end to end testing of the process could highlight any unexpected outcomes. Similarly, compliance testing should also be undertaken as part of significant IT systems upgrades.

A number of the Division's onsite engagements were undertaken jointly with another supervisory division, the findings from which generally continued to show that most firms are good at identifying and managing their money laundering and terrorist financing risks. Nevertheless, a small number of firms were referred to the Enforcement Division for further investigation, whilst 4 firms were required, as part of risk mitigation programmes, to appoint a third party expert to review practices or quality assure that the firm in question had sufficiently remediated serious financial crime deficiencies.



Policy

The principal project which dominated policy work in 2017 was the revision to the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Handbook to bring it into line with the Financial Action Task Force's (FATF's) International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation and to address the recommendations made by MONEYVAL following its evaluation of the Bailiwick's AML/CFT regime. This culminated in a joint consultation with the Policy and Resources Committee on revisions to the Proceeds of Crime legislation and associated rules and guidance issued by the Commission in the Handbook.

Significant efforts to reach out to industry in the consultation process saw us speak to approximately 500 people on the proposed changes which resulted in 75 responses giving us valuable industry perspectives on the proposals. For the second half of the year we have been giving careful consideration to those responses and how we can ensure that the revised measures are pitched at the FATF standards in what is the first major revision to the Bailiwick's AML/CFT regime since 2007. It is the intention for the revised Handbook to be issued in Quarter 2 of 2018 and for the legislation and associated rules to take effect in the second half of 2018.

A significant element of the FATF's preventive measures within its revised International Standards will be met at the technical level by the Bailiwick when this work is complete.

During the second half of the year we also made a significant contribution to the Global Forum on Transparency & Exchange of Information for Tax Purpose's assessment of Guernsey's compliance with international tax standards on the exchange of information upon request. This was in respect of the quality and availability of Beneficial Ownership information on Guernsey law trusts and companies which are administered here by the financial services sector. The report on the assessment will be finalised by the Organisation for Economic Co-operation and Development during 2018. We continued to provide input into the government-led National Risk Assessment which is assessing the money laundering and terrorist financing risk to the Bailiwick.

Internationally, we have represented the Group of International Finance Centre Supervisors on a joint FATF/Egmont Group project to report on the vulnerabilities linked to the concealment of Beneficial Ownership of trusts and companies. Through this work we have sought to share the significant knowledge and expertise of GIFCS members, including Guernsey, in the area of AML/CFT supervision of the fiduciary sector.

Risk Outlook

As international standards on AML and CFT, Tax and Beneficial Ownership become increasingly conjoined, the effectiveness of the Bailiwick's AML/CFT framework is likely to be subject to greater scrutiny by a number of international organisations. Such scrutiny includes assessing how well firms apply customer due diligence measures and monitoring controls to their business. How well businesses apply the measures proposed in the revised Handbook will form an important part of future assessments of the Bailiwick's regime.

Fiona Crocker
Director

General

In 2017, the Enforcement Division received a small, but steady flow of referrals from the supervisory divisions involving cases where serious concerns were raised regarding corporate governance failings, conduct issues, or AML/CFT breaches of a significant nature. The complexity of some cases led to a slight reduction in the overall number concluded in 2017, however, those are now at advanced stages and are expected to be progressed to a conclusion during 2018.

Cases which were concluded in 2017 are detailed below. They provide evidence of the Commission's commitment to addressing any serious failings or misconduct. Further details of the cases against regulated entities are to be found in the public statements on our website. In our public statements we endeavour to be as informative as we can, explaining clearly how the law was broken and the consequences.

During 2017, the Commission took steps to appoint inspectors in one enforcement case. This is a tool we do not use often but which can be very useful for supporting a firm in remedying failings and giving the Commission access to a specialist opinion on the failings. As a general guide, we may well seek to appoint an inspector in circumstances where a licensee has been previously sanctioned, where repeat breaches have been identified from previous onsite visits, where serious or systemic issues have been uncovered or where a licensee simply refuses to adhere to the rule of law. This is not an exhaustive list. The Commission is also acutely aware of the cost to the licensee of appointing inspectors and does not take such action lightly.

In 2017, I represented the Commission on Committee 4 for the International Organisation of Securities Commissions ("IOSCO"); previously, this role had been undertaken by colleagues from the Investment Supervision and Policy Division. It is an important Committee with over 114 member-countries. IOSCO is the international body that brings together the world's securities regulators and is recognised as the global standard setter for the securities sector. IOSCO develops, implements and promotes adherence to internationally recognised standards for securities regulation with a focus on market abuse, market manipulation and insider dealing. IOSCO explores best practice to enable the

underpinning of regulatory standards by ensuring that there are appropriate global deterrents in place to offer the maximum protection to markets. Our participation in Committee 4 helps us build confidence in Guernsey as a good quality jurisdiction for business and to exchange information across borders on troubled firms and individuals which operate internationally.

In January 2016, the States of Guernsey agreed to increase the maximum level of discretionary financial penalties which can be applied in cases where there have been serious breaches of the regulatory laws. The necessary legislation (Projet de Loi) to give effect to the proposals was enacted on 13 November 2017. The Commission has since published a schedule setting out bandings for the revised discretionary financial penalties. It must be stressed that the schedule is only intended as guidance and as such must be read in conjunction with all relevant legislation including any regulations which are in force. The increased penalties will only be applied in new enforcement cases which are commenced on or after 13th November 2017 and where the alleged breaches also took place on or after that date.



Cases reported

The Commission made a successful application before the Royal Court this year seeking director disqualifications against individuals previously convicted of money laundering and regulatory offences. This was part of our ongoing efforts to protect the public from those that seek to undermine the Bailiwick as an international finance centre. We will continue to bring these applications on a case by case basis.

The Commission also dealt with a case of unauthorised business, in this instance providing registered offices to a small number of companies by way of business, in breach of the Fiduciaries Law. The Commission takes a firm approach as it is unfair for licensees to bear the costs of being licensed and complying with regulatory requirements when others do not. Therefore, where the Commission finds that a person is conducting regulated activity without the appropriate license, it will respond accordingly.

Detecting unauthorised business can be difficult as it naturally occurs outside the gaze of a regulator, but we do “police the perimeter” of financial activity in the Bailiwick and we achieve this with the assistance of our overseas colleagues and of course, most importantly, by those within industry who may highlight such instances to us.

A further case dealt with last year involved a local investment adviser as well as two overseas companies which were operated from the local investment adviser’s offices. This case saw individuals purporting to be directors and acting on behalf of the two overseas companies including signing contracts when they were not, in fact, directors of those companies. The individuals were also undertaking promotion and providing investment

advice in Guernsey when they did not have a license to do so. One individual had been providing investment advice to clients over a number of years without making proper records of the advice being given. This case also involved significant governance failings where, for example, board packs were never produced, minutes were never signed and there was a lack of challenge to a dominant person on the Board who was failing to run the enterprise appropriately. For those individuals involved in this case, financial penalties and prohibitions were deemed both proportionate and necessary.

In another case involving a local fiduciary, serious failings were uncovered regarding insufficient client due diligence, inadequate monitoring of their clients and missing “red flags.” The majority of those “red flags” involved clients who were taken on prior to the AML/CFT Handbook and Regulations coming into force and included one client who had changed his name, his nationality and his physical appearance without a clear rationale being documented as to the purpose for doing this. Failing to constantly review, update and understand clients leaves not only the firm, but the Bailiwick, open to the real risk of reputational damage.

Due to the failure of the licensee to also register three loan companies which they were administering as Non-Regulated Financial Services Businesses, until six years after the Law came into force, the Commission considered it appropriate to seek to appoint a third party firm as Inspectors. But for the fact that the firm in question instigated an extensive remediation programme to address all of the serious deficiencies which had been identified, the penalties would have been more severe.

Outreach to Industry

We have continued to reach out to industry during 2017 particularly utilising opportunities for small, focussed group sessions. The presentations we provided during the year enabled us to speak directly to client relationship managers, senior management and boards in large organisations where we were able to provide an insight into the types of serious cases we deal with, the process we adopt and our continuing efforts to be transparent, reasonable and proportionate in all that we do.

Simon Gaudion
Director

Given the success of our 2017 programme in building understanding of our work and the issues we discover, we envisage that our 2018 outreach programme will be delivered to a wider audience.

Whistleblowing Line

Calls to the whistleblowing line during 2017 included the expression of concerns about the conduct of certain senior staff of licensees and other general reports of poor business practices. The reports were reviewed by the Intelligence Unit and relevant information passed to the supervisory divisions for further consideration where appropriate.

The whistleblowing line is 01481 748094. There is also an email address which may be used: whistleblower@gfsc.gg.



SENIOR DECISION MAKERS

In 2014, the Commission established a Panel of Queen's Counsel who sit as Senior Decision Makers and determine the outcome of the Commission's major enforcement cases.

For the first time since the creation of the Panel, as many as five cases were before a Senior Decision Maker during the calendar year 2017. In consequence, each of the available Senior Decision Makers was engaged on a case at some point in the year.

Two of the five cases were completed in the year. The first of the cases involved unlicensed business carried on in the Bailiwick by an individual for which a fine and prohibition were imposed. A full public statement was not legally possible because of limitation in the Commission's powers to make public statements about unregulated individuals. The second case came to an end in the Summer with no imposition of a penalty or other sanction.

The other three cases were all still in progress at the year end.

At the start of the year the Panel had been reduced to six available Senior Decision Makers, with the appointment in December 2016 of His Honour Malcolm Davis-White QC to judicial office in the North East of England. In the course of the year, the effective strength was further reduced by two more to a total of four. Richard Millett QC was appointed in the Spring to be Counsel to the Grenfell Tower Tribunal of Inquiry, and he will as a result not be available for service as a Panel Member for the visible future. During the course of the year, Nicholas Peacock QC resigned from the Panel. I am most grateful to each of them for their service in Guernsey as inaugural members of the Panel.

The working members of the Panel now comprise:

- Glen Davis QC (England and Wales);
- Kirsty Hood QC (Scotland);
- Terence Mowschenson QC (England and Wales), and
- Leigh-Ann Mulcahy QC (England and Wales and Northern Ireland).

As a result of this reduction in numbers, the Commission proposes to run a selection process early in 2018 in order to select further Panel Members; and by the time of publication of this annual report it may be that the appointments will have been made.*

There were no proceedings during 2017 in the Royal Court, or in the Court of Appeal for the Bailiwick of Guernsey, relating to the work of the Panel.

A further training day was organised for the Panel in late September and one of the main items to be discussed was the Commission's proposal to revise the 2014 Guidance on Decision Making. This covers, among other things, the expected procedure to be followed by the Senior Decision Makers at the relevant stage of an enforcement case. The new Guidance was thereafter adopted by the Commission on 26th October 2017 and is available on the Commission's website. All three outstanding cases are governed by the new Guidance.

The States of Guernsey have now passed legislation to increase the maximum penalties that can be imposed by the Commission in the event of a breach of regulatory requirements. This new system will apply to cases commenced on or after 13th November 2017 and where the alleged breach(es) also took place on or after that date. So far, however, there is no case before a Senior Decision Maker to which the new penalty regime applies.

Michael Blair QC
President of the Panel of Senior Decision Makers

*As of 19th April, four new appointments have been made.

CHIEF RISK OFFICER'S REPORT

2017 has been a year of stability at the Commission with a relatively low level of supervisory turnover and a consistent risk-based supervisory approach to all firms in the form of our PRISM model. This has not, however, meant that our pace has slackened; during the year we have carried out over 35 Full Risk Assessments to our firms, held over 39 governance panels, raised over 100 Risk Mitigation issues with over 200 associated actions to address the risks identified; and dealt with over 13,000 alerts that were raised from a wide range of different sources. This shows that even during a period of stability there are a range of different issues and risks for a regulator to address. These include developing risks, for example cyber risk, ensuring that we continue to address risk in the most efficient and effective manner, and demonstrating that we, as the Bailiwick's regulator, continue to meet international standards and expectations for a strong and sound regulatory system.

