

**Guernsey Financial Services Commission**

Independent evaluation review

30 November 2011

Ernst & Young LLP

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**Private and confidential**

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30 November 2011

Ladies and Gentlemen

**Independent evaluation review**

There have been remarkable changes in the world's economy and especially its financial services industry since we commenced work on this report. These changes serve to highlight how apposite it was that the Independent Evaluation Review was commissioned. We are honoured to have had the opportunity to carry out this work.

Our work has been spread over more than six months, and has involved extensive discussions with government and industry as well as directors and staff at the Commission. It has also involved regulators and industry participants from other jurisdictions.

We take this opportunity to thank all those who have contributed time and valuable insights to our work. Points of view have been many and varied; we have sought to consider them all in forming our conclusions and recommendations.

We hope that our recommendations are found to be worthwhile and relevant. We also look forward to continuing our contribution to this important work.

Yours sincerely

Michael Bane  
Partner  
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# 1. Executive summary

The Commission is a vital institution for the Bailiwick. It has an excellent track record but change is required.

Financial services account for a large proportion of the productive economy – as much as 75% on reasonable measures. Industry and government agree that financial services can only continue to flourish if the Island retains a ‘premier league’ reputation. This can only be done if regulation plays its part. Good regulation is therefore essential. We place emphasis on ‘good’ – not world leading, not the best possible, but simply good.

The Commission is highly regarded – not just locally but by the global regulatory community, global financial services institutions and their advisers. It has fought a good crisis and it is significant that Guernsey’s taxpayers have not been called on to pay for financial services failure.

In addition the Commission delivers value for money with few commentators expressing the view that regulatory costs are too high. The most significant driver, by far, of the Commission’s expense base is staff costs. Competition for good resources in the Bailiwick is intense and it is inevitable that industry can, generally, offer more attractive packages. Government should therefore consider whether, in the overall interests of the island, it would be beneficial to offer enhanced housing licensing arrangements to attract more staff of the right calibre – particularly as the focus of regulatory activity shifts to risk-based approaches that require greater skills and less process and administration.

## **Global regulatory developments**

There are, however, grounds for concern. The international environment is complex and dangerous. At the time this report was commissioned few would have anticipated the extent of the sovereign debt crisis in the Eurozone today. This is likely to encourage scrutiny of successful offshore jurisdictions. The world is currently in a period of significant regulatory change as governments and supervisors take action to address weaknesses exposed by the financial crisis. A far-reaching programme of reform is underway, placing considerable challenges on both regulatory authorities and market participants. These challenges are exacerbated by the current high risk economic and market environment.

Over the past three years, global leaders meeting at the G20 summits (most recently in Cannes in November 2011) have expressed and confirmed their commitment to consistent and timely implementation of regulatory reform. Whilst in practice regional and national legislative processes are leading to a more fragmented and uneven implementation path, the principal elements of the programme continue to progress, and combine with more robust supervisory approaches. The proposed changes include revisions to regulatory and market architectures, measures to make individual institutions more resilient and responsible, and new tools to reduce the systemic risks of institutions that do fail, without a requirement for taxpayer solvency support. These changes will inevitably increase the cost of regulation globally – and in the Bailiwick. It would be unrealistic for industry, government or the Commission not to expect additional costs.

## **Regulatory and market architectures**

Key themes of regulatory architecture change include an increased focus on macro prudential analysis, with stronger alignment to the supervision of individual firms. In addition, the scope of regulation is being extended to encompass unregulated market participants such as hedge funds. Major changes are proposed to strengthen the transparency of OTC derivatives markets, and to clarify the roles and responsibilities of ratings agencies and auditors.

### ***Resilience and responsibility of individual institutions***

The Basel II.5 and III requirements are designed to make banking institutions more resilient by setting out more onerous requirements for the quality and quantity of capital and liquidity, strengthening governance and risk management practices, and aligning remuneration to risk. In Europe, Solvency II has similar objectives for insurers. A raft of further proposals currently in progress at the EU level (and similar in the US) seeks to extend consumer protections and standards of transparency in market conduct, and to address excessive market volatility.

### ***Management of the failure of institutions***

There are concerns that certain institutions are too big to fail and have benefited from an implicit guarantee that in the event of failure they would be supported by government. Such an approach is now seen as unsustainable. Initiatives to address this issue involve raising the capital and risk management standards to be met by systemic institutions, restricting the activities permitted within a bank structure and introducing proposals for recovery and resolution plans. Authorities are placing increased focus on the structure, governance and strength of the parts of major groups that reside in their particular jurisdiction.

### ***Implications***

Regulatory and supervisory authorities around the world are considering how to respond to this agenda, and significant changes are underway in several countries. It is timely for the Guernsey authorities to be considering their own future in this broader context, as the expected standards for good regulation and supervision develop globally.

### **Constitutional and operational matters**

The current constitution of the Commission was designed at the end of the 1980s based on a government model of the time. It would be surprising if it was still entirely fit for purpose. We have observed clear examples of an inconsistent approach to regulatory policy formulation and in day to day supervision. Managerial processes are not strong enough to support the complexity of the Commission's business and operational inefficiencies can be observed by studying processes. These inefficiencies are also evident to industry.

The factors causing grounds for concern give rise to our recommendations which fall into three main areas; constitution and governance; regulatory capabilities; and managerial and operational efficiency. We summarise each in turn below.

### **Clarify constitution and relationship with Government**

The Commission currently has dual reporting lines to Government making for unclear accountability. We therefore recommend that the Commission reports to a single government department.

We note that the Commission can make policy for industry and introduce law, whether or not this aligns with the Island's strategy. It is a matter of significant concern, that there is no clear strategy for financial services for the Island. We recommend that such a strategy should be developed by government based on a thorough risk analysis and using existing economic data and trends – informed by the views of industry from a commercial perspective and the Commission from a regulatory perspective. The Commission should use this strategy to prioritise its regulatory focus and expertise on those areas that will be most significant for that strategy. Regulatory protocols should be agreed and a new 'protocol' is required for the Commission that has regard to economic effects. The role of the Commissioners also requires clarification – and more of them are necessary, appropriately remunerated and with a wider skill set.

### **Strengthen regulatory capabilities**

We recommend a re-organisation to respond to emerging regulatory challenges, which are very significant. Core regulatory processes should be centralised – and supervisory processes should be standardised across divisions. These processes require further review

and codification on a consistent basis. Interactions with government and industry also require improvement.

### **Improve managerial and operational efficiency**

By comparison to most financial services businesses the Commission lacks modern organisational and operating skills. We recommend the appointment of a Chief Operating Officer with responsibility for the efficient and effective running of the Commission. Committees and projects require significant rationalisation to focus effort on key activities. Managerial processes and performance management need improvement – greater accountability and management by performance measures is essential to improve efficiency. Resources should be deployed away from divisions to central processes to use resources better. Although improvements have been made recently, use of information technology is poor. Significant manual work could be eliminated through effective use of IT.

### **Looking forward**

Our recommendations have been made on the basis of existing regulatory scope. We believe that over time they will give rise to cost reductions, more efficient delivery of regulation and a more consistent regulatory experience for licensees. However, significant change is required which itself has a cost, may not be easy to manage and will take time to have effect. Progress is already being made on a number of our recommendations and the need for change had already been recognised in many areas.

We note above the significant change in the pipeline, particularly from legislative developments in the EU. Regulatory on-costs from these changes need careful consideration as part of the Island's financial services strategy, particularly taking account of the views of industry. Other potential changes to retail regulation, the effects of possible consumer protection legislation and pensions regulation would all require additional regulatory effort. If this effort is undertaken by the Commission (and it is far from clear that it has the right skills to do so) the resulting costs are likely to be significant and would require subvention from government.

The Commission will require flexibility to respond to the new business models that financial services firms are likely to adopt in response to the crisis and new regulation, including consideration of the implications for the Bailiwick of potentially more nationally focussed supervision elsewhere. It will need to maintain its strong reputation globally as expectations of proactive risk-based supervision and effective enforcement grow; by increasing specialisation and maximising the benefit to be gained from supervisory experience and expertise in its operations.

### **Limitations of our report**

Our work was performed in accordance with the terms of our contract dated 30 March 2011, and our procedures were limited to those described in that letter. Ernst & Young assumes no responsibility to any third party user of this Report and Appendices ("the Report"). Any third party who chooses to rely on our Report does so entirely at their own risk. There are other important limitations in our work. These are described in Appendix C.

### **Conclusion**

This report demonstrates a need for change. Historically, the Commission has evolved very effectively to meet changing regulatory demands. The pace of change and regulatory development is likely to accelerate over the next few years and the Commission will need to evolve with that. We found significant enthusiasm amongst Commissioners, directors and staff for the challenges ahead.

## 2. Understanding the challenge

### 2.1 A brief history

In January 1988 the States passed the Financial Services Commission (Bailiwick of Guernsey) Law, 1987. This legislation gave birth to the Commission in the legal form and with much of the powers rights and duties of the Commission and its Commissioners that exist today. In the 23 years since then there have been numerous significant events that have shaped what the Commission does – and how it does it. Change, however, has been evolutionary rather than revolutionary.

It is necessary to go back to the end of the '60s and the '70s to understand something of how the Commission came to be what it is today.

The beginnings of the emergence of the Bailiwick as a financial centre gave rise to The Protection of Depositors, Companies and Prevention of Fraud Bailiwick of Guernsey Law 1969 under which was made the Protection of Depositors Ordinance 1971. These were based on existing UK legislation. In the investment sector the Control of Borrowing Ordinance 1959 controlled, inter alia, the issue of prospectuses and raising of money from third parties. The Control of Borrowings Ordinance 1976 was used to regulate the formation of companies.

The UK secondary banking crisis of the early 70s affected the Island giving rise to reorganisation of some institutions – and the lifting of exchange controls in 1979 saw a step change in the Island's financial services industry.

However, it is arguable that the Barnett Christie affair, and the subsequent enquiry there into was the real catalyst for financial services regulation in the island. The States established a commercial relations office and recruited Bruce Riley as a Commercial Relations Advisor to deal with banking regulation and to supervise and administer the Control of Borrowing regime. His appointment led to the first Banking Supervision Law of 1987.

All these events closer to the end of the 1980s set the scene for the formation of the Commission as a body, independent of the States. It was staffed initially at a senior level by experienced former regulators mainly from the Bank of England. John Roper was the first Director General and Peter Crook, Steve Butterworth and Nigel Taylor the first directors of banking, insurance and investment respectively.

Guernsey has been, in part fortunate, but also vigilant and intelligent in its regulatory activity and approach and has avoided many of the financial scandals that have had significant effects in larger jurisdictions, for example the BCCI crisis, the pensions mis-selling scandal in the UK; the split capital investment trust affair; and more recently the demise of Lehman Brothers, Bernie Madoff's Ponzi scheme and the 'financial crisis'.

Guernsey has subjected itself to external scrutiny, and had scrutiny imposed on it. The Edwards Report, Foot Review and IMF inspections are all good examples.

The Commission has evolved in response to major financial events and to reports prepared by third parties. For example, 'development' was removed from the Commission's objectives following the publication of the Edwards Report – recognising that the regulator is there to regulate and that development is a fundamental conflict with this role. The Edwards Report also observed the potential conflicts in having a States member as Chairman of the Commission resulting in changes in appointment. Other important events have been the formation of the fiduciary division in 2000 and the introduction of anti-money laundering legislation creating the criminal offence of money-laundering under the Proceeds of Crime Law 1999. This has been successful in closing down inappropriate fiduciary and company administration business – and it should be recognised that this has been done without the benefit of significant global regulatory architecture in this industry niche.

The purpose of this pre-amble is to demonstrate that, whilst there has been major financial turmoil over the last twenty years together with intense scrutiny of offshore jurisdictions, and their purpose and place in the world, Guernsey, regulated by the Commission, has avoided the worst.

At the time of writing the Eurozone is gripped by an unprecedented sovereign debt crisis. Predicting the likely outcomes and analysing the causes are a very long way from the purpose of this review. However, the importance of good regulation could hardly be more pertinent.

The chart below sets out some of the key events since the Commission was formed.

Key events for Guernsey financial services regulation		World events
	<b>10/87</b>	Black Monday – markets fall by 20% or more in a day and continued to fall for the rest of the year
Financial Services Commission (Bailiwick of Guernsey) Law, 1987 passed by States of Guernsey Giving legal effect to the GFSC and its process	<b>01/88</b>	
	<b>07/91</b>	BCCI raided by authorities in seven jurisdictions
	<b>11/91</b>	Robert Maxwell 'lost' overboard
	<b>01/95</b>	Nick Leeson precipitates collapse of Barings
Home Office publishes Edwards Report on Financial Regulation in the Crown Dependencies	<b>12/98</b>	
The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999	<b>08/99</b>	
Anti Money Laundering legislation takes effect	<b>01/00</b>	
Regulation of Fiduciaries, Administration Businesses and Company Directors, etc., (Bailiwick of Guernsey) Law 2000	<b>03/00</b>	Dotcom bubble bursts
	<b>06/02</b>	FSA announces that pensions mis-selling scandal cost insurers nearly £12bn
	<b>07/03</b>	FSA announce that split capital affair is the largest investigation they have carried out
IMF, invited by A & F to review regulatory and law enforcement structure, releases first report on Guernsey	<b>11/03</b>	
	<b>07/05</b>	EUSD takes effect
	<b>09/08</b>	Start of 'The Crisis', Lehman Brothers files for Chapter 11 protection. Landsbanki taken into control of Icelandic FSA
	<b>12/08</b>	Bernie Madoff arrested
	<b>02/09</b>	Stanford International collapses
Foot review of British Offshore Financial Centres	<b>10/09</b>	
Lord Hunt's strategic review of Guernsey's Banking Industry	<b>11/09</b>	
IMF publishes second report on Guernsey	<b>11/10</b>	

## 2.2 Financial services are crucial for Guernsey

It is important to assess the relative importance of the financial services sector to the economy of the island. The table below shows recent statistics from Commerce & Employment (C&E) in respect of finance sector employment.

	Employment (% of all jobs)
Banking	6.5
Investment	5.2
Fiduciary	6.2
Insurance and other	3.3

These statistics show that only 21.3 % of all employment is in finance sector jobs. However, it is arguable that approximately 20% of jobs are in government and non-productive (in a financial sense) employment meaning that financial services jobs represents approximately 27% of the productive economy. In addition C&E estimate that the average finance sector salary is 1.5 times that of the rest of the economy. Furthermore each finance sector job is estimated to support at least 1.5 other jobs in the economy. Obvious examples are the accountancy and legal professions which would be very much smaller but for financial services. But it does not end there – restaurants, hotel and building trades are all very dependent on the activity generated by the finance sector at both a corporate and a personal level.

Some commentators consider that, after allowing for multiplier effects, financial services drive as much as 75% of the economy.

It is also important to note that the financial services industry consumes a relatively small part of government subsidy and spend. The Commission is currently self-financing, at least from a government perspective. By contrast, tourism, horticulture and some other sectors are significant users of States resources, grants and subsidies. None of this applies to financial services, underlining the net contribution the sector makes to funding government and the standard of living enjoyed on the island.

One of the most notable features of the recent financial crisis has been the extent to which governments, and by extension the taxpayer, have been forced to bail out impaired financial services institutions. There has been no such effect in Guernsey.

It is difficult to be sure of the reasons for this success. External commentators and the industry itself cite a number of reasons and themes. Our research points to the main factors being a hard-earned good reputation which is only too easily lost; flexibility and 'nimbleness' to exploit niche opportunities as they arise; quality of people and infrastructure; and regulatory pragmatism.

## 2.3 The Commission delivers value for money

A large majority of those interviewed and those surveyed expressed the view that the cost of regulation, in the sense of regulatory fees paid, was a small price to pay for the preservation of the Island's reputation and overall quality of regulation. We note that, although maintaining fees at the same level in 2012 as they were in 2011 has been appreciated by industry, there is a sense that indirect costs to business could be reduced if regulatory activity was more pragmatic and efficient. Nevertheless, the regulatory burden in this latter sense is not felt to be, in aggregate, inappropriate.

An analysis of the development of the Commission's operating costs shows that they have developed consistently with comparable jurisdictions. We conclude that increases are, on the whole, reasonable and supportable reflecting the increased burdens imposed by the external regulatory environment and pressures on offshore jurisdictions.

An initial analysis shows that regulatory fees per entity are high in Guernsey. However, it is difficult to properly compare like with like and cost per licensee does not compare unfavourably with competitor jurisdictions after taking account of relative costs in those economies. In addition, the relative sizes of the regulatory divisions are consistent with those in competitor jurisdictions when viewed in the context of the size of the industry. This is best demonstrated by the extracted statistics for Guernsey and Jersey in table 1 below in this section.

Recently staff costs have increased though this is balanced by a significant reduction in external legal costs which reached a peak of nearly 13% of total costs in 2008. This is partly a reflection of costs of the crisis but also an increase in internal legal capability (and hence costs) has reduced dependence on external legal support and on using much lower rates available through the Law Officers. We also note that the level of employment in the Guernsey economy, particularly in financial services, makes it very difficult for the Commission to compete effectively for the highly skilled people needed to execute the Commission's work effectively.

A significant surplus was made in 2010 balancing two years of deficit in 2008 and 2009. We also observe that there has been significant downward pressure on costs over the last 18 months yielding savings in travel and other semi-discretionary items.

Detailed analyses are shown in Appendix F.

**Table 1: Comparison of key data between Guernsey and Jersey**

	2010		2009		2008	
	Guernsey	Jersey	Guernsey	Jersey	Guernsey	Jersey
<b>Costs</b>						
Staff (£m)	7.8	8.3	7.4	8.3	7.3	7.3
Other (£m)	2.3	3.6	2.6	3.0	2.7	3.4
<b>Total (£m)</b>	<b>10.1</b>	<b>11.9</b>	<b>10.0</b>	<b>11.3</b>	<b>10.0</b>	<b>10.7</b>
<b>Banking</b>						
Fee income (£000's)	1,533	1,351	1,163	1,325	1,128	1,365
Number of licensees	38	45	44	47	48	47
Deposits (£bn)	111	162	117	165	157	206
<b>Fiduciary</b>						
Fee income (£000's)	1,976	2,552	1,696	2,275	1,489	2,299
Number of licensees*	146	139	145	N/A	N/A	N/A
<b>Insurance</b>						
Fee income (£000's)	2,483	850	2,307	764	2,228	629
Number of licensees	675	185	N/A	N/A	N/A	N/A
<b>Investment</b>						
Fee income (£000's)	5,271	4,812	4,616	4,634	4,521	4,383
Funds under management (£bn)	258	185	184	166	200	241
Number of funds	1,193	1,324	1,208	1,294	1216	1,472

\* Excluding individuals

## Notes

- ▶ Guernsey costs exclude Training Agency. Jersey costs include company registration.
- ▶ There is insufficient data to directly compare costs by division hence fees are used as a proxy.
- ▶ Data extracted from annual accounts and websites.
- ▶ Direct comparison of numbers and value of funds is hampered by different regimes and regulatory requirements. Guernsey includes open and closed ended and non-Guernsey schemes. Jersey includes CIF and COBO funds.

## 2.4 The world is now a more complicated and dangerous place

The first round of crisis in 2008 rocked the world's financial system. This provoked a strong reaction from G20 including some attempts to blame 'tax havens' and 'alternative investments' for problems that are more likely to have very different causes. Many now consider that the problems of the first round of crisis could be mild compared to the threats posed by the problems in the Eurozone.

In comparison to other jurisdictions, Guernsey has had a good crisis. The most notable event (at least from a public viewpoint) has been the collapse of Landsbanki. Inevitably this has attracted some criticism. Whilst it is axiomatic that the collapse of a banking institution, with consequent loss to depositors, cannot be helpful from a regulatory perspective, it is important to note that Landsbanki depositors in Guernsey have received a large proportion of their money back. Furthermore the reasons for the bank's collapse are not attributable to regulatory malfunction in the Island. It is also important to compare the fortunes of Landsbanki Guernsey depositors with those of depositors in other failed Icelandic banks. The Commission must take some credit for its actions both before the collapse of the bank and subsequently.

Since the crisis some weak financial institutions have left or been encouraged to leave the island – though this is not to suggest that all who have left are weak. This is indicative of the vigour and vigilance of the Commission in protecting the island's reputation.

The Foot review of British Offshore Financial Centres and Lord Hunt's review of Guernsey's Banking Industry did not identify significant shortcomings. Issues that were identified have largely been addressed. The establishment of the Guernsey Banking Deposit Compensation Scheme in 2008 is an example though its formulation had started before the reviews. The IMF's second review of the Industry was completed approximately a year ago. There were no material adverse findings.

Notwithstanding the above positive factors, there are significant clouds on the horizon. There is a very significant amount of financial services regulation in the EU legislative pipeline. Approximately 35 new directives are at various stages of development. Consideration of how they apply to the Island will be necessary – and this is before the effects of the Eurozone banking crisis filter through to changes in regulation.

Leaders of some Eurozone countries continue to apportion blame to 'tax havens' in recent speeches. Other established initiatives continue unabated. Of these, FATCA, AIFMD and Dodd Frank are probably the most visible. Recent developments such as the withdrawal of VAT consignment relief in the UK, though not directly affecting financial services, serve to illustrate the mood.

**The above factors raise very significant questions for Guernsey's policymakers.**

## 2.5 Industry Feedback

Our review has included meetings with leaders of Industry Associations, Licensees and an electronic survey sent to all Licensees. Detailed results from the survey are included in Appendix B of this report.

It cannot be overemphasised that the majority of feedback from this research, especially after allowing for inevitable special pleading, is positive. It should also be recognised that any survey of a regulator that paints an overwhelmingly positive picture would be a cause for concern because there is inevitable tension between regulator and regulated.

The table below is a selection of the most significant themes and comments from our research. They have been selected from many individual pieces of feedback where they are representative of themes or comments by others.

Feedback from industry meetings	Representative findings from survey
Proper governance structure is required	Silo mentality between divisions 'it's like having four different regulators'
Cannot afford luxury of being accountable to itself	Introduction of single relationship managers would save time and money
Divisions work in silos giving different answers and being uncoordinated	Lack of governance and accountability
Staff below director are sometimes very inexperienced – 'we're teaching them how the industry works'	Regulation should not be an inhibitor to business
Other jurisdictions are easier to deal with	Moving towards 'gold-plated' anti money laundering regulation and losing business because of it
Very late to electronic regulation – leads to inefficiency	Pragmatism of the past has been lost
You can't get answers to reasonable questions – current approach is breaking down open relationships	Consultation comes too late and industry views are ignored
We didn't get the results from an on-site visit for months after the fieldwork was finished	Communication is increasingly aggressive and less open
Findings from on-site visits are very different to post visit feedback	There is inconsistent staff experience
Commission appears nervous about taking enforcement action – hands tied by the system	Enforcement activity lacks transparency
Response times are inconsistent	On-site visits are becoming a box-ticking exercise and lack risk-based thinking
Appears to be project overload – and not enough regulating	Increasingly negative and unpredictable interaction gives rise to inhibited communication
Need to understand our business better – and focus on the risks	

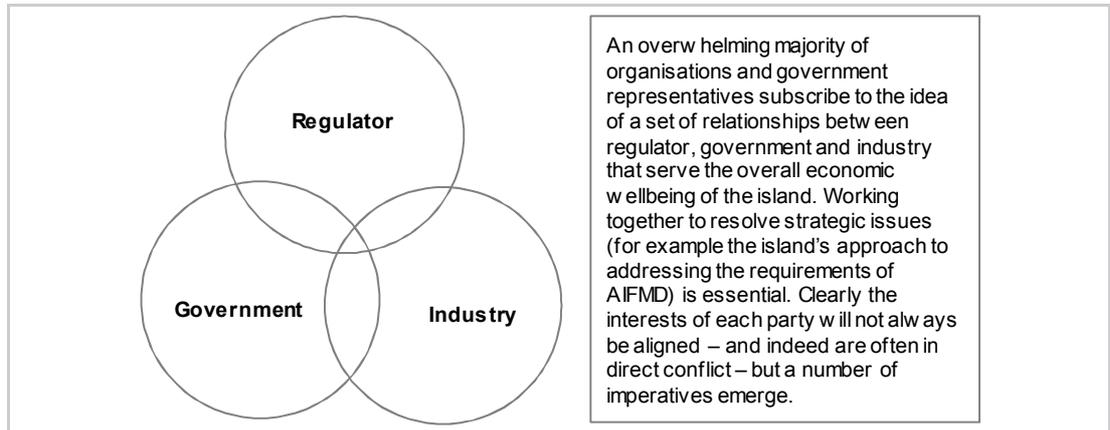
## 2.6 Special challenges for the Commission

The importance of the financial services industry to the prosperity of Guernsey makes the Commission a crucial component of the economy. Financial services in an offshore jurisdiction cannot flourish over the long term in the face of scandals and a dubious reputation – and the regulator is a primary guardian of reputation.

Some theorists argue that regulation is an activity that exists for and of itself – that it cannot be beholden to government or the regulated because that influence would corrupt the effectiveness of regulation. These views are not without merit given the scale of regulatory failure that has occurred in some jurisdictions in recent years. However, in an economy whose fate is very largely dependent on a regulated industry, the regulator must be answerable to government and responsive to industry at a level that is conducive to economic performance. Put another way, it is for government to decide business direction

informed by regulatory consequences, not for the regulator to decide on the direction of regulation in isolation.