As mentioned in our 2016 annual report, the Commission decided to appoint an independent expert to assess our compliance with international standards and the expectations for financial regulators. This assessment was carried out in the first part of 2017 by Ian Tower, an ex-IMF inspector who reviewed our compliance with financial regulatory standards, including the Insurance Core Principles detailed by the International Association of Insurance Supervisors, the Banking Core Principles laid out by the Basel Committee on Banking Supervision, and the IOSCO Objectives and Principles of Securities Regulation. We were reassured that whilst the output of the review highlighted a number of areas for development, these were either areas that we are currently working on, such as the revision of our regulatory laws, or areas where international standards are currently developing so we are well placed to be in line with, but not ahead of current expectations. Over the course of 2018 we will continue to work on our main projects and also consider the areas for development identified during the review.

A system or model is only good if it is used appropriately and any system requires continual monitoring to ensure that it is used as efficiently and effectively as possible, as well as delivering the desired outcomes, which in this case is a reduction in the regulatory risks for the Bailiwick of Guernsey. To this end, during 2017 the Risk Unit, like the second line of defence at any firm, has been carrying out a series of assurance reviews to ensure that we continue to follow our risk-based supervisory approach including making fair and consistent decisions across supervisory teams and divisions. The output of these reviews has meant that we have been continually developing our processes and personnel to enable them to make clear risk-based decisions and challenge firms appropriately on how they manage the risks within their businesses. This does not mean that we will always agree with

a firm's determination and mitigation of its risks, but rather that our supervisors will be able to have detailed conversations on the risks at a firm, including how it implements and monitors its own risk appetite, and the reasons for our potentially differing views.

Finally, whilst there has been relatively little change in our supervisory teams or divisions, there continues to be development in the risks we face across all financial services sectors in the Bailiwick. Risks, such as cyber risk, continue to increase for all firms, in all sectors, and only with continued vigilance, training and preparation can we ensure not just that the probability and impact of an event occurring in the Bailiwick is reduced, but also that any events which may occur are dealt with swiftly and carefully. As well as cyber risk there is also an ongoing risk in the number of changes and developments facing each of our financial services sectors whether these are from internal projects, business model challenges or international developments. Firms need to ensure that they target their resources appropriately and understand their limits. We will continue to review the risks faced by firms individually but in 2018 we will also consider the best methods to address these cross-sector risks in order to ensure we continue to meet our objective of protecting the reputation of the Bailiwick.

Katherine Jane
Chief Risk Officer



AUTHORISATIONS UNIT

The Authorisations Unit has continued to see a wide variety of application submissions being made to the Commission. The diversity in submissions makes the Authorisations Unit an exciting and interesting area to work in. On a day-to-day basis we have contact with potential and existing licensees, as well as representatives from the Bailiwick and UK legal sectors. The array of skills and specialisms within the team ensures that we are able to effectively review the majority of submissions, enabling supervisors to focus on their core role of supervision. The volume of submissions increased during 2017, as did the complexity of structures and business models we received.

The adoption of a risk-based approach to the assessment of application submissions and personal questionnaire (PQ) information has enabled the team to maintain a high quality and timely service when faced with increasing submission rates. It also ensures that we focus on the issues which pose the greatest risk to the Bailiwick. Overall, the volume of applications submitted to the Commission increased by 13% relative to 2016, with a total of 563 received during 2017.

It was a challenging year for the Investment sector with submissions slightly down in total on the previous year. Encouragingly, we did see an increase in applications during the second half of the year, a trend we hope continues during 2018. There were a number of innovative proposals reviewed during the year, including the licensing of the first investment Incorporated Cell Company (ICC) structure and a number of funds with unusual asset classes.

The Insurance sector had a buoyant year in 2017. After consultation with industry the Commission issued 'The Insurance Business (Special Purpose Insurer) Rules 2016' which came into force on 1 January 2017. These rules formalised the Commission's expectations and requirements in relation to certain types of Insurance-Linked Securities (ILS) business, including reinsurance and catastrophe bonds. The rules acknowledge that unlike traditional insurers these structures carry no risk-gap between their assets and liabilities and are fully collateralised. The restructuring of this regime by the Commission, combined with our existing insurance expertise, contributed towards a significant increase in the number of applications in the first half of 2017. Following the robust response of the ILS market to the devastating hurricane season, in what can be argued was the first substantive test of the ILS structures for catastrophe insurance, this increased level of applications was maintained in the latter part of 2017. This trend should continue into 2018 as more firms enter the market and also become aware of Guernsey's expertise and knowledge in relation to this particular structure.

Whilst Fiduciary licence applications have remained stable during the year, with a limited amount of consolidation balanced out by a number of new applications, the majority of the growth in submissions in this sector has been accounted for by an increased number of discretionary exemption applications. The main drivers of this increase are unclear but is likely to include a growing awareness of the width of activities covered by our fiduciary laws, an increasing cross-over in activities between sectors as individual firms provide more services to their clients and more firms carrying out a regulated activity on an ancillary basis to their main role. We will continue to monitor the reasons for these applications and ensure that the activities being exempted are appropriate.

The Authorisations Unit has continued to work closely with colleagues in all the supervisory divisions to utilise their specialist knowledge during the review of complex submissions. The use of Authorisation Review Panels, the equivalent of Risk Governance Panels (RGPs) under PRISM, allow for consistent and fair decision making process. The panels bring together a variety of expertise and experience to assist the Authorisations Unit in reaching high quality decisions.

Once again only a small number of applications did not proceed to the approval stage during 2017. In 2016, over 96% of applications submitted were approved; in 2017 the figure was 95%. Those applications which did not proceed were either withdrawn by the applicant or lapsed (i.e. our questions were never responded to by the applicant). The approach taken by the Authorisations Unit to the assessment of applications can highlight weaknesses in business models and plans, which need to be addressed in order for applicants to demonstrate that they are able to meet the minimum criteria for licensing.

Changes of controller for licensees have been a common theme during 2017; the review of a proposed change of controller for an existing licensee is an extensive piece of work for the Authorisations Unit and is often similar to the assessment of a new licence application. The introduction of a fee for a change of controller in 2018 for two sectors initially, is a reflection of the amount of time which is required to assess these submissions. A small portion of licensed firms have changes of controller on a regular basis, whereas the ownership of the majority remains unchanged for extensive periods. The new fee will ensure these review costs are borne by the appropriate licensees. There has been a continued growth in private equity ownership of Bailiwick licensees with both divestment by existing shareholders and new entities or individuals making investments into the Bailiwick for the first time.

A total of 8,547 submissions were made through the online Personal Questionnaire (“PQ”) portal during the year, this was similar to 2016. People are now familiar with the technology and are willing to engage with the Commission via our online services. There are still a number of individuals in prescribed positions who have yet to register on the online PQ portal and obtaining online personal questionnaires for these individuals will be an area of focus for the Authorisations Unit during 2018.

The online submissions portal was launched in October 2015 and during the first 15 months approximately 7,500 submissions were made. During the last 12 months this figure has risen to 11,500. The bulk of this increase in submissions is accounted for by the rise in online returns, last year nearly 10,000 returns were made online. The provision of this information from industry enables the supervisory divisions to focus their attention on the areas which represent most risk to the Bailiwick. Encouragingly, the number of calls and emails to the online services help desk is dropping at the same time providing some evidence that industry is becoming increasingly comfortable with navigating the Commission’s online services.

One of the major work-streams for the Authorisations Unit during 2017 was the introduction of the new regulatory and supervisory framework for the pension sector on 30th June. The extension of regulated activities under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2000 to include the formation, administration and management of pension schemes and gratuity schemes meant that all current Fiduciary licence holders had to be contacted to ascertain if they were carrying out the newly regulated activities. Confirmation of whether these 770 entities and individuals were carrying out pension activities was obtained via the online submissions portal. The Authorisations Unit provided formal confirmation to each licensee of whether the new regulated activities were included or excluded from their licence and then updated the Commission’s records accordingly.

Staff members from the Authorisations Unit continued to meet with potential and existing licensees to discuss proposed and ongoing applications. Meetings in advance of applications which involve innovative or new proposals are often beneficial and ensure that the application review process runs smoothly. It is pleasing to note that overall the quality of application submissions to the Commission is improving. The Authorisations Unit will continue to engage with applicants and industry to ensure that the authorisations process remains as effective and efficient as possible.

Katherine Jane
Chief Risk Officer



General

The Commission believes that with time the very recent past will be seen as a short age of great uncertainty and little turbulence. Quite an abnormal mix. Geopolitical uncertainties remained high throughout the course of 2017 but volatility as measured by the Volatility Index (VIX) remained low throughout. Events in early 2018 imply that mix is now changing and more normal levels of turbulence will return to global financial markets. This naturally has implications for, inter alia, the relative profitability of trading strategies and portfolio allocations for investors. In itself, however, it does not change underlying levels of systemic risk in the system, but it does increase the probability of material events materialising though by how much it would be foolhardy to say.

The policy response post-global financial crisis was on increasing the resilience of the system to systemic shocks at a cost perhaps to developing better methods of preventing the build up of risk in the system. Within the Bailiwick, our response has included the implementation of the Basel III prudential standards for the banking sector and a risk-based capital standards regime in the

insurance sector. On the prevention front, with respect to global risks in the system. There is little we here in Guernsey can affect. We are not a source of global risk generation.

Irrespective, systemic risks were reviewed during the course of the year by FINSTAC, the committee established by the States to provide a forum for 'monitoring financial stability and coordinating policy responses'. The source of exposure to global risks to the Bailiwick remained as they were when the IMF reviewed the Bailiwick in its Financial Stability Assessment Programme visit in 2010. Then, as now, the main sources of risk to the banking sector were credit and counter-party risk. The appropriate policy response remains ensuring firm-level prudential standards are maintained and leverage is monitored as much as is practically possible and desirable. As part of its contribution to FINSTAC, the Commission plans to work with FINSTAC to develop a set of financial soundness indicators to help FINSTAC further develop its understanding of the Bailiwick's economy.

Policy

Over the course of 2017, macro-prudential policy moved centre stage in the Brexit debate as awareness that, what are termed 'prudential carve outs' (exclusions for financial services where significant prudential risk may exist), are standard clauses in free trade agreements. Such clauses may obviously be used to excuse excluding most financial services from any future trade agreement between the UK and EU. As outlined at the Commission's annual Industry Presentations, numerous senior European policy makers have been very clear in public that they view maintaining European financial stability and integrity as one of their top concerns in the Brexit process.

In January, the FSB and IOSCO jointly published 14 measures to address structural vulnerabilities in the asset management industry (substantive progress on this has been hampered by a lack of consensus on a single definition of 'leverage'). Whilst the European Commission chose not to incorporate these FSB measures into its mid-term review of its Capital Markets Union programme (as many, including the ECB expected), in a rather

provocative move, it did publish legislative proposals in June the European Market Infrastructure Regulation II (EMIR II) to give itself powers to require third country clearers to move euro transactions to within the EU27 where it considers systematic risks to be too high. As a direct consequence, CityUK dedicated a complete chapter to this single issue in its September report outlining its proposals for services within a free trade agreement between the UK and EU27.

Whilst interesting, this specific aspect of the Brexit debate is perhaps only of little more than academic interest to us in the Bailiwick. Keeping abreast of developments in the negotiations on free trade in services is of more practical and immediate interest. As is now better appreciated, regulation is the principal non-tariff barrier to cross-border trade in financial services and achieving what is now commonly known as mutual regulatory recognition (i.e. where both sides review and accept each other's standards) is seen as the way to overcoming this barrier.