Notwithstanding the economic imperatives, it is essential to remember that Guernsey is a small place and conflict is inevitable. The opportunity for inappropriate influence (both deliberate and unintentional) is much greater than in large jurisdictions – so the regulator must have a free hand to pursue the day-to-day business of regulation without interference from politicians, government or industry.



### **Good regulation is essential**

In this context emphasis is placed on 'good'. The consensus is that world leading and aggressive regulation is detrimental to industry, particularly given the fierce competition between financial centres. There is evidence that in some areas the Commission applies harsher standards than other jurisdictions (particularly anti money laundering). In strategic terms regulation must be sufficient to protect reputation, but be fairly prosecuted and not uncompetitive.

### **Commercial responsiveness required**

At a macro level government and industry are entitled to expect a level of engagement that allows macro change to evolve effectively. Similarly at a micro level, licensees should expect to, for example, have questions answered and results of inspections delivered within set timeframes to allow businesses to function effectively.

**Clear accountability without interference in the regulatory process is required.**

## **2.7 Key assumptions**

The preceding analysis gives rise to a set of key assumptions which are set out below.

### **Financial services are crucial – but the Commission's role is not to actively develop**

The direction and furtherance of particular areas of financial services and their suitability for the Island should be a matter for governmental policy primarily informed by Industry initiatives. The Commission's role should be, initially, to advise government and industry on the suitability, risk and regulatory consequences of proposed initiatives and, subsequently, to provide a reputable, reliable and efficient regulatory environment for that initiative.

### **Guernsey wishes to retain 'Premier League' status**

The Commission's role is to protect the island's reputation, ensure financial stability and enforce regulatory compliance. In doing so the Commission should:

- ▶ Align to international standards at a good level, having regard to economic effect.
- ▶ Implement regulation once policy is determined by government.

### **The Commission will have to do ‘more for same’**

The volume and complexity of regulation is growing at a fast rate. Industry is reluctant to pay more. Skilled resources are hard to come by in an economy of full employment for the skills that are relevant to the Commissions functions.

### **Status quo is not an option**

Without change the Commission will be unable to respond effectively to the changing demands being forced on it by external pressures. Development/improvement is required in the following areas:

- ▶ Mandate and key objectives.
- ▶ Flexibility and responsiveness.
- ▶ Greater operational efficiency.
- ▶ Optimal allocation of limited resources.
- ▶ Re-evaluation of organisational structure.

### **Demonstration of adherence to objectives**

The Commission’s objectives are set out below. These require re-examination in light of a changed relationship with government and industry. Whether or not objectives change it will be vital to demonstrate adherence to objectives.

- ▶ Maintain financial stability in the regulated financial sector.
- ▶ Managing risk to the financial system and maintaining market confidence.
- ▶ Ensuring fair, efficient and transparent markets.
- ▶ Protecting financial services customers.
- ▶ Countering financial crime and the financing of terrorism.

## **2.8 Constitution requires greater clarity**

The Commission is established under the 1987 Law as a body corporate. However it is constitutionally unique and very different to a limited company. In particular, powers and duties are enshrined in the 1987 Law rather than in memorandum and articles of association as would be the case for a Company.

In addition the role of Commissioners under the 1987 Law is somewhat unusual. For example, Commissioners have the power to delegate most functions and activities to the Executive. It is also noted that Commissioners are equivalent to neither non-executive directors nor executive directors (in a conventional sense).

These arrangements which, too many, are unusual and opaque, lead to lack of clarity in strategy and direction. This lack of clarity, in turn, makes it harder for the Commission as a whole to discharge its functions effectively.

We have considered whether it would be better to replace the existing structure with a normal limited company. However, we have concluded that it is better to adapt the existing structure where necessary because:

- ▶ The existing structure is part of the uniqueness of Guernsey.
- ▶ It is not obviously broken and has a strong track record.

**A form of ‘protocol’ is required to establish clarity. The ‘protocol’ should include economic objectives and dependencies.**

## 2.9 Commissioners

A comparison of the current remuneration of a Commissioner with comparable jurisdictions and with a typical Guernsey non-executive director role of a listed investment fund demonstrates that current remuneration is not consistent with current responsibilities. It can be seen from table 1 below that, relative to the size of its financial services industry, Jersey has a greater number of Commissioners. Table 2 demonstrates that the remuneration for a typical public non-executive role is higher, and the demands on time very much lower, than is the case for a Commissioner.

Data from 31/12/10 reports	Average remuneration	Number of Commissioners
Jersey	£24,000	11
Isle of Man	£16,000	6
Guernsey	£21,000	6

### Guernsey public non-executive director role

- ▶ Typical remuneration £25,000
- ▶ Four meetings per annum
- ▶ Two days per meeting including reviewing papers
- ▶ Annual commitment ten man days

The above time commitments compare to 10 Commission meetings a year together with significant one-off enforcement responsibilities which make the annual commitment at least three times as great as a typical non-executive role. It is also noteworthy that Commissioners take on extensive responsibilities under the 1987 Law. The role is also a public one with high visibility locally and the attendant responsibilities this creates.

In addition the Commission is heavily dependent on the goodwill of the Commissioners – and this dependency is unsatisfactory for a modern efficient regulator.

The current Commissioners have strong backgrounds in regulated financial services. There is also a good local/non-local balance. However, a broader range of backgrounds would be likely to improve the governance of the Commission. Strong representation from the legal profession is important. Other skill sets likely to benefit governance would include strong business skills, academics and civil servants – though these suggestions are intended to be indicative rather than absolute. The important issue is to broaden the skill and experience base of the Commissioners as a body. There would also be merit in sharing a Commissioner with Jersey.

The DG is not currently a Commissioner. This is a curious situation given the importance of the role. However, it is certainly arguable that it is necessary given the drafting of the 1987 Law under which the Commissioners delegate functions to the Executive, embodied by the DG. If the Commission were constituted as a limited company with directors one would expect the DG to be a director.

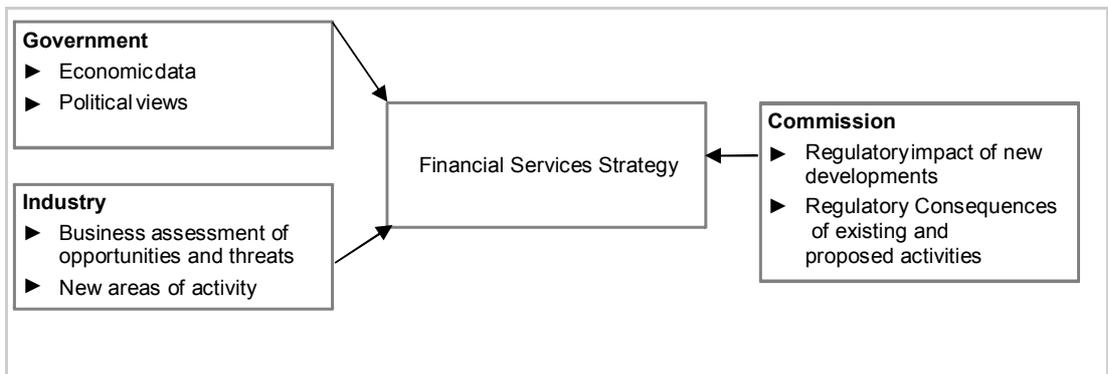
**Recruit more Commissioners to broaden skill base and balance workloads. Adjust role and compensation into better balance.**

## 2.10 Financial services strategy

We support the view that, in a small jurisdiction where financial services sustains the economy, responsibility for regulatory strategy is a governmental decision. In this context strategy includes deciding what the jurisdiction’s responses to external regulatory developments should be. It also includes setting the overall tone for regulation and regulatory objectives.

Regulatory strategy and the setting of objectives are likely to give rise to best results when it is done in the context of a strategy for financial services. We therefore recommend that government develops the existing strategic themes for financial services. Many factors will inform such a strategy. We would emphasise the importance of the following, illustrated by the diagram below:

- ▶ Reliable data about the position of the economy, interdependencies of existing activities and observable trends.
- ▶ The views of industry about opportunities for and threats to existing activities and possible new activities.
- ▶ The views of the Commission about the regulatory consequences of existing and proposed activities and the regulatory impact of new extra-territorial legislation and initiatives.



**A financial services strategy is essential. It should be informed by economic data provided by government, opportunities informed by industry and regulatory consequences informed by the Commission.**

**Government should be responsible for strategy, the Commission for implementation of regulatory strategy.**

## 2.11 A slave with two masters is a free man

At present the Commission’s reporting line and responsibility is to Policy Council – which is a committee within government rather than a department. This makes it hard to set and sustain clear regulatory strategy and objectives. Almost all commentators agree that a clear reporting line to a government department, with agreed areas of reporting, is highly desirable. This is difficult to achieve within the current arrangements

We recommend that a single government department should be responsible for the Commission. It is, however, difficult to determine which department this should be.

Commerce and Employment Department (C&E) clearly has the strongest capability to deal with this responsibility. There is good knowledge of the industry within the department and people with appropriate skill sets to liaise with industry and the Commission. However, C&E also has a significant conflict because it is responsible for development of financial services. Very strong safeguards would be necessary to deal with the conflicts that would arise from this dual responsibility.

Treasury and Resources Department (T&R) is freer from conflict. Furthermore, most jurisdictions with a significant finance sector vest responsibility for regulation in departments of government that are equivalent to T&R. However, there is currently less capability to execute this role within T&R. It would be less than optimal to leave the direction of regulation to a department that does not have the skills and resources to properly handle it.

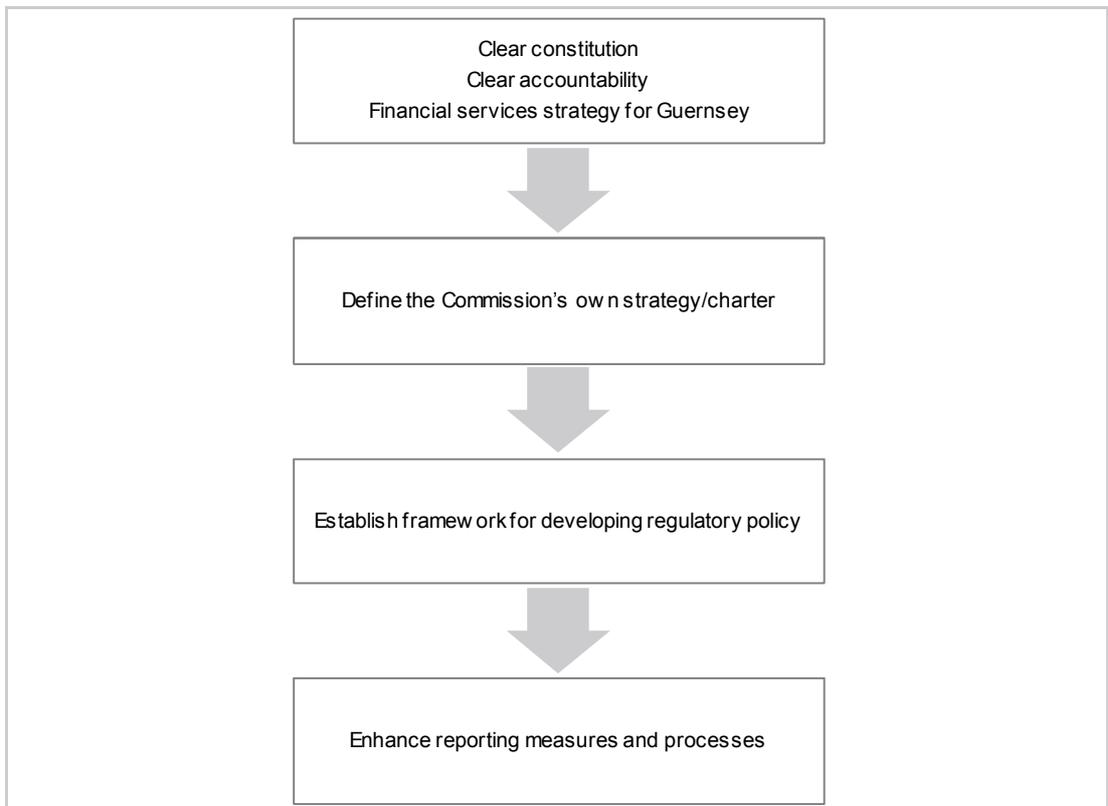
**Responsibility for regulation should rest with a single government department.**

**Identification of departmental responsibility is required.**

**Responsibility and reporting mechanisms should be clearly defined.**

**Safeguards are required to ensure that Government cannot interfere in the day-to-day business of regulation.**

**Recommendations are summarised in the following flow diagram.**



### 3. Organisational and operational efficiencies

Throughout the course of our work performed we have identified that the Commission staff we have spoken to are knowledgeable about the Laws and Regulations relevant to their divisions and the supervisory and operational processes and procedures that they currently conduct. The survey results have demonstrated that the Commission is highly regarded by the licensees. In addition, our discussions with industry have identified that many individuals at the Commission are well respected due to the level of their knowledge and experience.