If achieved, how that is done in terms of agreed processes or criteria used for regulatory recognition within any UK/EU27 agreement, has the potential to become a template for future international agreements, whether more broadly in a WTO context or just within future UK agreements (where there is the potential for the Channel Islands to be brought in scope). Indeed any such template has the potential to be recycled or incorporated

into UK national regime arrangements. As such, understanding and keeping on top of developments will be to our economic interests. Recognising this, the Commission maintained an active programme of engagement with senior figures in the UK regulatory sector.

Risk Outlook

Last year, the Commission suggested that the sources of global risks to the financial stability of the global economy remained depressingly constant: excessive debt, the low interest rate environment and Chinese imbalances. We also suggested that by far the most likely outcome would see the Commission expressing the exact same sentiments in twelve months' time. We believe we were half right. Whilst our view remains unchanged, that these are the three greatest risks to global financial stability, we are less confident that the next twelve months will prove to be as benign.

In December 2017, the IMF stated it felt that Chinese debt levels pose a major risk to global financial stability (Chinese non-financial corporate debt stands at 165% of GDP and its credit to GDP ratio is 25% above its long run trend) and called on Chinese policy makers to act. At the end of 2017 and early in 2018, several ratings agencies queued to warn of risks in US corporate bond markets. At the time of preparing this report in February, yields

remain at sixty year lows, several rate rises are expected during the course of 2018 both in the US and UK. Yet in Europe, demand for debt, fuelled by continuing quantitative easing of the ECB, showed little sign of abating. Finally, the Commission is concerned with the scale of funds that have moved into Exchange Traded Funds (ETFs) and other passive investment products in recent times. Often synthetic, our concern, to echo the point made above, is that given their scale, the risk in these markets has not been fully appreciated and may result in liquidity problems if there are continued attempts to move towards monetary policy normalisation in 2018.

All told, a potent mix, if as suspected, there is a general rise in turbulence across global markets in 2018.

Andrew Sloan
Director



Human Resources:

Whilst our staff remain our greatest asset, we kept our headcount under review in 2017 and back office savings made in 2017 have once again allowed us to move more staff into front line regulation. Specifically for 2017, we have increased our enforcement, pensions regulation and policy development teams whilst remaining within our overall complement of 114.

The Graduate Programme continues to be a successful method of bringing in and supporting the development of young talent in the Bailiwick; in 2017, we received 73 applications and made two appointments.

We have continued to develop initiatives to ensure that our training is intelligent, coordinated and cost-effective as well as being engaging. For example, a programme of Technology, Entertainment and Design (TED) lunchtime talks introduces current and emerging issues such as crypto currencies, improves core skills such as critical thinking as well as covering broader issues along the lines of health and well-being at work. A proportion of our essential core and annual training is now delivered via our intranet (through a programme called Net Consent) thus allowing us to re-allocate staff training time (which averaged 5 days per staff member in 2017) to specialist training across all our regulatory areas.

Financial Information

As the Director General explains in his section of the annual report, for the fifth year the Commission has returned an operational surplus although the amount is reducing. Overheads, including an increase in our rent which was re-negotiated in 2017, have been contained and year on year expense rises have been minimal. As an example, salary costs increased by 2.4%, closely tracking inflation in 2017. We have managed this through the thoughtful re-allocation of existing resources against our agreed operational and strategic objectives.

Looking beyond this operational picture, the impact of the closure of the Commission's separate actuarial account within the States superannuation fund can be seen across the Balance Sheet, the Statement of Comprehensive Income and the Statement of Reserves on the following pages of this report and it is this impact which I will now spend some lines explaining.

By way of background, in November 2003 an actuarial account for those members of the States Public Sector Pension Scheme (PSPS) employed by the Commission, was created within the States Superannuation Fund. The assets continued to be integrated into and managed by the States of Guernsey, valued by BWCI actuaries and audited by the States auditors.

In 2017, the States and the Commission entered into discussions about whether concluding the actuarial account arrangement within the PSPS would be appropriate given that the scheme was

closed to new contributions. After appropriate actuarial and legal advice, agreement was reached to conclude the arrangement.

It is important to state at this juncture that the contractual entitlement of Commission Scheme deferred and pensionable members to pension and benefits is unaffected by the closure of the actuarial account. This is because, as confirmed by the States Treasurer in October 2002, all pensions would be paid from the States Superannuation Fund and furthermore, the States guaranteed to the Commission in 2002 that any shortfall in this fund would be made from the States General Revenue account.

From an accounting perspective, due to the transfer and closure of the Commission's actuarial account, the resultant settlement has removed the net pension liability from our balance sheet. Going forward, our financial statements should be simpler.

Looking at the vapour trail of this across the Statement of Comprehensive Income, and noting that all settlement calculations are based on the position as at 30 April 2017, it can also be seen that the FRS 102 net interest charge on our liabilities, relating to the defined benefit pension scheme, showed a £196,000 positive movement.

Further details are in the accompanying notes from pages 36 to 46.

Communication and Information Systems: _____

One of our aims is to improve our outward facing systems to ensure that our licensees have a good experience in their interaction with the Commission, as well as ensuring that data from our online submissions is accurately and succinctly transposed into PRISM, our supervisory system. This ensures that all our data and the information and knowledge that we create from that data is accurate, relevant and readily available to our supervisors. 2017 saw the establishment of a Development Prioritisation Committee, which brought together providers and users of our core information systems to, as the name suggests, prioritise development work.

For example, during 2017 we completed a significant amount of development work on our online Personal Questionnaire portal to refine the processes surrounding prescribed positions, appointments, directorships and withdrawals. We have also completed notable improvements to the back-end of online forms to improve their interaction with PRISM. Overall, predominantly using our in-house resources, five new bespoke online return forms have been created this year: four to support fiduciary supervision and one specifically to encapsulate the new pensions regulation regime.

Our attention to information security and data management is now routine. In addition to planned rotational IT external audits, a cyber audit was undertaken in 2017 by a UK professional services firm. It concluded that the Commission had a 'mature and well-rounded security programme'.

Although already in a strong position, we have continued to prepare for the incoming Data Protection (Bailiwick of Guernsey) Law, 2017 which will take effect in May 2018. Our preparations included revisiting our Data Protection and Retention policies and digitising our archives.

Stephen Cole
Chief Operating Officer



Independent auditor's report to the Commissioners of the Guernsey Financial Services Commission

Opinion

We have audited the financial statements of the Guernsey Financial Services Commission (the 'Commission') for the year ended 31 December 2017 which comprise the Statement of Comprehensive Income, the Statement of Reserves, the Balance Sheet, the Statement of Cash Flows and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 102; The Financial Reporting Standard applicable in the UK and Republic of Ireland (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the Commission's affairs as at 31 December 2017 and of its surplus for the year then ended;
- are in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been properly prepared in accordance with The Financial Services Commission (Bailiwick of Guernsey) Law, 1987.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the financial statements' section of our report. We are independent of the Commission in accordance with the ethical requirements that are relevant to our audit of the financial statements in Guernsey, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Who we are reporting to

This report is made solely to the Commission. Our audit work has been undertaken so that we might state to the Commission 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 as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Commission's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Commission has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Commission's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The Commission is responsible for the other information. The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the

other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of the Commission for the financial statements

As explained more fully above, the Commission is responsible for the preparation of the financial statements which give a true and fair view and for such internal control as the Commission determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Commission is responsible for assessing the Commission's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is inappropriate to presume that the Commission will continue to operate.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

For and on behalf of Grant Thornton Limited
Chartered Accountants
St Peter Port
Guernsey

4th May 2018



FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

| | Note | 2017 | 2016 |
|---|------|--------------|--------------|
| | | £ | £ |
| Income | | | |
| Fees receivable | | 13,147,710 | 12,934,718 |
| Financial penalties imposed | 13 | 136,500 | 573,375 |
| Bad debts recovered | 13 | 34,748 | - |
| Interest receivable and similar income | | 83,673 | 116,240 |
| Net change in investments measured at fair value through profit or loss | 11 | 107,921 | 208,250 |
| | | 13,510,552 | 13,832,583 |
| Expenses | | | |
| Salaries, pension costs, staff recruitment and training | | (8,911,156) | (8,700,111) |
| Commissioners' fees | | (273,654) | (235,433) |
| Legal and professional fees | | (536,824) | (478,505) |
| Premises and equipment, including depreciation and dilapidations | | (1,817,448) | (1,793,084) |
| Other operating expenses | | (1,282,658) | (1,279,431) |
| Bad debt provision expense | 13 | (101,636) | (371,421) |
| Auditor's remuneration | | (8,250) | (8,750) |
| | | (12,931,626) | (12,866,735) |
| Surplus before net gain on pension scheme | | | |
| | | 578,926 | 965,848 |
| Other pension costs | 7(b) | (137,856) | (333,818) |
| Gain on settlement of defined benefit pension scheme | 7(b) | 14,172,606 | - |
| Surplus for the financial year | | | |
| | | 14,613,676 | 632,030 |
| Other comprehensive income | | | |
| Re-measurement of net defined benefit liability | 7(c) | 761,080 | (5,794,164) |
| Total comprehensive (loss)/income for the year | | | |
| | | 15,374,756 | (5,162,134) |

The notes on pages 36 to 46 form an integral part of these financial statements

STATEMENT OF RESERVES

For the year ended 31 December 2017

| Note | 2017 | 2016 |
|--|-------------------|--------------------|
| | £ | £ |
| Opening reserves | (2,294,873) | 2,867,261 |
| Total comprehensive income/(loss) for the year | 15,374,756 | (5,162,134) |
| Balance at 31 December 2017 | 13,079,883 | (2,294,873) |

2017 reserves are stated after the accumulated pension liability of £14,916,656, as at 31 December 2016, was extinguished as at 30 April 2017 - see note 7(a).

The notes on pages 36 to 46 form an integral part of these financial statements



BALANCE SHEET

As at 31 December 2017

| | Note | 2017 | 2016 |
|--|------|-------------|--------------|
| | | £ | £ |
| Fixed assets | | | |
| Tangible assets | 4 | 2,891,857 | 3,303,982 |
| Current assets | | | |
| Debtors and prepayments | 5 | 603,494 | 679,690 |
| Short-term deposits | 10 | 6,759,004 | 6,110,473 |
| Investments | 11 | 3,298,894 | 3,190,973 |
| Cash at bank and in hand | 10 | 1,532,839 | 659,059 |
| | | 12,194,231 | 10,640,195 |
| Current liabilities | | | |
| Creditors – amounts falling due within one year | 6 | (1,770,236) | (1,124,298) |
| | | 10,423,995 | 9,515,897 |
| Non-current liabilities | | | |
| Provisions for liabilities | 14 | (235,969) | (198,096) |
| | | 13,079,883 | 12,621,783 |
| Net assets before post-employment benefit liability | | | |
| Post-employment benefit liability | 7(a) | - | (14,916,656) |
| | | 13,079,883 | (2,294,873) |
| Net assets/(liabilities) | | | |
| | | 13,079,883 | (2,294,873) |
| Total reserves | | | |
| | | 13,079,883 | (2,294,873) |

The Financial Statements on pages 32 to 46 have been approved by the Commissioners and signed on their behalf on 4th May 2018 by:-

C Schrauwers
Chairman

R Moore
Vice-Chairman

W Mason
Director General

The notes on pages 36 to 46 form an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

| | Note | 2017 | 2016 |
|--|------|------------------|--------------------|
| | | £ | £ |
| Cash flows from operating activities | | | |
| Surplus for the financial year | | 14,613,676 | 632,030 |
| Adjustments for: | | | |
| Defined benefit pension scheme: | | | |
| Gain on settlement of pension scheme | 7(b) | (14,172,606) | - |
| Contributions to pension scheme | 7(e) | (122,159) | - |
| Pension scheme administration costs | 7(e) | 1,333 | 4,000 |
| Other pension costs | 7(b) | 137,856 | 333,818 |
| Depreciation of tangible fixed assets | 4 | 764,480 | 781,034 |
| Loss on disposal of tangible fixed assets | 4 | 8,461 | 2,678 |
| Interest receivable | | (83,673) | (116,240) |
| Unrealised gain on investment portfolio | 11 | (107,921) | (208,250) |
| Decrease/(increase) in debtors and prepayments | | 76,196 | (4,801) |
| Increase in creditors | | 645,938 | 47,214 |
| Increase in provisions for liabilities | | 37,873 | 26,020 |
| Net cash generated from operating activities | | 1,799,454 | 1,497,503 |
| Cash flows from investing activities | | | |
| Purchases of tangible fixed assets | 4 | (360,816) | (354,423) |
| Interest received | | 83,673 | 116,240 |
| Purchase of short-term deposits | 10 | (648,531) | (1,610,473) |
| Net cash from investing activities | | (925,674) | (1,848,656) |
| Net increase/(decrease) in cash at bank and in hand | 10 | 873,780 | (351,153) |
| Cash at bank and in hand at the beginning of the year | | 659,059 | 1,010,212 |
| Cash at bank and in hand at end of the year | | 1,532,839 | 659,059 |

The notes on pages 36 to 46 form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

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

I. Accounting policies

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

i. Presentation and functional currency

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

ii. Legal status

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

iii. Preparation

The preparation of financial statements in compliance with FRS 102 requires the use of certain critical accounting estimates. These financial statements have been prepared on a going concern basis. The principal accounting policies which the Commissioners have adopted within that convention are set out below. They have been applied consistently in dealing with items which are considered material to the financial statements of the Commission.

iv. Going concern

The Commission continues to meet its day-to-day working capital requirements through its bank balances and short-term deposits.