Some processes and procedures have been in place for many years and Commission staff are familiar with the required steps. However, there have been a number of recent changes, for example in relation to the enforcement process, which still need to be fully established within the divisions.

We have identified many good practices at the Commission including, the Human Resources Strategy, loyalty of staff, level of regulatory knowledge and strong teams. However, as in all organisations when processes and procedures are challenged efficiencies can be identified.

The key themes of our recommendations in relation to organisational and operational efficiencies are that:

- ▶ The supervisory approach requires greater consistency.
- ▶ The creation of a unified and centralised regulatory process is recommended.
- ▶ The organisation structure could be streamlined.
- ▶ The operational platform should be more efficient.
- ▶ The management processes require strengthening.

#### 3.1 The supervisory approach requires greater consistency

##### Core principles

- ▶ Supervision is performed in a consistent and appropriate manner in line with the responsibilities of the Commission.
- ▶ The Supervision process is formal, structured and transparent.
- ▶ The Commission has appropriately skilled supervisors to meet its supervisory responsibilities.

##### Recommendations

The Commission should put in place a structured and transparent supervisory programme, adopting a consistent risk based supervisory approach across the Commission. The approach adopted should be documented and aligned to the overall strategy, business plan, budget and objectives of the Commission to demonstrate how these are met. This should provide a comprehensive set of documented procedures. A risk based supervisory approach will facilitate the deployment of resources to higher risk areas and more effectively focus the supervisory effort.

The supervisory programme should include appropriate protocols and operating standards applicable to all divisions to ensure consistent and timely communication with licensees and the timely completion of reviews and on-site visits. Communication and consultation should be encouraged throughout the Commission through the setting of performance standard expectations in the Commission's business plans.

Staff should be trained and coached in any new supervisory approach in advance of implementation to ensure that a consistent and common understanding is gained and the programme is adopted as intended. In addition, their adherence to the supervisory approach should be monitored as part of their overall annual appraisal.

Timely and regular management information should be created to facilitate good operational governance and increase the accountability of staff (see Section 3.5 for greater detail). This will demonstrate adherence to standards and protocols set.

The Commission should continue to progress towards the consolidation of its regulatory laws to facilitate the development of a common regulatory handbook.

The Commission should consider the use of a lead supervisor wherever possible, creating a single key point of contact for multiple licence holders and a co-ordinated and consolidated visit programme.

### **Benefits**

- ▶ The Commission is able to demonstrate a consistent supervisory approach to all licensees, independent assessors and any legal challenges.
- ▶ Identification of risks on a timely manner across the divisions and focussed supervisory approach to address the risks.
- ▶ The increased focus on risks and use of management information would enable greater mobilisation and efficient allocation of resources.
- ▶ Greater understanding and a transparent supervisory approach will encourage licensees to engage in more open dialogue with the Commission.

## **3.2 Creation of unified and centralised regulatory process is recommended**

### **Core principles**

- ▶ The Commission's organisational structure should be appropriate to ensure it can meet its duties in an efficient and effective manner.
- ▶ The Commission utilises its staff to ensure the optimum use of their skill set.
- ▶ The skill set of resources are aligned to the task required.

### **Recommendations**

Efficiencies could be gained from creating centralised functions to perform common processes. Potential efficiencies would include:

- ▶ Focussed time spent by staff rather than managing a number of different responsibilities.
- ▶ Consistent approaches adopted across common processes where regulatory laws allow.
- ▶ Focussed knowledge within centralised functions.
- ▶ Tasks carried out quicker more efficiently and smarter due to process focus (e.g., improved response time to licensee).
- ▶ Allowing supervisory staff to focus on supervisory issues.
- ▶ Use of centralised data will save staff time and effort.
- ▶ Co-ordinated processes across divisions.

- ▶ Remove time spent in multiple reviews of common documentation received.
- ▶ More effective enforcement action.

We therefore recommend a standardised approach should be implemented for the common processes in the following functions; authorisation, anti-money laundering on-site visits and data management. This would require the reallocation of staff within the Commission, identifying those with the required skill set to be part of the new functions.

The proposed units will require a head of unit to manage their activities but this may be someone with shared responsibilities across functions. In addition there needs to be significant interaction with the supervisory divisions, as regulatory decisions would still remain their responsibility for respective licensees.

**a. Authorisation unit**

We would expect the following activities could be conducted by a centralised authorisation unit:

- ▶ Notify supervisory division of authorisation application or PQ.
- ▶ Receipt of application.
- ▶ Acknowledgement of receipt.
- ▶ Completion of initial checks on completeness of data and data verification.
- ▶ Organisation of applicable initial meetings.
- ▶ Collate information for authorisation process.
- ▶ Co-ordinate multi licence applications.
- ▶ Involve supervisors as appropriate to enable detailed review.
- ▶ Perform due diligence checks on key persons.
- ▶ Chase information requirements from potential licensee or approved person.
- ▶ Provide supervisory division and authorisation committee (where applicable) with information for approval.
- ▶ Overall oversight of the authorisation process (monitoring and controlling progress).

This would require close contact and co-operation between the authorisation unit and the relevant supervisory divisions. The success of the process is dependent upon the continual involvement of specialists from supervision, to apply their judgement and knowledge to the process when applicable.

A separate authorisations unit is utilised at both the IOM FSC and Financial Services Authority ('the FSA').

**Benefits**

- ▶ Improve overall management and oversight over the process.
- ▶ Enable supervision to focus on ongoing monitoring and supervisory issues by providing specialist input on specific matters.

- ▶ Benefits from economics of scale through applying single processes particularly in areas of receipt and initial processing of applications, coordinating review process, undertaking common processes such as due diligence on controllers, Directors, Managers, etc.
- ▶ Improved consistency of response to licensee.
- ▶ Facilitate application of robust formal policies and procedures tailored to the needs of the Commission.
- ▶ Flexibility to cover fluctuations in work volumes between divisions.
- ▶ Encourage staff development across functions and between authorisation unit and supervision divisions.
- ▶ Work to standardised protocols for authorisations.

**b. Anti-money laundering unit**

We would expect the following activities to be conducted by an AML unit:

- ▶ Conduct AML focussed visits in accordance with risk based assessment.
- ▶ Work in conjunction with supervisory teams to communicate any issues arising and share knowledge.
- ▶ Conduct monitoring of prescribed businesses.
- ▶ Conduct joint on-site visits where appropriate with supervisory teams.
- ▶ Provide expertise in relation to AML/CFT Laws and regulations.
- ▶ Reduce number of AML visits conducted for multi-licensees.

This would require close contact and co-operation between the AML unit and the relevant supervisory divisions and the success of the process is dependent upon the supervision divisions' application of the knowledge gained through relevant AML on site visits.

***Benefits***

- ▶ Demonstrate the Commission's key focus on AML to help maintain the Bailiwick's reputation.
- ▶ Specialist focus on specific AML Laws and related Handbook.
- ▶ Focus resources on specific regulatory matters.
- ▶ Optimisation of expert skills.
- ▶ Co-ordinate AML visits for multi licensees.
- ▶ Ensure consistent approach across all licensees.

**c. Enforcement function**

We would expect the following activities to be conducted by an enforcement function:

- ▶ Provide central point of contact and support for all enforcement action.
- ▶ Provide challenge to proposed enforcement action.
- ▶ Ensure consistency of enforcement action across divisions.

- ▶ Collate data to monitor the nature and level of enforcement action.
- ▶ Liaise with the FIU, the States of Guernsey Police, HM Procureur, external legal advisers and external forensic accountants as required.
- ▶ Ensure evidential standards are sufficient to support proposed enforcement action.
- ▶ Liaise with the Enforcement Committee, as required.
- ▶ Responsibility for taking cases forward where enforcement action cannot be delivered by the division.

There does not currently appear to be a case to support the creation of a fully staffed enforcement function as exists at the FSA, IOM FSC and JFSC. The current level of enforcement action conducted at the Commission is low and resources would be underutilised at this point in time. However the Commission should reconsider the creation of a fully staffed enforcement function, should the level of enforcement action increase.

Any new enforcement process requires embedding within the Commission processes and procedures and an enforcement function would ensure cases are dealt with appropriately and individuals are given the required guidance to deliver a case. The unit should be staffed as and when required by appropriately skilled individuals from within the supervisory divisions reporting to a head of enforcement.

Consideration should be given to the clarity of the relationship with the Law Enforcement agencies (including HM Procureur). We note that Jersey has recently signed a Memorandum of Understanding between the JFSC and States of Jersey Police, to provide structure and clarity to their relationship. Greater liaison with the Law enforcement agencies would contribute to the delivery of a co-ordinated approach to the seven strategic imperatives of the Financial Crime Strategy, of which the Commission is a key stakeholder.

Effective enforcement action requires appropriately skilled staff. Mutual secondments to the FIU or enforcement function of IOM FSC or JFSC would be a cost effective way to assist in the up-skilling of staff in this area.

### **Benefits**

- ▶ Ensuring all areas of the Commission apply sound processes that will support enforcement actions for example retention of records, quality of documentation, evidential standards.
- ▶ Provide a consistent approach across divisions.
- ▶ Provide comparative information.
- ▶ Apply consistent policies and processes.
- ▶ Provide clear guidance on what constitutes enforcement and rules of consultation.
- ▶ Cases better able to withstand challenge and appeal.
- ▶ Data to monitor level and nature of enforcement.
- ▶ Access to experienced resource.

### **d. Data management unit**

We would expect the following activities to be conducted by a data management unit:

- ▶ Receive statutory report and accounts, audit management letters, regulatory returns.

- ▶ Monitor and chase receipt of report and accounts, management letters, returns.
- ▶ Verify information received.
- ▶ Initial identification of key issues to be investigated by the supervisory divisions.
- ▶ Consistently store information so accessible for supervisory teams.
- ▶ Enter information received into Customer Relationship Management (CRM) system
- ▶ Inform supervisor of information relating to licensee.
- ▶ Production of summary reports on licensee.
- ▶ Provide and manage central data for supervisory divisions, for example contact details of licensees.
- ▶ Send routine or general communications to licensees.

This would require close contact and co-operation between the data management unit and the relevant supervisory divisions and the success of the process is dependent upon the supervision divisions application of the knowledge gained through relevant data management.

#### **Benefits**

- ▶ Improve overall management and oversight over the process.
- ▶ Enable supervision to focus on ongoing monitoring and supervisory issues.
- ▶ Work to standardised protocols for data processing.
- ▶ Reduce backlogs within supervisory division.
- ▶ Reduce multiple data requests or receipts from licensees.
- ▶ Facilitate the coordinated central storage of information, reducing time spent requesting and finding data by supervisors.
- ▶ Provide timely and appropriate communication to regulated and registered entities.

### **3.3 Organisation structure could be streamlined**

#### **Core principles**

- ▶ The Commission has the appropriate staff, both in quantity and skills, as well as organisational policies and processes to carry out its activities.
- ▶ Staff development and responsibilities should be co-ordinated and aligned to the strategy of the Commission.

#### **Recommendations**

The organisational structure should be challenged to enable the implementation of the recommendations in section 3.2 regarding focussed regulatory operations divisions and the need for increased operational oversight.

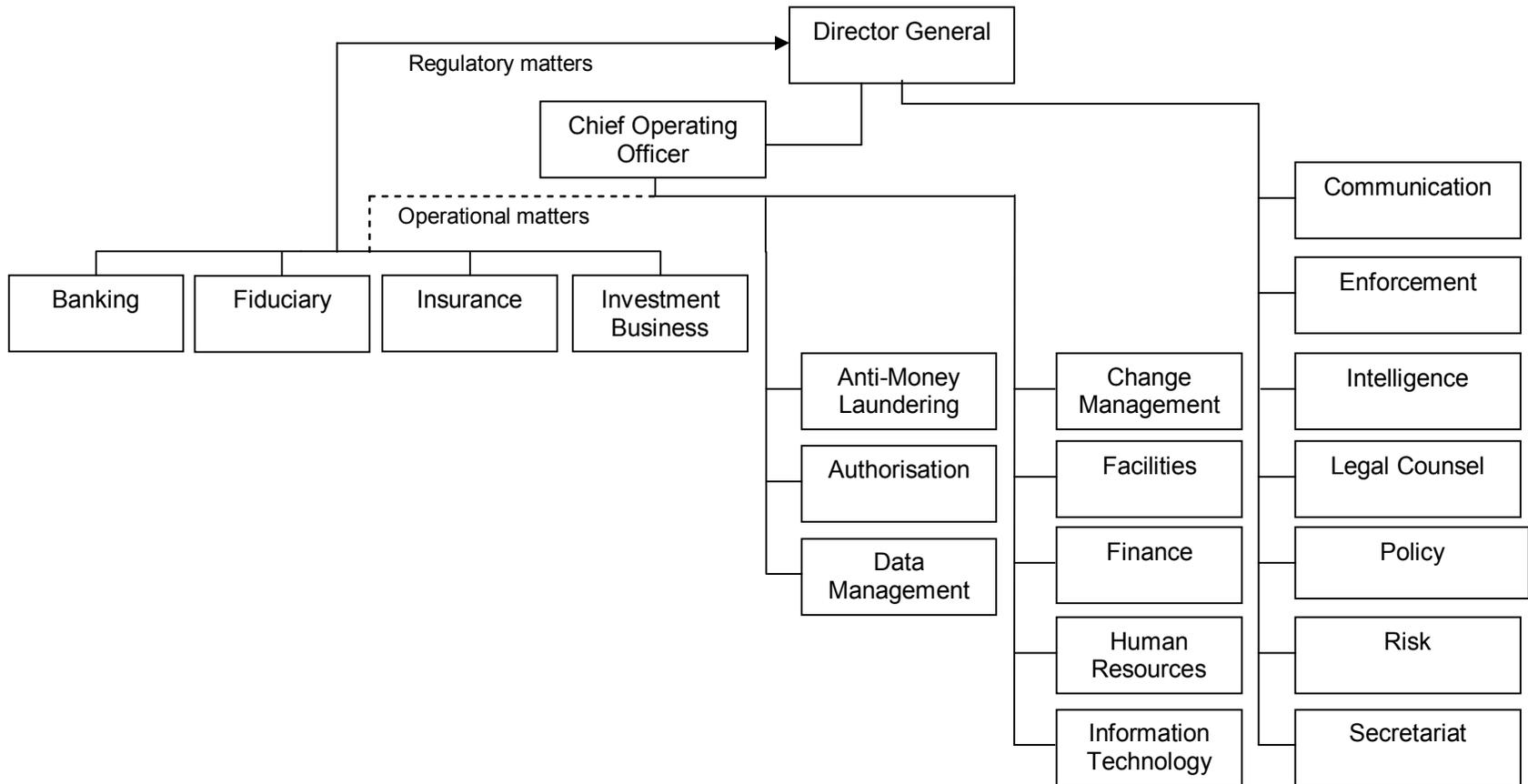
We have outlined below a proposed functional organisational chart to demonstrate the functions we are recommending.

The recommendations in relation to the centralised functions have been detailed in Section 3.2. We have also detailed the expected activities of the new functions below.

Efficiencies could be gained from the implementation of these functions due to the:

- ▶ Focussing of resources.
- ▶ Improved oversight encouraging improved performance and delivery.
- ▶ Cost and time efficiencies in project delivery.
- ▶ Effective management of risk enabling focussing of resources.

Proposed functional matrix



**a. Chief Operating Officer**

We would expect the following activities to be conducted by a Chief Operating Officer;

- ▶ Managing the application of limited resources to the most productive uses, with particular focus on high risk areas.
- ▶ Ensuring alignment of strategy, divisional business plans, staff objectives and budgets.
- ▶ Developing and cascading the Commission's strategy to the staff, and implementing appropriate rewards and recognition policies.
- ▶ Coaching staff and delivering disciplinary measures to ensure that personnel activities and behaviours are aligned with the strategy and objectives.
- ▶ Maintaining and monitoring staffing levels, knowledge, skills, expectations and motivation to fulfil Commission requirements.
- ▶ Driving performance measures for the Commission (including a consideration of efficiency versus effectiveness), in the form of review of high level performance indicators.
- ▶ Ensuring that all processes are conducted and any issues are dealt with or escalated to the Director General or Commissioners.

***Benefits***

- ▶ Enhanced operational oversight
- ▶ Improved and consistent communication
- ▶ Improved resource utilisation
- ▶ Improved efficiency and cost control

**b. Change management function**

We would expect the following activities to be conducted within a change management function;

- ▶ Responsibility for the definition and management of the process standards, generally related to project management.
- ▶ Introduce and monitor the standardised processes in the execution of projects.
- ▶ Provide the source of documentation, guidance and metrics on the practice of project management and execution.
- ▶ Collate best practices in process and project management.
- ▶ Monitor project deliverables, timetable and overall project progress.

***Benefits***

- ▶ Improve overall management and oversight over processes.
- ▶ Enable supervision to focus on ongoing monitoring and supervisory issues.
- ▶ Work to standardised processes for project management and delivery of change.

- ▶ Reduce time spent on change management by supervisory staff.
- ▶ Encourage accountability.
- ▶ Provide defined functions to conduct oversight and change management.

**c. Risk function**

We would expect the following activities to be conducted within the risk function;

- ▶ Identification, assessment, and prioritisation of risks to the Commission.
- ▶ Characterise and assess identified risks.
- ▶ Assess the vulnerability of the Commission to identified risks.
- ▶ Determine the nature of each identified risk (i.e., the expected consequences facing the Commission).
- ▶ Determine ways to reduce identified risks.
- ▶ Maintain a 'watch list' of the greatest risks faced by the Commission and monitor and report to management.
- ▶ Prioritise risk reduction measures based on an agreed strategy.

**Benefits**

- ▶ Early identification of risks.
- ▶ Improved and focussed risk management.
- ▶ Effective risk mitigation and monitoring.
- ▶ Improved corporate governance.

### **3.4 Operational platform should be more efficient**

**Core principles**

- ▶ The Commission has the appropriate information technology and data management support to carry out its activities.
- ▶ The Commission has adequate management information and key performance indicators to manage the operational performance of the Commission.
- ▶ The Commission actively and efficiently manages its costs to deliver value for money to their stakeholders.

**Recommendations**

Costs and efficiency can be improved by aligning the Commission's activities to its objectives and strategy and by assessing and analysing the operational performance across the Commission. This will lead to redeployment of resources and identification of inappropriate resource levels. It is not possible to quantify the potential cost savings or efficiency savings due to the lack of current available data.

The Commission should align its strategy, business plans and budgets to ensure focussed and efficient use of Commission resources to meet its objectives. This should include the Information Technology Division, where it is key that their strategy and plans are aligned to the overall objectives of the Commission and other divisions.

The business needs to understand the role and focus of the current information technology resource to ensure that the skills are effectively utilised and greater value for money of the Commission resources is achieved. Tasks and projects need to be prioritised based on their importance to the Commission not the individual who requests the action.

The electronic submission of data should be prioritised to increase the operational effectiveness of the Commission. Consideration needs to be given to the available resources, skills and time constraints of delivering a project of this nature and size from within the Commission. The Commission should expedite its extranet project to remove the level of manual processing currently being conducted. In addition, licensees should be encouraged to submit data in electronic form wherever possible and provide their own analysis of significant data movements to facilitate the Commission review. For example, justification of any movement in data over 10% from the previous return submitted.

Licensees could provide additional statements of compliance with Codes, Rules, Legislation or Instructions as part of the supervisory process. This increases a licensee's monitoring and awareness to enable them to make the relevant statement and potentially flag issues earlier to the Commission. In addition, auditors who are already conducting their own processes and procedures at the licensees could be further engaged to ensure that information they may have is utilised. This can take the form of independent reports or tripartite meetings with licensees and auditors. There are significant cost implications for licensees from the increased use of auditors and this would need to be considered as part of a regulatory impact analysis.

To enhance the accountability and responsibility of staff and monitor the efficiency and effectiveness of the Commission, key performance indicators need to be embedded within the operational processes. These should include but not be limited to:

- ▶ Response times
- ▶ Volume of notifications including changes in directors and senior managers.
- ▶ Themes and volumes of complaints.
- ▶ Number of on-site supervisory visits planned for the year.
- ▶ Progress against planned on-site programme.
- ▶ Time spent to complete on-site visits including finalisation of reports.
- ▶ Timeline for review of returns, and report and accounts.
- ▶ Progress against that timeline.
- ▶ Summary of key findings including frequency of common findings from desk based monitoring and on-site visits.
- ▶ Common themes and volume of enforcement action during the period.
- ▶ Volumes of outstanding returns and statutory report and accounts.
- ▶ Level of overtime being conducted within a division.
- ▶ Level of sick leave within a division.

The management information provided by the key performance indicators requires review and challenge by a senior member of the Commission. Under the proposed structure in Section 3.3, this would be the responsibility of the Chief Operating Officer. The publication of key trends and key performance indicators (along with expected performance) will improve the transparency of the Commission's activities.

Continual challenge needs to be raised against costs. Where proposals are made to exceed budgets set, these should be justified, robustly challenged and pre-approved by a senior member of the Commission. Consideration should always be given to working with other regulators to share the cost of assessing new regulations, drafting rules, staff training and system changes.

All international travel should be approved and part of the approval process should be to ensure that the activity is in line with the overall regulatory strategy. On return, staff should be required to disseminate the knowledge gained through presentations, memoranda or reports.

### **Benefits**

- ▶ The Commission has a cohesive strategy and budget linked to its objectives.
- ▶ Staff are accountable and responsible for delivering their operational and regulatory responsibilities.
- ▶ Information technology is effectively used and delivered efficiently.
- ▶ The Commission utilises up to date technology to deliver an efficient service to licensees.
- ▶ Greater cost control and management of budgets.

## **3.5 Management processes require strengthening**

### **Core principles**

- ▶ A clear Governance & Committee structure exists to ensure that there is sound and effective corporate governance of the Commission.
- ▶ Senior management oversight and governance is in place for all aspects of operations within the Commission.
- ▶ Policy and information is disseminated in a timely, clear and consistent manner at all levels of the Commission.
- ▶ Management receive effective, regular and reliable management information to fulfil their oversight and governance responsibilities.
- ▶ A committee structure is in place to provide a formal and transparent management process.
- ▶ All committees are managed such that all senior managers are kept properly informed, are able to provide oversight and can fulfil their duties and obligations.
- ▶ A committee structure demonstrates that the senior managers have enough input into, and are able to challenge, decisions at a local level.

### **Recommendations**

To strengthen and enhance the current management processes, a number of changes would be required, including:

- ▶ Addressing the corporate governance structure.
- ▶ Formal change management process.
- ▶ Implemented Human Resources strategy.
- ▶ Effective training.

The Commission should implement a corporate governance structure this should involve applying the following principles:

- ▶ Effective group who are responsible for governance.
- ▶ Collective responsibility for directing and supervising the affairs of the Commission.
- ▶ Good standards of business conduct, integrity and ethical behaviour and operating with due care and diligence and at all times act honestly and openly.
- ▶ Formal and transparent arrangements in place for presenting a balanced and understandable assessment of the Commission's position and prospects and for considering how they apply financial reporting and internal control principles.
- ▶ Suitable oversight of risk management and maintain a sound system of risk measurement and control.
- ▶ Timely and balanced disclosure to stakeholders of all material matters concerning the Commission.
- ▶ Remuneration arrangements are structured fairly and responsibly and remuneration policies are consistent with effective risk management.
- ▶ Satisfactory communication with stakeholders based on a mutual understanding of needs, objectives and concerns.

The role of Commissioners and senior management in a corporate governance framework will depend upon the future constitution of the Commission and respective responsibilities.

Successful corporate governance requires an effective committee structure. The Commission needs to put in place a clear, formal and documented committee structure. The remit, membership and accountability of the committees should be clearly identified. Key committees should include:

- ▶ **Executive Management Committee:** A senior-level management committee empowered to make and implement major organisational decisions. To act as an overseer of organisational activities and have the authority to request justification of certain matters, as well as to plan activities. To report on the performance and progress being made by the Commission and to provide a forum for discussion about key strategic issues facing the Commission.
- ▶ **Regulatory and Risk Committee:** To ensure that the Commission is equipped to tackle new legislation and emerging risks. To review and ensure that appropriate supervisory systems and controls are in place for all new regulations and products. A forum for senior management to discuss regulatory issues across divisions and share common regulatory themes identified by each division.
- ▶ **Enforcement Committee:** To provide the Director General and senior management with an integrated view of supervisory or enforcement risks and developments. To provide a forum for decisions as to the effective management and delivery of enforcement action.

A committee or regular meeting should not be set up without the approval of the Director General or Chief Operating Officer, if appointed. A full list of all internal and external Committees and regular meetings, their attendees, objectives, frequency and their terms of reference, should be maintained and regularly reviewed to ensure ongoing consistency with the Commission's objectives and current needs. This will also assist in understanding the level of time spent by Commission staff in meetings and committees.

The Commission should put in place formal communication processes and channels to disseminate information in a clear and consistent manner at all levels of the organisation, for example tailored town halls, circulars and email notices.