The following significant accounting policies have been consistently applied:

(a) Fees receivable

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

(b) Financial penalties imposed

The Commission imposed financial penalties during the year under Section 11D (1) of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended. Financial penalties are recognised as income receivable when the decision is made and the public statement is placed on the Commission’s website. When the circumstances of a debtor give rise to concerns over settlement, and/or payment is not made within 7 days of the financial penalty being imposed, consideration is given to raising a provision.

(c) Interest receivable

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

(d) Investigation and litigation

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

(e) Tangible fixed assets and depreciation

Tangible fixed assets are stated at historical cost less accumulated depreciation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to bringing the asset to the location and condition for it to be

capable of operating in the manner intended by management. Depreciation on tangible fixed assets is calculated, using the straight-line method to allocate the cost of assets, less their residual value, over their estimated useful economic lives, at the following annual rates:

| | |
|------------------------|--|
| Leasehold improvements | over the shorter of the term of the lease and the estimated useful economic life of the assets |
| Office equipment | 25% straight-line |
| Furniture and fittings | over the shorter of 10 years and the estimated useful economic life of the assets |
| Computer equipment: | |
| Hardware | 33 1/3 % straight-line |
| Software | over the shorter of 10 years and the estimated useful economic life of the assets |

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

i. Recognition

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

ii. Initial measurement and subsequent measurement

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

iii. De-recognition

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

(g) Cash at bank and in hand

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

(h) Short-term deposits

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

(i) Investments

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

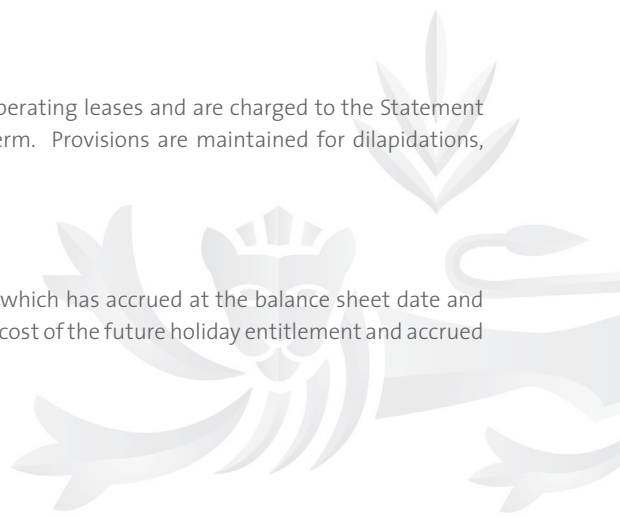
(j) Leases

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

(k) Employee benefits

i. Short term benefits

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



NOTES TO THE FINANCIAL STATEMENTS (continued)

ii. Defined benefit scheme

Following closure of the defined benefit scheme to future service accrual on 30 June 2014, employees had the option to transfer out their pension or become deferred members of the scheme. Following this date, the Commission's actuarial account was kept open to accurately calculate and pay what became either deferred or pensioner members. The actuarial account was closed as at 30 April 2017 following the agreement by the States of Guernsey to assume responsibility for all historic and future liabilities.

Upon closure of the actuarial account, a net settlement gain is recognised within the Statement of Comprehensive Income.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is recognised in the Statement of Comprehensive Income as 'Other pension costs' and was calculated as at 30 April 2017.

Actuarial gains and losses arising from experience adjustments and changes to actuarial assumptions are charged or credited to other comprehensive income, within the Statement of Comprehensive Income. These amounts together with the return on plan assets, less amounts included in net interest, are disclosed as 'Re-measurement of net defined benefit liability'. All such disclosures are calculated at 30 April 2017, prior to the closure of the actuarial account.

iii. Defined contribution schemes

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

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

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

i. Tangible fixed assets (see note 4)

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

ii. Lease classification (see note 8)

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

iii. Investments (see note II)

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

iv. Bad debt provision (see note 13)

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

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

v. Dilapidations (see note 14)

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

3. Taxation

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

4. Tangible assets

| | Leasehold improvements | Office equipment furniture and fittings | Computer hardware | Computer software | Total |
|---|---------------------------|---|----------------------|----------------------|------------------|
| | £ | £ | £ | £ | £ |
| Cost | | | | | |
| At 1 January 2017 | 1,360,938 | 425,054 | 750,970 | 4,126,475 | 6,663,437 |
| Additions | 14,503 | 6,558 | 93,256 | 246,499 | 360,816 |
| Disposals | - | (29,212) | (19,222) | (114,362) | (162,796) |
| At 31 December 2017 | 1,375,441 | 402,400 | 825,004 | 4,258,612 | 6,861,457 |
| Depreciation | | | | | |
| At 1 January 2017 | 350,938 | 340,755 | 641,418 | 2,026,344 | 3,359,455 |
| Charge for the year | 70,366 | 25,481 | 78,047 | 590,586 | 764,480 |
| On disposals | - | (29,212) | (19,222) | (105,901) | (154,335) |
| At 31 December 2017 | 421,304 | 337,024 | 700,243 | 2,511,029 | 3,969,600 |
| Net book value at 31 December 2016 | 1,010,000 | 84,299 | 109,552 | 2,100,131 | 3,303,982 |
| Net book value at 31 December 2017 | 954,137 | 65,376 | 124,761 | 1,747,583 | 2,891,857 |

NOTES TO THE FINANCIAL STATEMENTS (continued)

5. Debtors and prepayments

| | 2017 | 2016 |
|---------------------------------------|----------------|----------------|
| | £ | £ |
| Prepayments | 535,312 | 564,132 |
| Provision for bad debts (see note 13) | (227,142) | (253,909) |
| Other debtors | 295,324 | 369,467 |
| | 603,494 | 679,690 |

Included in the total are prepayments of £52,362 (2016: £116,774) which relate to periods longer than 12 months.

6. Creditors - amounts falling due within one year

| | 2017 | 2016 |
|--------------------------|------------------|------------------|
| | £ | £ |
| Creditors and accruals | 659,065 | 674,793 |
| Fees received in advance | 1,111,171 | 449,505 |
| | 1,770,236 | 1,124,298 |

7. Post-employment benefits

- (i) FRS 102 (Section 28) Disclosure for the Guernsey Financial Services Commission (“GFSC”) Actuarial Account of the States of Guernsey Public Servants Pension Scheme (“PSPS”)

Background

Having closed the above scheme to future accrual of benefits with effect from 30 June 2014, all remaining active members were treated as having left pensionable service with effect from that date, and were classified as deferred members. Following the closure date, the GFSC’s actuarial account was kept open to accurately calculate and pay what became either deferred or pensioner members, active membership being closed.

In 2017, the Commission entered into an agreement with the States of Guernsey to close the actuarial account and settle outstanding liabilities. All of the GFSC’s deferred and pensioner members as at 30 April 2017 were reclassified as being in the combined pool section of the PSPS. The agreement allowed for the States to assign the value of the GFSC’s actuarial account to the combined pool. As a result all of the historic defined benefit pension financial commitments were removed from the Commission’s balance sheet as at 30 April 2017.

7. Post-employment benefits (continued)

Employee benefit obligations

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

| | 2017 | 2016 |
|--------------------------------------|------|--------------|
| | £ | £ |
| Fair value of scheme assets | - | 20,328,639 |
| Present value of funded obligations | - | (35,245,295) |
| Net defined benefit liability | - | (14,916,656) |

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

| | 2017 | 2016 |
|---|------------|-----------|
| | £ | £ |
| Net interest on net defined liability | (137,856) | (333,818) |
| Settlement gain | 14,172,606 | - |
| Gain/(expense) recognised in the Statement of Comprehensive Income | 14,034,750 | (333,818) |

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

| | 2017 | 2016 |
|--|-------------|-------------|
| | £ | £ |
| Return on assets (not included in interest) | 563,530 | 1,889,321 |
| Actuarial gains/(losses) on obligation | 197,550 | (7,683,485) |
| Total re-measurements recognised | 761,080 | (5,794,164) |
| Cumulative amount of re-measurements recognised in other comprehensive income | (4,095,086) | (4,856,166) |
| Actual return on scheme assets | 747,959 | 2,573,961 |

NOTES TO THE FINANCIAL STATEMENTS (continued)

7. Post-employment benefits (continued)

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

| | 2017 | 2016 |
|--|--------------|---------------------|
| | £ | £ |
| Opening defined benefit obligation | (35,245,295) | (27,059,679) |
| Liabilities extinguished on settlement | 35,196,206 | - |
| Interest on obligation | (322,285) | (1,018,458) |
| Experience gains | 197,550 | 629,591 |
| Loss from changes in assumptions | - | (8,313,076) |
| Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values | 173,824 | 516,327 |
| Closing defined benefit obligation | - | (35,245,295) |

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

| | 2017 | 2016 |
|--|--------------|-------------------|
| | £ | £ |
| Opening fair value of scheme assets | 20,328,639 | 18,275,005 |
| Assets distributed on settlement | (21,023,600) | - |
| Interest on scheme assets | 184,429 | 684,640 |
| Return on assets (not included in interest) | 563,530 | 1,889,321 |
| Contributions by employer | 122,159 | - |
| Net benefits paid including pensions, lump sums, refunds of member contributions and transfer values | (173,824) | (516,327) |
| Administration expenses | (1,333) | (4,000) |
| Closing fair value of scheme assets | - | 20,328,639 |

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

| | 2017 | 2016 |
|-----------------|------|------|
| | % | % |
| Equities | - | 75 |
| Corporate bonds | - | 14 |
| Property | - | 7 |
| Other assets | - | 4 |

7. Post-employment benefits (continued)

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

| | 2017 | 2016 |
|---|------|------|
| | % | % |
| Discount rate at end of the year | - | 2.75 |
| Discount rate at start of the year | - | 3.8 |
| Inflation | - | 3.4 |
| Rate of increase in deferred pensions | - | 3.4 |
| Rate of increase in pensions in payment | - | 3.4 |

As required by FRS102, the assumptions used to calculate the surplus in the actuarial account at 30 April 2017 were the final assumptions adopted for the 31 December 2016 disclosures.

h) Disclosure for defined contribution schemes

i) Defined contribution scheme I

The amount recognised in the profit and loss account as an expense in relation to the Commission's defined contribution scheme, for the year ended 31 December 2017, was £100,464 (2016: £114,509). No contributions were outstanding as at 31 December 2017 or 2016. Employer contributions are calculated at 12% of pensionable salary and mandatory employee contributions were at a rate of 5% of pensionable salary up until 30 June 2014. Subsequent to this date, employee contributions are entirely voluntary.

ii) Multi-member RATs scheme ("GFSC Group Pension Scheme")

The net expense of employer contributions to the GFSC Group Pension Scheme for the year ended 31 December 2017 was £429,390 (2016: £332,818). No contributions were outstanding as at 31 December 2017 or 2016 and no contributions were prepaid as at 31 December 2017 or 2016. Employer contributions are calculated at 12% of pensionable salary and employee contributions are entirely voluntary.