The Commission should put in place a change management process that clearly defines the levels of project management and prioritisation required. This should include senior management oversight and governance for all aspects of change within the Commission. An assessment of the impact of new policies and procedures should be performed, not just for internal impact but also to understand the effect on the relevant stakeholders. In addition, a coordinated programme function should be established to ensure that all change is integrated to the strategy and plans of the Commission and delivered within budget. A Change Management Department is recommended as demonstrated in Section 3.3. Responsibility to run this department should be with an appropriately trained senior member of staff. Projects should be under the control of the project management office to ensure they are effectively run and delivered. No project should be commenced, even within a division, without the approval of the Director General or Chief Operating Officer, if appointed.

To implement an effective Human Resources policy, in addition to the need for overall buy-in from the staff, each staff member must have:

- ▶ Competencies relevant to their role.
- ▶ Objectives linked to the business plan.
- ▶ Objectives that are specific, measurable, achievable, realistic and timely.
- ▶ Regular monitoring of their performance against their objectives.
- ▶ Open, honest feedback from their managers and direct reports.

Greater consideration needs to be given to succession planning at all levels of resources, including Commissioners. A formal policy and procedure needs to be implemented to address succession planning. Candidates should be identified where possible and managed through the promotion or recruitment process.

There are many skills within the Commission that could be transferred through internal training and mobilisation of staff across divisions or units. Current staff come from a variety of backgrounds and they could provide training themselves to transfer their skills, for example processes and procedures, financial accounting, system capabilities, project management and legal knowledge. This would reduce costs of bringing in external consultants to provide training. In addition, the effectiveness of training should be monitored through feedback from attendees and by assessing behavioural changes and improved knowledge via the appraisal process.

The Commission needs to ensure that staff have good industry knowledge to effectively deliver their supervisory responsibilities. This could be improved through secondments to other regulators or industry and mentoring by more experienced staff as well as formal training.

Staff should feel accountable for their actions and the overall delivery of the Commission objectives. The Commission needs to demonstrate that under performance is not acceptable and that there are consequences for those relevant individuals. It should also be clear that achievement is rewarded appropriately. Rewards can have a non-monetary value, for example additional vacation, as well as monetary rewards such as bonuses. Bonuses do not necessarily need to be of a significant value but can be used as an incentive and reward, for example vouchers for meals or hotels. Regulators in other jurisdictions do use bonus schemes to reward good performance.

***Benefits***

- ▶ Structured and effective committees.
- ▶ Informed staff through better communication.
- ▶ Performance of staff aligned to Commission objectives.
- ▶ Improved management of staff performance.
- ▶ Greater accountability and input from staff.
- ▶ Greater industry knowledge of staff.

## Appendix A Background and approach

We were engaged to conduct an independent evaluation of the way in which the Commission is structured and organised to discharge its functions, and where appropriate, to make recommendations within those areas the Commission currently regulates.

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

The current objectives of the Commission are:

- ▶ Maintaining financial stability in the regulated financial sector.
- ▶ Managing risk to the financial system and maintaining market confidence.
- ▶ Ensuring fair, efficient and transparent markets.
- ▶ Protecting financial services' customers.
- ▶ Countering financial crime and the financing of terrorism.

During our independent evaluation we undertook the following steps:

- ▶ Analysed the existing framework within which the Commission operates.
- ▶ Assessed current processes against available benchmarks.
- ▶ Reviewed the roles, responsibilities and objectives of the Commission.
- ▶ Reviewed the effectiveness and efficiency of each division in meeting the regulatory objectives of the Commission.
- ▶ Analysed the efficient and effective delivery of the Commission's functions.
- ▶ Identified areas of improvement to existing processes and procedures.
- ▶ Considered the skills and resources required by the Commission to deliver more efficient and effective financial regulation in Guernsey.
- ▶ Reviewed the regulatory structure and processes by which the Commission currently achieves its regulatory objectives.
- ▶ Reviewed the management of resources to meet those objectives.

The Review was required to analyse the current regulatory framework and produce findings and recommendations to include the following:

- ▶ A model of regulation which is effective, efficient and appropriate for Guernsey.
- ▶ Any changes in the structure, organisation and operation of the Commission which would improve its efficiency and effectiveness.
- ▶ Proposed enhancements of industry understanding of the Commission's role within the financial services sector.

Our work was carried out over the period from April to November 2011. During this period the Commission has implemented a significant amount of change in processes and procedures. Processes and procedures assessed by us may have changed during the course of our work or subsequent to our conclusions. We are therefore aware that some of our findings have already been addressed by the Commission during this time. We have included in this report all our findings from the work carried out over this period.

Our work was carried out in seven phases. The work undertaken and subsequent work products from each stage are detailed below.

### **Phase 1 – Current state analysis**

- ▶ We identified the current state detailed analysis of the structure and functions of the Commission through discussion, review of procedural documentation, walkthrough and documentation of the key process flows and workshops.
- ▶ We requested and reviewed available procedural documentation for key processes.
- ▶ We ‘walked through’ all key processes with reference to documentation provided.
- ▶ We held in excess of 40 interviews internally within the Commission, across all levels and divisions.
- ▶ In addition, all Commission staff were asked to provide their views via a suggestion box.
- ▶ The discussions held assisted in our understanding of the structure, principles and aims of the Commission and the processes conducted to deliver them.
- ▶ We held five workshops to discuss and validate our findings with the Commission project team, directors and Commissioners.
- ▶ Results for this phase included:
  - ▶ Meeting notes.
  - ▶ Observations matrix.
  - ▶ Process flow documentation.
  - ▶ Identification of key committees.
  - ▶ Initial identification of potential recommendations.

### **Phase 2 – Market and Regulatory development**

- ▶ We considered market and jurisdiction developments, changing regulatory environment, current projects in place and recent reviews conducted, e.g., IMF report.
- ▶ Discussions were held with Jersey Financial Services Commission (‘the JFSC’) and Isle of Man Financial Services Commission (‘the IOM FSC’).
- ▶ We performed cross comparison of relevant regulatory bodies including financial information, employee data, structures and regulatory focus.
- ▶ We identified key regulatory challenges both internationally and within the local market place.

- ▶ We considered the Commission's:
  - ▶ Supervisory philosophy.
  - ▶ Operating model and resources.
  - ▶ Activities of supervisors.
- ▶ Results for this phase included:
  - ▶ Identification of key regulatory challenges.
  - ▶ Development of recommendations to ensure the Commission is best placed to deal with key regulatory challenges.
  - ▶ A matrix of cross comparison of regulatory jurisdictions and summary of key findings.

### **Phase 3 – Stakeholder consultations**

- ▶ Discussions were held with stakeholders including: licensees, counterparties of licensees, other regulators, customers of licensees, Government, staff, local industry bodies, trade bodies and law enforcement agencies.
- ▶ 19 meetings were held with States members, industry bodies and the Financial Investigations Unit ('the FIU').
- ▶ All licensees and registered entities were sent a survey to capture their views, with more than 600 surveys distributed.
- ▶ Discussions and survey questions identified feedback in relation to, but not limited to:
  - ▶ Expectations.
  - ▶ Approach.
  - ▶ Communication quality and timeliness.
  - ▶ Information provided.
  - ▶ Resources, including staff competence and skills.
  - ▶ Structure.
  - ▶ Reputation.
  - ▶ Value for money considerations.
  - ▶ Commerciality.
  - ▶ Legislation.

- ▶ Results for this phase included:
  - ▶ Minutes.
  - ▶ Survey results.
  - ▶ Initial identification of potential recommendations.

#### **Phase 4 – Comparison of Regulatory processes**

- ▶ Key processes and procedures were compared with other relevant regulatory bodies, current practice and international norms.
- ▶ Relevant processes and procedures were identified from reviews of market and regulatory development and stakeholder consultations, in addition to our understanding of current practice by other regulators.
- ▶ The efficiency of key current processes was reviewed.
- ▶ The current fee structure was assessed, including the management and responsibility of costs and revenue.
- ▶ Consultations were held with JFSC and IOM FSC.
- ▶ Results for this phase included:
  - ▶ Draft findings and recommendations in relation to the assessment of:
    - ▶ The effectiveness and efficiency of each division in meeting regulatory objectives
    - ▶ 'The value for money' of functions
    - ▶ The ability of current structures and working methods to optimise value to Guernsey and its financial community
    - ▶ The manner in which staff and relevant resources are applied in meeting regulatory objectives
  - ▶ The identification of current processes and procedures that are not efficient or effective.

#### **Phase 5 – Review of resources and skills**

- ▶ We reviewed current skills and resources available to assess their adequacy to deliver the proposed revised framework and to identify relevant recruitment and training needs.
- ▶ We have identified potential re-allocation of resources and better utilisation of current skills.
- ▶ Results for this phase included:
  - ▶ Recommendations regarding current operational structure and effective utilisation of staff.

**Phase 6 – Development of findings and drafting of report:**

- ▶ Workshops have been held with the Commission project team, directors and Commissioners to validate findings.
- ▶ During these discussions we communicated our understanding of current processes and procedures and discussed the feasibility of the implementation our recommendations.
- ▶ Results for this phase include:
  - ▶ Draft recommendations for change covering, but not limited to:
    - ▶ Constitution and corporate governance.
    - ▶ Current processes and procedures.
    - ▶ Operational structure.
    - ▶ Resourcing allocation and utilisation.

**Phase 7 – Report finalisation**

- ▶ Confirmation of report format.
- ▶ We held a final discussion of the draft findings and recommendations with the Commission project team, directors and Commissioners.
- ▶ We finalised the drafting of the Report.
- ▶ We agreed and discussed the communication of our findings and recommendations to industry and States of Guernsey.

## Appendix B Survey results

### Background

All entities registered with (including non-regulated Financial Services Businesses), or regulated by the Commission were invited to participate in our industry survey. In total 600 surveys were distributed and we received 160 fully completed surveys. The survey formed part of Ernst & Young's Independent Evaluation Review of the structure and organisation of the Commission.

The survey consisted of 26 questions and participants were requested to provide quantitative and qualitative responses. The survey was sent to participants on 12 August 2011 and they were requested to respond by 23 September 2011.

All contact details were provided to Ernst & Young by the Commission. All individual responses to the survey were only be seen by Ernst & Young and remain entirely confidential. This Appendix summarises the overall results of the survey and themes identified.

### Objectives of the Commission

The majority of respondents felt that the Commission was quite effective or very effective at meeting all five of its objectives. 86% rated the Commission as very effective or quite effective at achieving the objective of countering financial crime and the financing of terrorism.

However respondents felt that there should be an additional objective, that regulation should be effective, efficient and proportionate and not an inhibitor to business.

Respondents considered supervision and regulation of the industry the Commission's most important activity but that on-site examinations were the least important.

Many respondents felt that the approach and effectiveness of these activities varied from division to division, noting a silo mentality and a lack of interaction between divisions. A large number of respondents suggested a single relationship manager for multiple licence holders would be extremely beneficial.

There is a sense that the Commission has become increasingly aggressive in its activities over the last couple of years, with on-site visits becoming more confrontational. Respondents commented that the Commission appeared to have lost its pragmatic approach and that communication was no longer open and easy.

It was also felt that on-site visits had become a box ticking exercise, with too much focus on irrelevant details and a lack of risk based thinking. Respondents commented that the Commission seemed to want to punish minor shortcomings as opposed to work with businesses to enhance compliance or suggest improvements.

Respondents noted that enforcement activities, in particular, lacked transparency.

### Communication and information

Regulations were considered the most useful form of information provided by the Commission, Annual Reports the least.

Face-to-face was considered the most effective communication method used by the Commission, publications the least. Respondents commented that emails were a more efficient method of communication than blanket letters, but that the Commission should ensure they are sent to the most relevant contacts.

Whilst the majority of respondents found the content and relevance of information on the Commission website, and the ease of finding that information, to be good or very good, some concerns were expressed with regard to downloading documents and a lack of an alert facility to highlight new document postings.

58% of respondents found the October 2010 GFSC Annual Industry Seminars very useful or quite useful.

### ***Interaction with the Commission***

83% of respondents found it fairly easy or quite easy to contact the relevant person at the Commission.

A lack of consistency between divisions was noted in efforts to engage with Industry and with individual businesses. There were further calls for a single relationship manager to enhance engagement and interaction with businesses.

With regard to Consultations, it was felt that the Commission should engage with Industry earlier in the process. There was an impression that the Commission's initial view would tend to prevail, regardless of Industry input, which discouraged some from participating in the Consultations. 27% of respondents felt that the Commission rarely or never listened to the views of the Industry.

Respondents felt that more informal communication should be encouraged to build mutual trust, respect and understanding.

75% of respondents rated the professionalism of the Commission staff as excellent or good. However 18% rated the speed of response by the Commission as very poor or poor.

### ***General comments***

73% of respondents rated their experience of dealing with the Commission as excellent or good, with 70% very confident or fairly confident that the Commission is effectively regulating the Financial Services industry in the Bailiwick.

A single relationship manager was seen as the most likely way to improve communication and interaction with the Commission. It was also felt that reverting to more regular, informal communications and early discussions on matters would be a great benefit.

Respondents commented that interaction had become increasingly negative and unpredictable over time, resulting in Industry having reservations about interacting with the Commission.

The silo nature of the divisions was seen as a key reason for the high costs of compliance locally, with a lack of information sharing and coordination resulting in increased time and money burdens.

Concerns were expressed that the Commission was moving towards 'gold-plated' regulation which was more stringent than competitor jurisdictions. A number of respondents commented that they felt they were losing business due to regulatory arbitrage.

Respondents highlighted a lack of governance and accountability at the Commission, feeling there was no place to go if the Executive got things wrong. Some were concerned that there was too much power in the hands of individual directors when it came to sanctions or censures, suggesting a peer review as a minimum check.

Respondents noted that enforcement activities, in particular, lacked visibility.

### **Key statistics**

- ▶ 73% rated their experience of dealing with the Commission was excellent or good.
- ▶ 70% were very confident or fairly confident that the Commission is effectively regulating the financial services sector.
- ▶ 86% rated the Commission as very effective or quite effective at achieving the objective of 'countering financial crime and the financing of terrorism'.
- ▶ 27% felt that the Commission rarely or never listened to the views of the Industry.
- ▶ 83% found it quite easy or fairly easy to contact the relevant person at the Commission.
- ▶ 75% rated the professionalism of the Commission staff as excellent or good.
- ▶ 18% rated the Commissions speed of response as very poor or poor.
- ▶ 58% found the October 2010 GFSC Annual Industry Seminars very useful or quite useful.

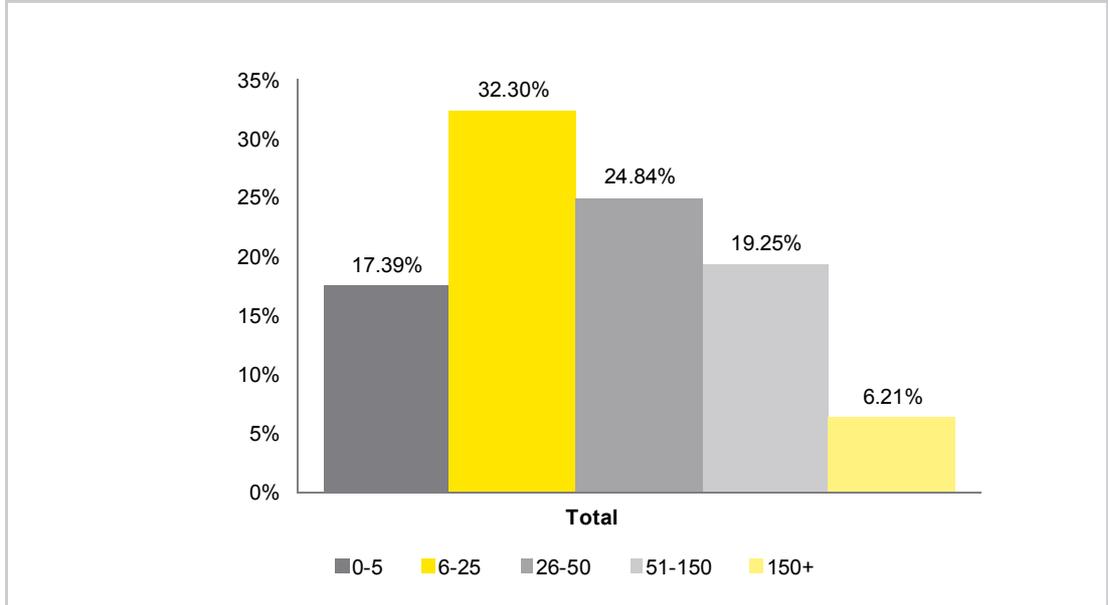
### **Comments – key themes**

- ▶ The Commissions should ensure regulation is effective, efficient, proportionate and not an inhibitor to business.
- ▶ Silo mentality between divisions, which is leading to inefficient regulatory relationships – *'It's like having four different regulators'*.
- ▶ Introduction of single relationship managers would save the Commission and businesses time and money.
- ▶ Lack of governance and accountability at the Commission.
- ▶ The Commission seems to be moving towards 'gold-plated' regulation and the Island is losing business because of it.
- ▶ Consultations come too late in the process and Industry views are often ignored.
- ▶ Communication with the Commission is increasingly aggressive and less open.
- ▶ Informal communication should be encouraged to build mutual trust, respect and understanding.
- ▶ Pragmatism of the past has been lost.
- ▶ The focus appears to be on punishing minor shortcomings but not working with businesses to improve compliance.
- ▶ Enforcement activity lacks transparency.
- ▶ There is an inconsistent staff experience across divisions.
- ▶ On-site visits are becoming a box ticking exercise and lack risk-based thinking.
- ▶ There are concerns over the high costs of the Commission pension scheme and premises.

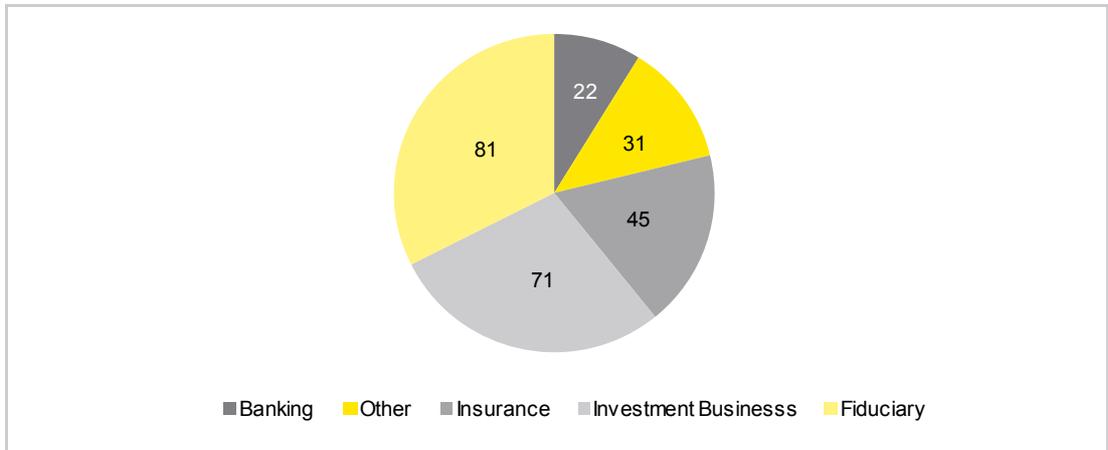
## Detailed survey results

### Your organisation

How many staff does your organisation employ in Guernsey?



Which sector does your organisation operate in (please tick all that apply)?



### The objectives of the Commission

How effective do you think the Commission is at meeting its objectives?

	Very effective	Quite effective	Not very effective	Not at all effective	Don't know
Maintaining financial stability in the regulated finance sector	15	63	11	4	7
Managing risk to the financial system and maintaining market confidence	12	57	20	4	7
Ensuring fair, efficient and transparent markets	7	54	18	5	16
Protecting financial services' customers	10	56	23	5	6
Countering financial crime and the financing of terrorism	30	56	7	1	6

### Do you have any other comments with regard to the Commission's objectives?

A number of respondents felt that the Commission should also have an objective to ensure that Guernsey remains competitive and to act in the best interests of local Financial Services industry. It was felt the objectives should recognise that regulation should be effective, efficient and proportionate and not an inhibitor to business. One respondent highlighted the JFSC's Key Purpose statement, which includes "... *protecting and enhancing the reputation and integrity of Jersey in commercial and financial matters [and] safeguarding the best economic interests of Jersey ...*"

Respondents noted that some of the objectives were impacted by external factors and there might be little the Commission could do to influence them. In particular it was felt that the objective to maintain financial stability was more global and the responsibility of politicians and not the Commission.

### From the following list of activities currently undertaken by the Commission, please could you rate how important you feel each activity is for the Commission in achieving its objectives?

	Very important	Quite important	Not very important	Not at all important	Don't know
Authorisation of new business	73	22	3	1	1
Supervision and regulation of the Industry	75	23	2	0	0
Provision of codes of practice, guidance notes and policy for the Industry	57	34	9	0	0
Enforcement	50	45	4	0	1
On-site examinations	34	52	12	1	1
Provision of information and guidance	58	37	5	0	0
Representation to international regulatory organisations	45	45	7	3	0
Liaison with the States of Guernsey	48	41	8	2	1
Liaison with regulators in other jurisdictions	42	45	11	1	1
Taking action against unauthorised business	79	19	1	0	1

### Do you have any other comments with regard to the Commission's activities?

Many respondents felt that the approach and effectiveness of these activities varied from division to division. They noted a lack of interaction between divisions, resulting in an inconsistent approach to the activities across the Commission. In particular respondents who held a number of licences expressed frustration at dealing with different divisions on the same issues, feeling the lack of information sharing at the Commission was unnecessarily costing their business time and money. A large number of respondents suggested a single relationship manager would be extremely beneficial.

There is a sense from respondents that the Commission has become increasingly aggressive over the last couple of years, with on-site visits becoming more confrontational. Respondents commented that the Commission had lost its pragmatic approach and that communication was no longer open and easy. In particular frustration was expressed at an apparent lack of willingness by the Commission to help businesses interpret rules and guidance or deal with queries and clarifications.

It was felt that on-site visits had become a box ticking exercise, with too much focus on irrelevant details and a lack of risk based thinking. Respondents commented that the Commission seemed to want to punish minor shortcomings as opposed to work with businesses to enhance compliance or suggest improvements.

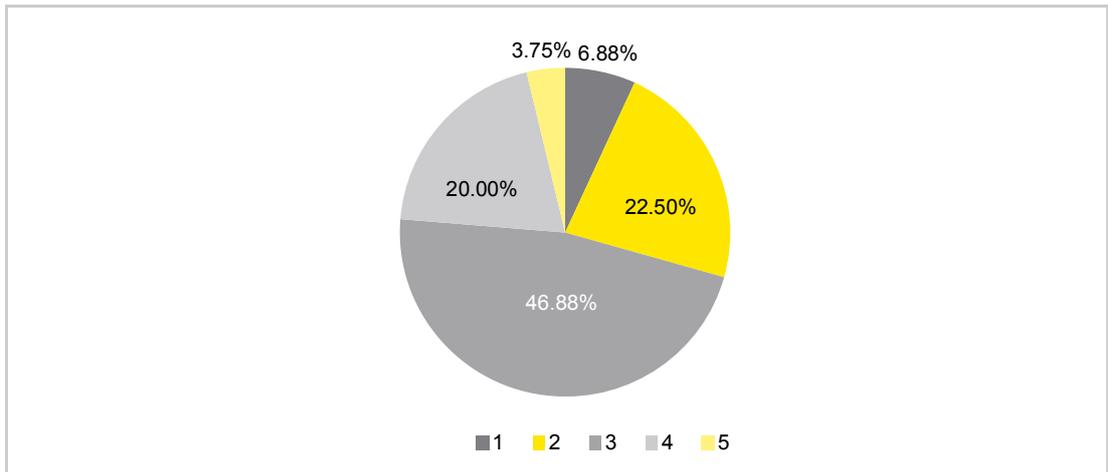
Respondents felt that enforcement activities, in particular, lacked visibility. They referred to rumours of action but little communication of results. One respondent noted that they were unsure whether the lack of publicity meant that enforcement was effective or that there was just no activity.

A number of respondents commented on consultation with industry, that timescales were often inadequate and that they felt the process lacked two-way dialogue and was more a case of the Commission telling industry and not engaging with it.