8. Operating lease commitments

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

| | £ |
|---|-------------------|
| Lease payments up to 1 year after balance sheet date | 664,927 |
| Lease payments between 1 and 5 years after balance sheet date | 2,659,708 |
| Lease payments more than 5 years after balance sheet date | 7,786,022 |
| Total future minimum lease payments | 11,110,657 |

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. Controlling party

In the opinion of the Commissioners there is no controlling party of the Commission, as defined by FRS 102 (Section 33.5), as no party has the ability to direct the financial and operating policies of the Commission with a view to gaining economic benefits from their direction.

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

| | At 1 January 2017 | Cash flow | At 31 December 2017 |
|---------------------------------------|----------------------|----------------|------------------------|
| | £ | £ | £ |
| Call account balances | 73,444 | 22,846 | 96,290 |
| Cash at bank and in hand | 585,615 | 850,934 | 1,436,549 |
| Total cash at bank and in hand | 659,059 | 873,780 | 1,532,839 |
| Certificates of deposit | 1,259,418 | (3,498) | 1,255,920 |
| Fixed deposits and notice accounts | 4,851,055 | 652,029 | 5,503,084 |
| Total short-term deposits | 6,110,473 | 648,531 | 6,759,004 |

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

II. Current asset investments

| | 2017 | 2016 |
|---|------------------|------------------|
| | £ | £ |
| Opening fair value | 3,190,873 | 2,982,723 |
| Purchases | - | - |
| Net movement in fair value through profit or loss | 107,921 | 208,250 |
| Market value | 3,298,894 | 3,190,973 |

A defensive strategy for these current asset investments is employed and the portfolio comprises shares, bonds and funds held in listed companies and gilts, which are traded on a regular basis. The total unrealised gain recognised on these investments in the year was £107,921. The portfolio was first established in February 2015.

12. Financial instruments

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

| | 2017 | 2016 |
|--|-----------|-----------|
| | £ | £ |
| Financial assets | | |
| Financial assets measured at fair value through profit or loss | 3,298,894 | 3,190,973 |
| Financial assets measured at amortised cost | 8,895,337 | 7,428,216 |
| Financial liabilities | | |
| Financial liabilities measured at amortised cost | 2,006,205 | 1,322,394 |

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

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

Financial liabilities measured at amortised cost comprise creditors.

13. Financial penalties and provisions for bad debts

During the year the Commission imposed financial penalties under section 11D (1) of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended, amounting to £136,500 (2016: £573,375). The amounts written off and provided for by the Commission during the year amounted to £101,636 (2016: £371,421).

The total of provisions relating to financial penalties as at 31 December 2017 were £194,946 (2016: £195,417). Provisions relating to other fees outstanding at 31 December 2017 total £32,196 (2016: £58,492). 2017 debts totalling £23,726 (2016: £117,512), written off during the year, are also reflected under Bad debt expense. Recoveries of previously disclosed doubtful debts, reflected under Bad debts recovered, amounted to £34,748.



NOTES TO THE FINANCIAL STATEMENTS (continued)

14. Provision for liabilities

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

| | 2017 | 2016 |
|--|----------------|----------------|
| | £ | £ |
| Provision brought forward from previous year | 198,096 | 172,076 |
| Dilapidations charged to Statement of Comprehensive Income | 37,873 | 26,020 |
| Total provision at year end | 235,969 | 198,096 |

15. Related party

Key management personnel compensation

Key management comprises the Commissioners and members of the Executive Committee. The compensation paid to key management for employee services in 2017, including pension and social insurance, amounted to £2,158,460 (2016: £1,920,944).

Related-party transactions

No related-party transactions took place during 2017.

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COMMISSIONERS

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

Drs. Schrauwens is a Dutch economist with over forty years' experience in financial services. He has served as Managing Director of Aviva International, CGU Insurance and Commercial Union, covering both the general insurance and life sectors. He was instrumental in the mergers with General Accident and Norwich Union which resulted in the creation of Aviva plc. Following the mergers he was appointed Managing Director of Aviva International, gaining valuable experience in dealing with regulators across the globe, including North America. Prior to this, he was a Partner with Coopers & Lybrand in charge of its insurance consultancy practice. He has served as Chairman of Drive Assist Holdings Limited, Senior Independent Director of Brit Insurance Holdings Plc. and Brit Syndicates Limited, Non-Executive Director of Canopus Holdings UK Limited and Canopus Managing Agents Limited, Director of Munich Re (UK) Plc and as Senior Independent Director of Record Plc for nine years. He was also formerly an Independent Director at the Scottish Widows Group. He is currently Chairman and Commissioner of the Guernsey Financial Services Commission. Cees was appointed as a Commissioner in 2008 and Chairman in 2012 and is also Chairman of EC3 Legal LLP, a firm focussing on the London insurance market. He was educated at the Vrije Universiteit Amsterdam and the Nautical College Den Helder. He lives with his wife near London.

Bob Moore **Vice-Chairman of the Commission**

Bob Moore was appointed as a Commissioner in February 2012 and Vice-Chairman with effect from 2 February 2017. He has spent over thirty years in the financial services industry in Guernsey and internationally. From 1979 to 1997, he held positions in international banking and international private banking with the Lloyds Bank/Lloyds TSB group in South America, the United States, the United Kingdom and in Luxembourg. These included responsibility for Lloyds' international private banking operations in New York and in Luxembourg. From 1997 to 2011, he was jurisdictional Managing Director with responsibility for the Butterfield Group's operations in Guernsey, including banking, investment management, custody and fiduciary services. In June 2011, he was appointed to the position of Executive Vice-President and Head of Group Trust for the Butterfield Group. He has also been a Director of a number of other banks and investment funds.

The Lord Flight MA (Cantab) MBA FRSA **Commissioner**

Howard Flight was appointed as a Commissioner in 2005. He was the Conservative Member of Parliament for Arundel and South Downs from 1997 to 2005, during which time he was Shadow Chief Secretary to the Treasury and a member of the Shadow Cabinet. From 1999 to 2004 he had Shadow Treasury responsibilities for the Finance Acts, the financial services industry, financial regulations and pensions. He has worked for over forty years in the financial services industry, starting his career at Rothschilds. In the second half of the 1970s he worked for HSBC's merchant bank in Hong Kong and India. In 1979 he joined Guinness Mahon and established what became Guinness Flight Global Asset Management, of which he was joint Managing Director until it was acquired by Investec in 1998. He formed, and is Chairman of, Flight & Partners, which is the manager of the Flight & Partners Recovery Fund, and is currently a Director of Investec Asset Management Limited, Metrobank plc, Aurora Investment Trust plc. and a number of other companies and investment funds.

Richard Hobbs MCIPD **Commissioner**

Richard Hobbs was appointed as a Commissioner in January 2012. His first career was in the UK Civil Service where he concentrated on a variety of consumer protection and European issues. Latterly, he was a Director of the Department of Trade and Industry's Insurance Division where he was responsible for overall supervision of the Lloyd's insurance market during its reconstruction in the mid-1990s. He has been Head of Life and Pensions at the Association of British Insurers, and for the past fifteen years has been a consultant advising a wide range of clients in financial services on regulatory, risk and governance issues. He was previously Chairman of Faber Global Ltd, a wholesale insurance broker and Non-Executive Chairman of Barbican Managing Agency Limited, a Lloyd's managing agent.

Simon Howitt
Commissioner

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

Wendy Dorey
Commissioner

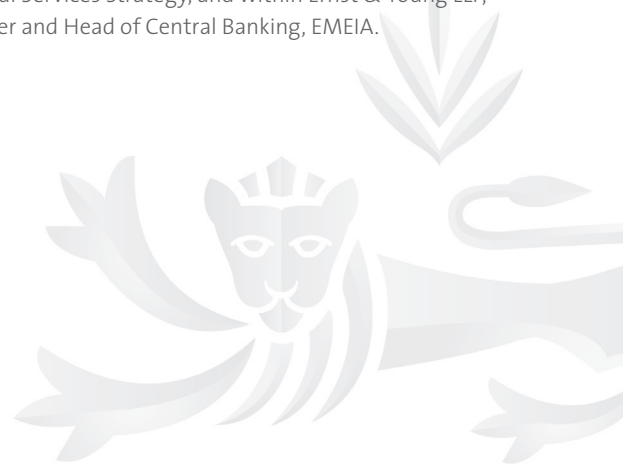
Wendy Dorey was appointed as a Commissioner in November 2015. She has spent nearly twenty years in the financial services industry in the UK, France and Guernsey. Prior to moving to Guernsey in 2010 as Director of Dorey Financial Modelling, she occupied senior posts in financial marketing, distribution and business planning and strategy with Robert Fleming, Friends Ivory & Sime and M&G Asset Management in London. During that period she was also responsible for internal audit reporting, external risk reporting to the Financial Services Authority and embedding new "Treating Customers Fairly" processes. In 2005, she was responsible for the launch and on going promotion of the Guernsey-domiciled M&G Property Fund to the UK Market. She also previously assisted the Investment Management Association in developing a new investment management syllabus for Independent Financial Advisors. In November 2017, she was appointed as a Non-Executive Director of Schroders (C.I.) Limited.

John Aspden MBE
Commissioner

John Aspden is a senior finance professional with significant experience in investment and banking supervision in both the public and private sectors. He was Chief Executive of the Financial Supervision Commission in the Isle of Man from 1998 to 2015, where he was responsible for the regulation and supervision of all banking, securities and funds, trusts and companies, and money transmission activities. Prior to taking up his role at the Financial Supervision Commission in the Isle of Man, Mr Aspden held roles in the private sector including Managing Director of Matheson InvestNet Ltd, at the time Hong Kong's largest independent distributor of, and adviser on, collective investments for retail investors. Mr Aspden has also held the role of Deputy General Manager of the International Bank of Asia Ltd and has worked in banking supervision at the Bank of England and at the Office of the Commissioner of Banking in Hong Kong, now HKMA. Mr Aspden is also Chairman of the Group of International Finance Centre Supervisors and was made MBE for his work in financial services supervision.

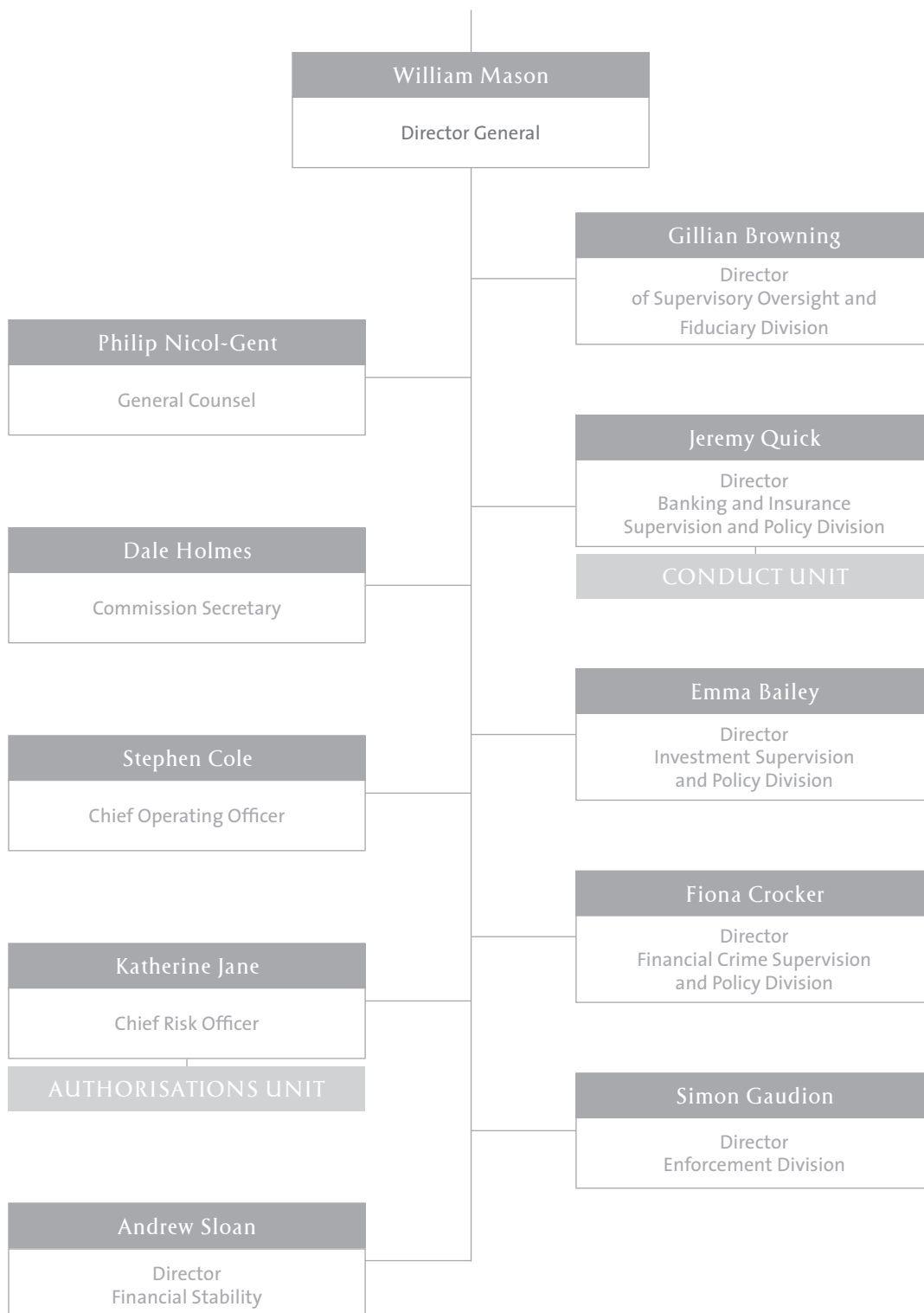
Philip Middleton
Commissioner

Philip Middleton is a senior financial services strategist with significant recent experience in advising government, central banks and financial institutions on crisis related issues. Since 2014, he has carried out consulting and advisory work in central banking and financial services through Rifle House Capital Ltd. He is also a member of the Board of the Official Monetary and Financial Institutions Forum, a leading Central Banking think tank. He has had significant experience in the private sector, holding various roles within KPMG LLP, including Partner and European Head of Financial Services Strategy, and within Ernst & Young LLP, including Partner and Head of Central Banking, EMEIA.



SENIOR OFFICERS OF THE COMMISSION

COMMISSIONERS



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Investment Supervision and Policy

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

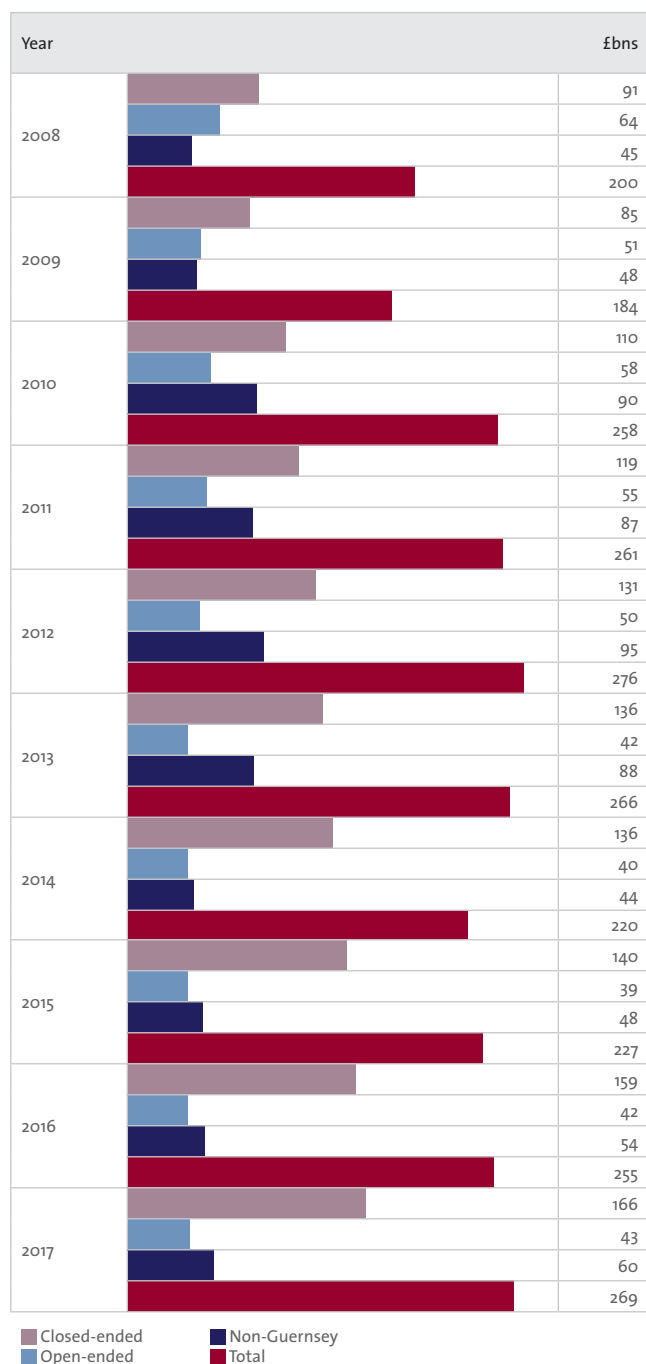


Figure 2. Total number of investment funds at the year end

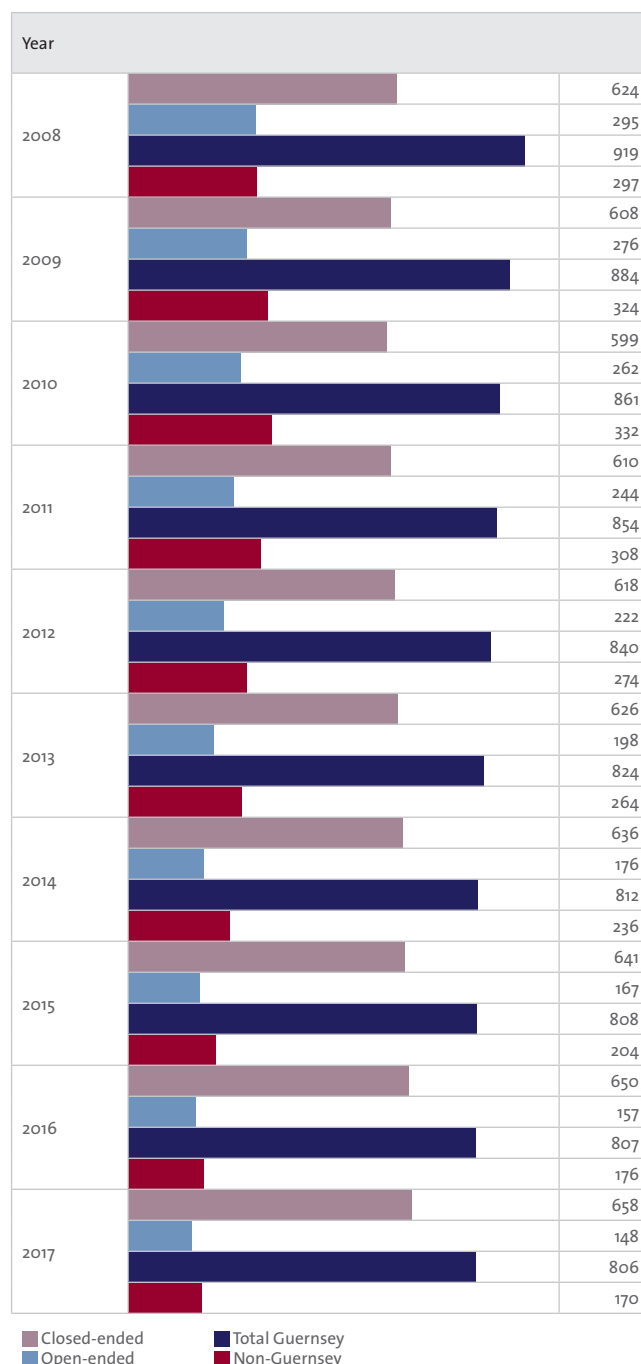


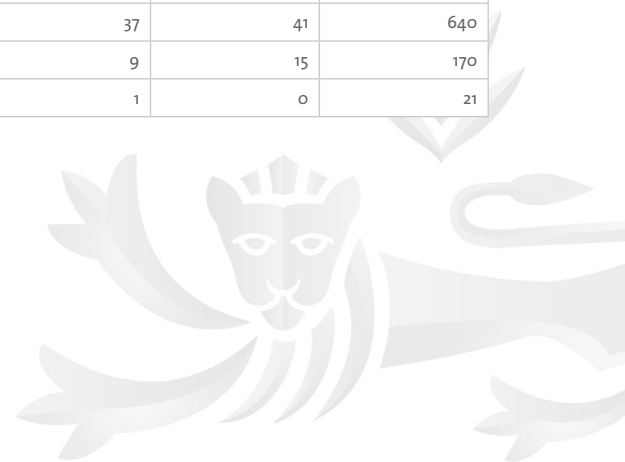
Figure 3. Total number of investment licensees at the year end

| Year | |
|------|-----|
| 2007 | 636 |
| 2008 | 680 |
| 2009 | 661 |
| 2010 | 652 |
| 2011 | 654 |
| 2012 | 644 |
| 2013 | 635 |
| 2014 | 622 |
| 2015 | 639 |
| 2016 | 644 |
| 2017 | 640 |

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

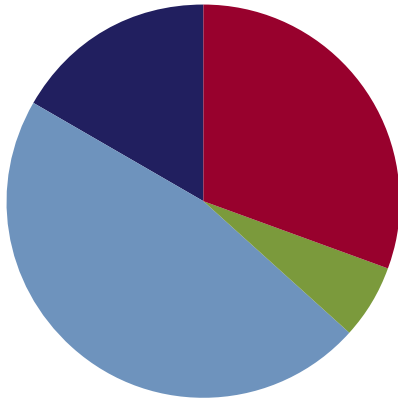
Figure 4. Movements within period

| Type | Total as at 31 December 2016 | Approved in year | Lost in year | Total as at 31 December 2017 |
|---|---------------------------------|------------------|--------------|---------------------------------|
| Total of open-ended schemes | 157 | 5 | 14 | 148 |
| of which Authorised | 145 | 2 | 12 | 135 |
| of which Registered | 12 | 3 | 2 | 13 |
| of which Qualifying Investor Funds (QIFs) | 26 | 1 | 4 | 23 |
| Total of closed-ended schemes | 650 | 47 | 39 | 658 |
| of which Authorised | 392 | 4 | 27 | 369 |
| of which Registered | 258 | 43 | 12 | 289 |
| of which QIF's | 162 | 4 | 6 | 160 |
| Total of licensees | 644 | 37 | 41 | 640 |
| Total of non-Guernsey schemes | 176 | 9 | 15 | 170 |
| of which QIF's | 20 | 1 | 0 | 21 |



Fiduciary Supervision Policy and Innovations

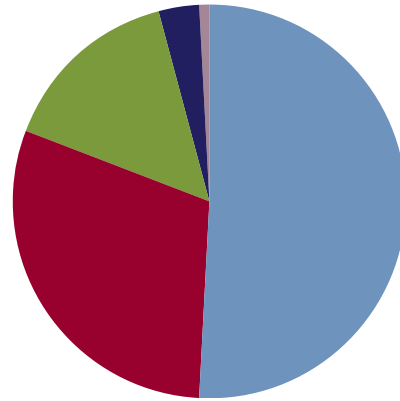
Figure 5. Ownership of lead licensees as at 30 June 2017*



| | 2017 | 2016 |
|-------------------------------|------|------|
| International financial group | 46 | 47 |
| Lawyers and accountants | 9 | 12 |
| Privately owned – local | 70 | 70 |
| Privately owned – overseas | 25 | 25 |

*Based on 150 persons holding a full fiduciary licence as at 30 June 2017.

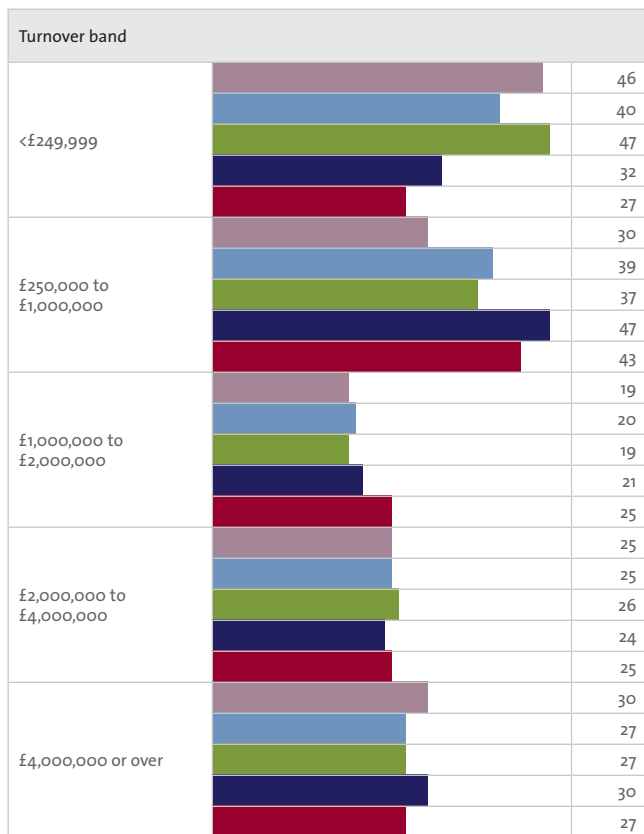
Figure 6. Staffing levels of licensees based on total number of staff carrying out regulated fiduciary activities*



| | 2017 | 2016 |
|--------------------|------|------|
| Up to 10 staff | 75 | 80 |
| 11-25 staff | 44 | 45 |
| 26-50 staff | 22 | 24 |
| 51-75 staff | 5 | 4 |
| More than 75 staff | 1 | 1 |

*Based on the submission of an annual return by 147 licensees.

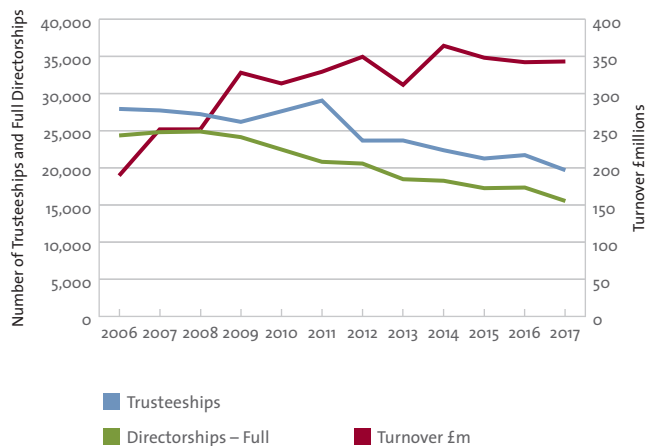
Figure 7. Number of licensees in each turnover band based on fiduciary turnover for accounting periods falling in the year ended 30 June 2017*



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

2013
2014
2015
2016
2017

Figure 8. Number of Director and trustee appointments for full fiduciaries at the year end; aggregate turnover of full fiduciary licensees*



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



Insurance Supervision and Policy

Figure 9. International insurers as at 31 December 2016

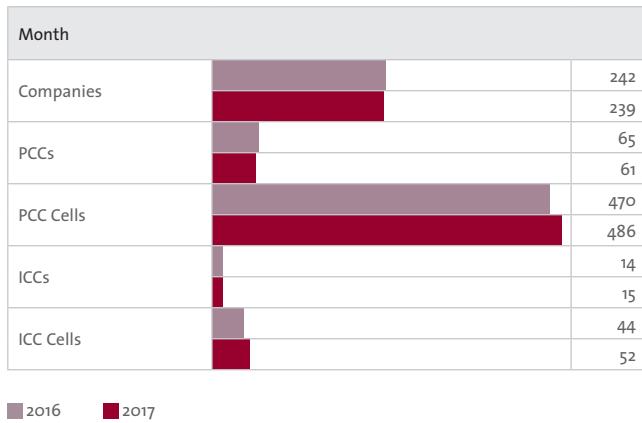


Figure 10. International insurers – net worth

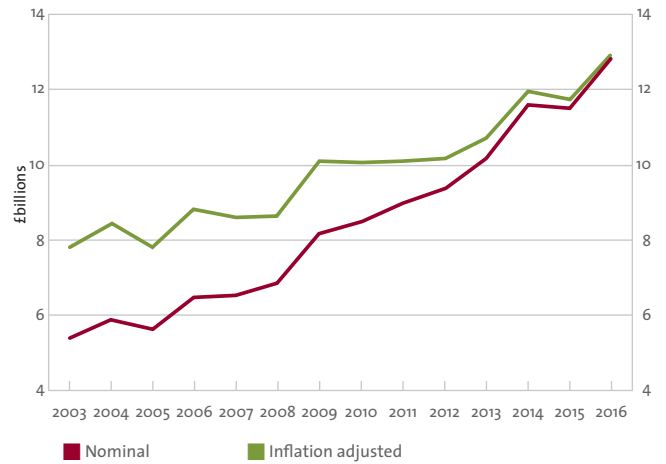


Figure 11. International insurers – gross assets



Figure 12. International insurers – gross premium



Banking Supervision and Policy

Figure 13. Guernsey bank assets

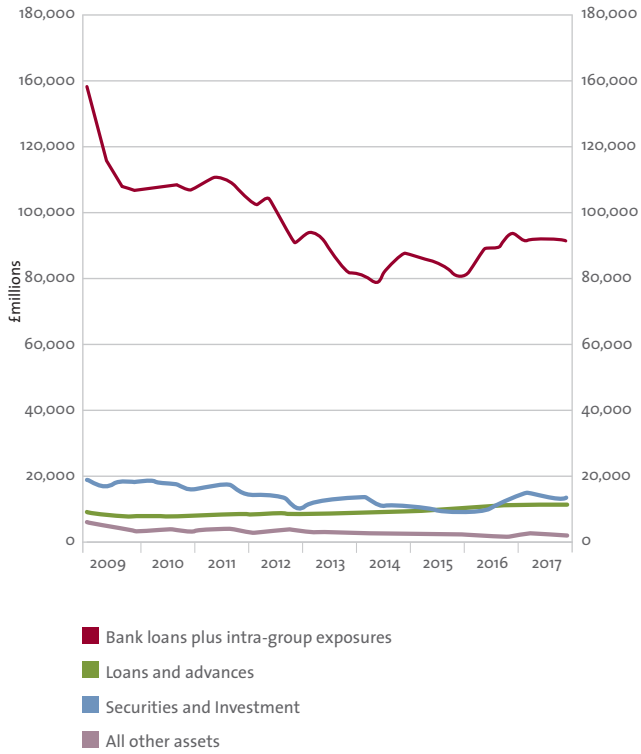
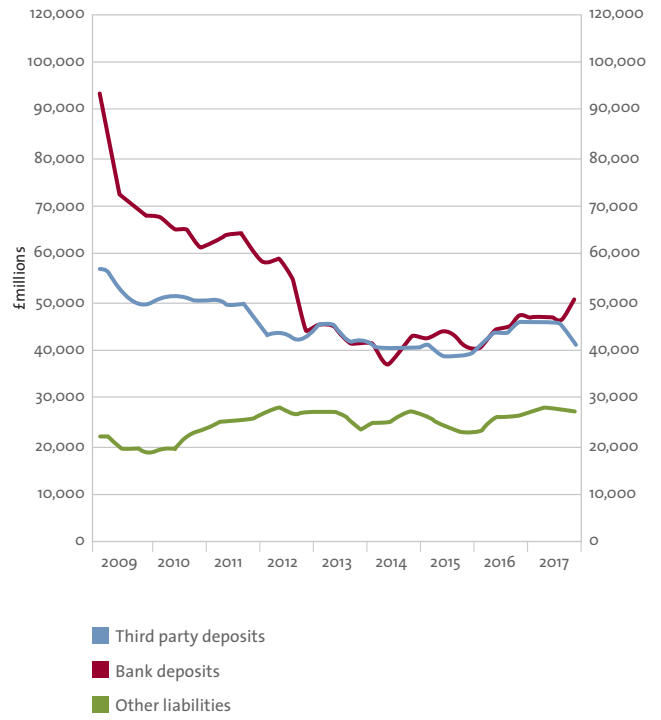


Figure 14. Guernsey bank liabilities



Authorisations Unit

Figure 15. Total application and one-off fees by volume and type - 2016 to 2017 comparison

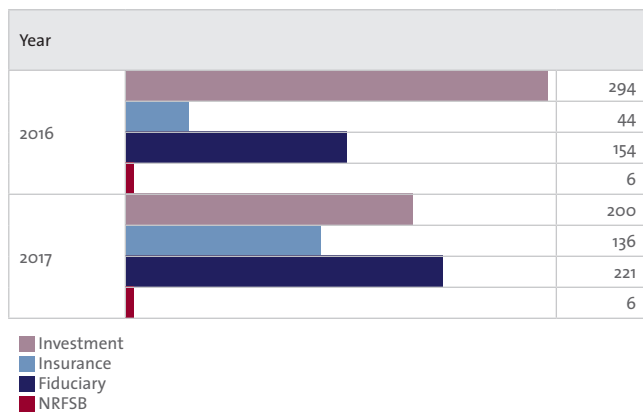


Figure 16. Online submissions 1 January to 31 December 2017

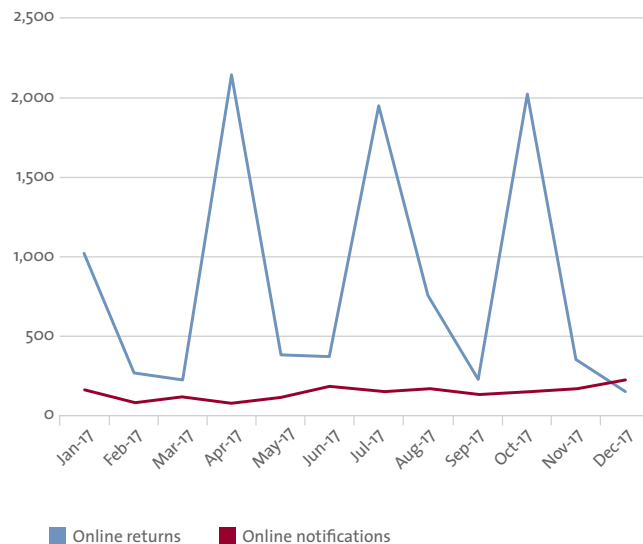
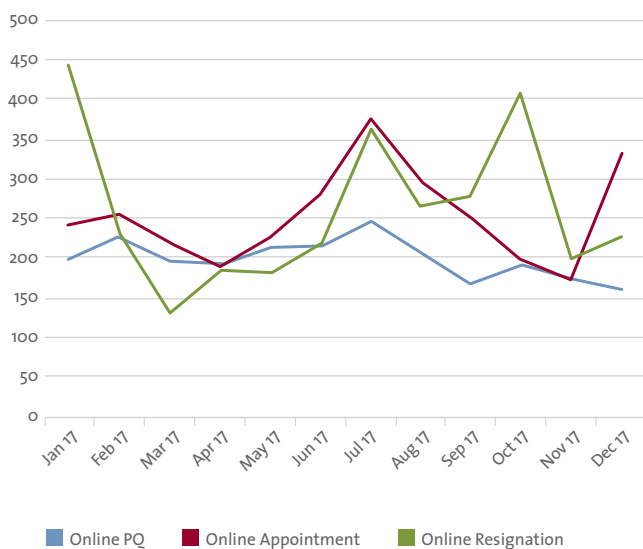


Figure 17. Online Personal Questionnaire portal submission 1 January to 31 December 2017



Finance and Operations

Table 1. Expenditure by functional area

| | 2017 | 2016 |
|--|---------------|---------------|
| | £'000 | £'000 |
| Enforcement | 1,445 | 1,481 |
| Authorisations | 816 | 814 |
| Risk | 525 | 419 |
| Supervisory and Policy divisions | 5,500 | 5,644 |
| Internal operational support functions | 1,315 | 1,361 |
| Overheads incl. Premises, IT expenses and depreciation | 3,331 | 3,148 |
| Total | 12,932 | 12,867 |

Table 2. Salaries and related costs

| | 2017 | 2016 |
|--|--------------|--------------|
| | £'000 | £'000 |
| Salaries | 6,964 | 6,845 |
| Pension costs | 750 | 723 |
| Social insurance, permanent health and medical insurance | 840 | 780 |
| Recruitment and training | 357 | 352 |
| Total | 8,911 | 8,700 |

Table 3. Number of staff by salary band

| Annual salary | 2017 | 2016 |
|---------------------------|--------------|--------------|
| £0- £39,999 p.a. | 41 | 42 |
| £40,000 - £79,999 p.a. | 51 | 46 |
| £80,000 - £119,999 p.a. | 14 | 16 |
| £120,000 - £159,999 p.a. | 7 | 7 |
| £160,000 p.a. and above | 1 | 1 |
| Total number of staff | 114 | 112 |
| Full time equivalent | 109.6 | 106.9 |
| Comprising: | | |
| Permanent staff | 112 | 109 |
| Fixed-term staff | 2 | 3 |
| | 114 | 112 |
| FTE vacancies at year end | 4 | 5 |

Table 4. Legal and professional fees

| | 2017 | 2016 |
|-------------------------------|------------|------------|
| | £'000 | £'000 |
| Legal fees - enforcement | 129 | 156 |
| Legal fees - judicial process | 68 | 70 |
| Legal fees - advisory | 24 | 8 |
| Professional fees | 278 | 205 |
| Internal audit | 38 | 40 |
| Total | 537 | 479 |



Finance and Operations

Table 5. Commissioners' fees

| | | 2017 | 2016 |
|------------------|----------------------------|--------|--------|
| | | £ | £ |
| Cees Schrauwens | | 67,800 | 65,431 |
| Robert Moore | | 27,000 | 25,667 |
| Alex Rodger | Retired 1 February 2017 | 2,354 | 25,667 |
| Lord Flight | | 35,000 | 35,667 |
| Richard Hobbs | | 35,000 | 31,667 |
| Simon Howitt | | 27,000 | 25,667 |
| Wendy Dorey | | 27,000 | 25,667 |
| John Aspden | Appointed 3 April 2017 | 26,250 | - |
| Philip Middleton | Appointed 3 April 2017 | 26,250 | - |

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Functions, Structure and Corporate Governance and other Control Systems of the Commission

Functions of the Commission

The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended (the Commission Law) established the Commission with both general and statutory functions. The general functions include the taking of “such steps as the Commission considers necessary or expedient for the effective supervision of finance business in the Bailiwick”. The statutory functions include those prescribed under or arising pursuant to the following regulatory laws:

- the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended;
- the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended;
- the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999;
- the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 as amended;
- the Insurance Business (Bailiwick of Guernsey) Law, 2002 as amended;
- the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 as amended;
- the Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) Law, 2008.

Relationship with the States

The Policy and Resources Committee is responsible for financial matters and for establishing the policy framework for financial regulation, including the government’s relationship with the Commission. The Commission Law states that the Commission shall issue its audited financial statements and the two reports, referred to later in this appendix, annually to the Policy and Resources Committee.

The Commission maintains regular dialogue with the States. During 2017, the Commission continued to engage with the Policy and Resources Committee, with meetings held in order to facilitate an open exchange of views on matters of importance to the States and the Commission. The Commission also engaged with the Committee for Economic Development in relation to financial services legislation.

Outside of formal meetings and presentations, the Commissioners and Director General maintain regular contact with senior States Members.

The Commissioners

The activities of the Commission’s executive are overseen by the Board of the Commission (Commissioners). The Commission Law provides that the Board shall consist of a minimum of five members (with no maximum) who are elected by the States from persons nominated by the Policy and Resources Committee and appearing to it to be persons having knowledge, qualifications or experience appropriate to the development and supervision of finance business in the Bailiwick. The Chairman is appointed for a period of three years from amongst the Commissioners and is elected by the States following nomination by the Policy and Resources Committee. The Vice-Chairman is appointed for a period of three years by the Commissioners. A Commissioner is appointed for a period not exceeding three years. A member whose term of office has come to an end is eligible for re-election. The Chairman and Vice-Chairman are also eligible for re-election to their positions. Commissioners must currently retire on reaching the age of 75 years.

The Commissioners during 2017 were Drs. Cees Schrauwes, Alex Rodger (retired 1 February 2017), The Lord Flight, Richard Hobbs, Bob Moore, Simon Howitt, Wendy Dorey, John Aspden and Philip Middleton. A brief résumé for each Commissioner is provided on pages 48 and 49 of this report. All of the Commissioners are non-executive; three reside in Guernsey, with the remainder living in the UK.

There were 13 meetings of the Board in 2017. The attendance was as follows: Drs. Cees Schrauwes 13, Howard Flight 12, Richard Hobbs 12, Bob Moore 13, Simon Howitt 11, Wendy Dorey 13, John Aspden 10 and Philip Middleton 11. Commissioners Aspden and Middleton were not appointed until 7 April 2017. Commissioner Howitt was conflicted out of 2, firm-specific, meetings. Prior to each meeting, Commissioners are provided, save in exceptional circumstances, with a full information pack to support the meeting’s agenda.

An induction programme is in place for new Commissioners. The Commissioners periodically consider their roles, responsibilities and accountabilities. In addition, each year Commissioners undertake a board effectiveness review.

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

Delegation of functions to executive staff

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

- the power of the Commissioners to delegate functions;
- the Commissioners' duty to make an annual report on the Commission's activities during the previous year to the Policy 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 and Resources Committee on its activities during the preceding year. The President of the Committee shall, as soon as possible, submit that report for consideration by the States.

The Commission Law also provides that the Commission shall:

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

and that the accounts of the Commission shall be:

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

The Commission includes a copy of its audited financial statements in the annual report to the Policy and Resources Committee, referred to above.

Report on internal control and corporate governance

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

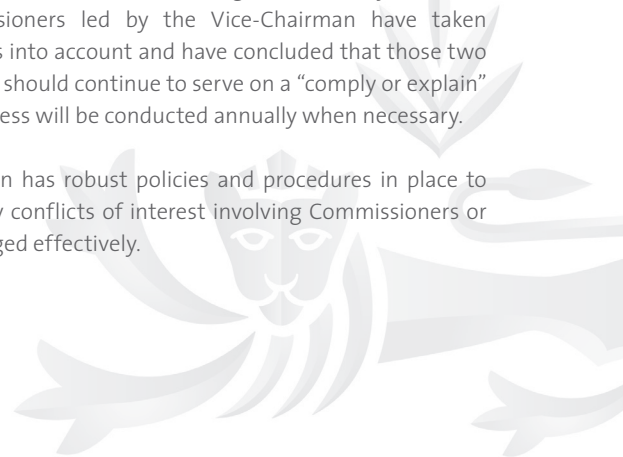
- (a) the adequacy and application of the Commission's systems of internal control;
- (b) the selection and application of the Commission's accounting policies and accounting procedures;
- (c) the effective, efficient and economical management of the Commission's assets and resources; and
- (d) the Commission's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

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

The Commissioners are responsible for overseeing the Commission's corporate governance regime and for monitoring the effectiveness of management's systems of internal control. These systems are subject to regular review by management and address the risks to which the Commission is exposed. The Commission has an ongoing process for identifying, evaluating and managing operational risks (including regulatory and financial risks). Although not required to comply with the UK Corporate Governance Code, the Commission has regard to the guidance contained therein and complies wherever valid to do so.

Two Commissioners, Drs Cees Schrauwers and the Lord Flight have served as Commissioners for longer than nine years. The other Commissioners led by the Vice-Chairman have taken relevant factors into account and have concluded that those two Commissioners should continue to serve on a "comply or explain" basis. This process will be conducted annually when necessary.

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



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

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

Audit Committee

In 2017, the Commission's Audit Committee comprised Simon Howitt, Wendy Dorey and John Aspden and was chaired by Richard Hobbs. The Committee covered oversight of the management of risk, reviewed corporate governance and the systems of internal control and reported routinely to meetings of the Board as a whole. Meetings were usually attended by the Director General, the Chief Operating Officer and the Financial Controller.

The Committee met 4 times in 2017. The attendance of the individual members at these meetings was as follows: , Richard Hobbs 4, Simon Howitt 4, Wendy Dorey 4 and John Aspden 3. The Audit Committee has oversight for non-regulatory risk; regulatory risk is reviewed by the Board as a whole.

Remuneration Committee

The Remuneration Committee, which comprised Bob Moore (Chairman), Richard Hobbs, Wendy Dorey and Philip Middleton, is mandated to advise and assist the Commission in fulfilling appropriate governance in respect of remuneration policies, practices and structure.

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

Meetings were attended by the Director General and the Chief Operating Officer. The Committee met twice in 2017 with all members attending both meetings other than Wendy Dorey who attended one. The Commission's Chairman also attended one meeting.

Review systems

The Commission has retained specialist internal and external expertise to monitor the Commission's non-regulatory internal audit standards to ensure that the Commission is up to date with current expectations.

During 2017, the Commission appointed an external party to undertake internal audits in the following areas:-

- Budgetary controls;
- Revenue Procedures and Controls;
- Payroll and Pension administration.

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

In 2017, the corporate governance standards of the Commission were reviewed by the Board. The Commission is satisfied that it meets expectations in connection with internal audit and corporate governance. The International Monetary Fund (IMF) undertook an evaluation of the Bailiwick against international regulatory and supervisory standards in 2010 under its Financial Stability Assessment Programme. The Commission and the other authorities in Guernsey were found by the IMF to have a high-level of compliance with these standards. This was reaffirmed by the Council of Europe's Financial Action Task Force regional inspectorate, Moneyval, which visited the Bailiwick in late 2014 and which published its final report in January 2016.

During 2017, an assessment was conducted of the Bailiwick's regulatory regime against current international standards. This was undertaken by Mr Ian Tower, a former IMF assessor who was contracted by the Commission. The principal conclusion was that the main areas for improvement are already being progressed through the "Revision of Laws" project which is anticipated to be concluded by the end of 2018.

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