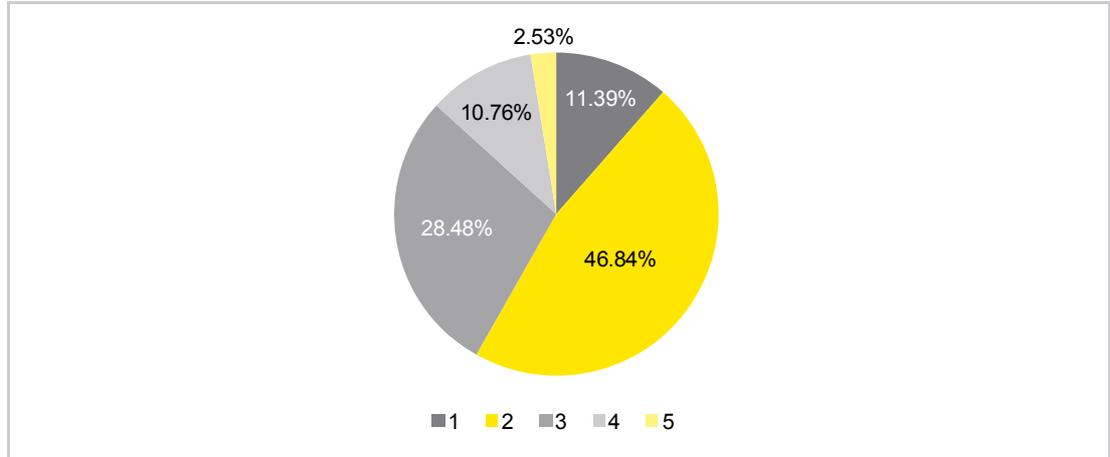
**How effectively to you feel the Commission performs these activities?**

	Very effective	Quite effective	Not very effective	Not at all effective	Don't know
Authorisation of new business	20	52	15	1	12
Supervision and regulation of the Industry	17	64	15	2	2
Provision of codes of practice, guidance notes and policy for the Industry	14	52	27	6	1
Enforcement	11	51	20	5	13
On-site examinations	11	49	28	4	8
Provision of information and guidance	8	55	27	9	1
Representation to international regulatory organisations	14	43	10	2	31
Liaison with the States of Guernsey	7	34	24	3	32
Liaison with regulators in other jurisdictions	9	45	10	2	34
Taking action against unauthorised business	14	41	15	4	26

**Overall, to what extent do you think that the Commission's activities benefit or hinder your organisation? (1 = Greatly benefit down to 5 = Greatly hinder)**



**Overall, to what extent do you think that the Commission's activities are of benefit to the Bailiwick? (1 = Greatly benefit down to 5 = Greatly hinder)**



### Communication and Information

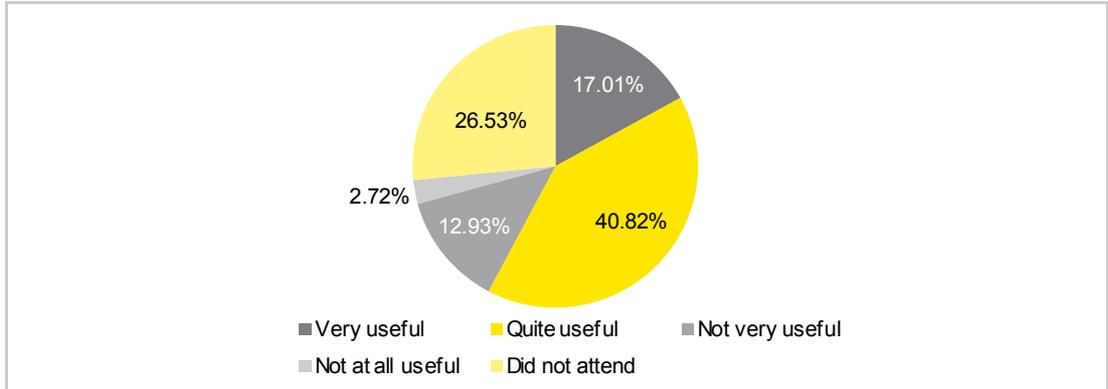
**For the following information provided by the Commission**

	Very useful	Quite useful	Not very useful	Not at all useful	Don't know
Regulations	43	49	7	0	1
Instructions	32	50	16	2	0
Rules	38	53	7	2	0
Codes	34	50	14	1	1
Guidance	30	49	19	2	0
Consultation papers	24	52	18	4	2
Warnings, prohibitions and public statements	31	48	18	2	1
Annual Reports	9	40	35	15	1

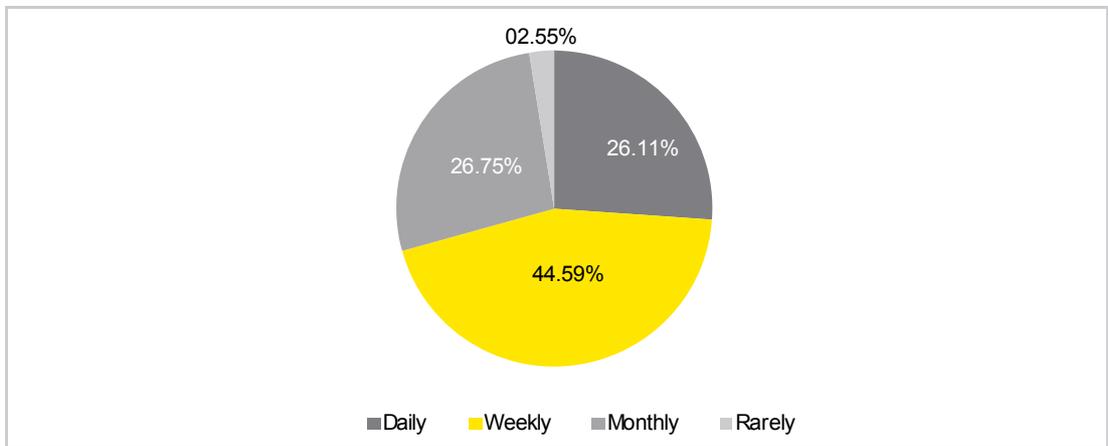
**For the following communication methods used by the Commission, please can you indicate how effective you find that method?**

	Very effective	Quite effective	Not very effective	Not at all effective	Don't know
Commission website	25	59	12	4	0
Email	35	45	10	5	5
Letter	21	53	19	6	1
Publications	8	48	28	6	10
Telephone	25	39	19	5	12
Face-to-face	44	32	12	3	9
Workshops	17	45	13	5	20
Industry seminars and presentations	21	48	21	4	6

**If you attended the October 2010 GFSC Annual Industry Seminars, how useful did you find them?**



**How regularly do you visit the Commission's website?**



**Please can you rate the Commission's website in the following categories?**

	Excellent	Good	Average	Poor	Very poor	I do not use the website
The ease of finding the information you need	6	47	34	7	5	1
The content of the website	6	62	29	2	0	1
The relevance of the information	12	61	24	2	0	1

**Do you have any comments with regard to information provided, and communication methods used, by the Commission?**

The Commission website was felt to be cumbersome and difficult to navigate, with a number of respondents experiencing problems downloading documents. Respondents noted that announcements were not always in the news section and it was felt that an alert mechanism when new documents are posted on the website would be very useful.

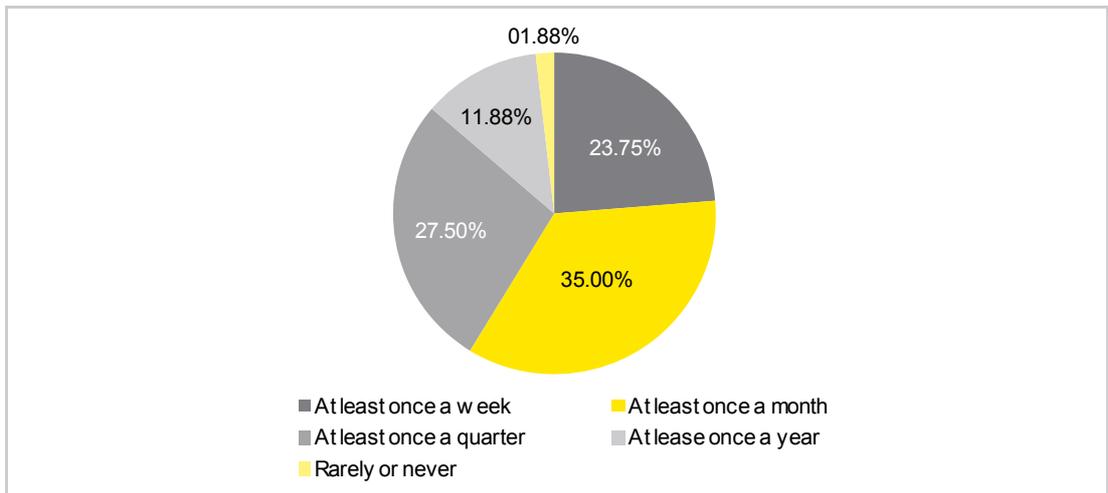
Respondents noted that communications were often sent to a number of individuals in an organisation (particularly for businesses holding multiple licences) but they were not clear who they were sent to and why.

Many felt that general, blanket letters were not useful or cost effective and would prefer email correspondence and updates on the website.

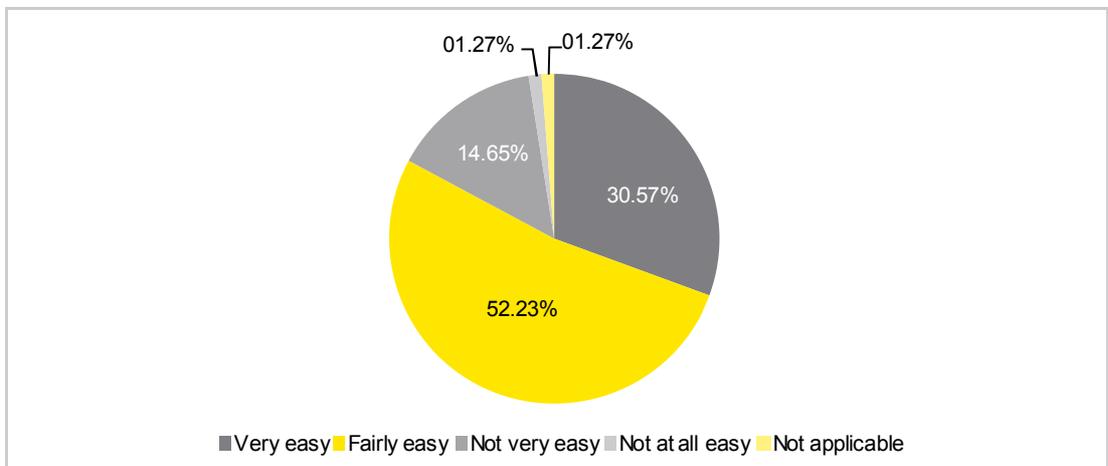
The move away from informal communication to a requirement by the Commission for all queries to be put in a letter was a source of frustration for a number of respondents. They also noted that they often had to chase responses to letters and emails from the Commission which could take months to reply, while demanding immediate responses from the organisations to their letters.

### Interaction with the Commission

**How often does your organisation interact with the Commission?**



**How easy does your organisation find it to contact the relevant person at the Commission?**



**Do you have any comments with regard to the frequency with which the Commission interacts with Industry?**

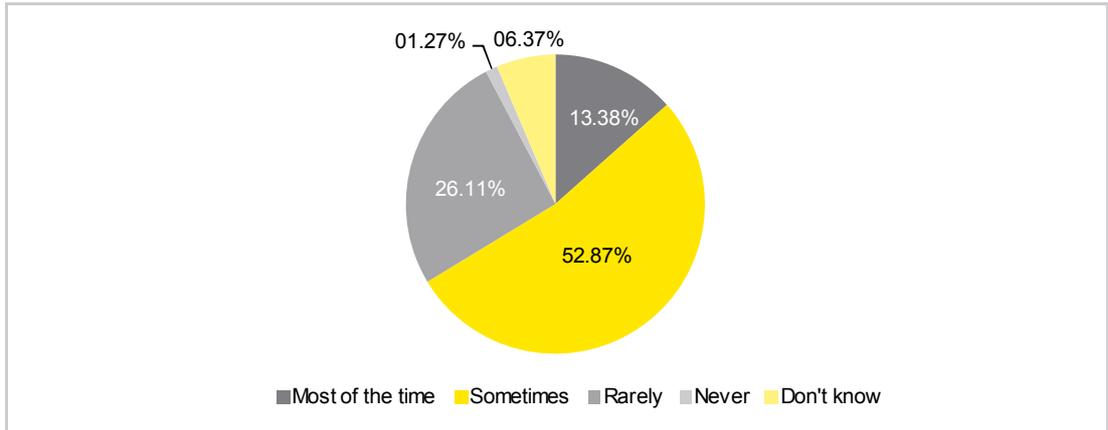
A lack of consistency between divisions was noted in efforts to engage with Industry.

With regard to Consultations, it was felt that the Commission should engage with Industry earlier in the process. There was an impression that the Commission’s initial view would tend to prevail, regardless of Industry input, which discouraged some from participating in the Consultations.

Seminars and workshops were seen as a positive step forward, but it was felt they focussed too much on the negatives and should also include examples of best practice.

Again there was a theme of encouraging more informal communication to build mutual trust, respect and understanding.

**To what extent do you feel that the Commission listens to the views of the Industry?**



Overall, please rate the interaction between your organisation and the Commission staff for the following:

	Excellent	Good	Average	Poor	Very poor	Don't Know
The Commission staff's understanding of your organisation and the situation	10	42	31	13	3	1
The Commission staff's knowledge of the relevant regulations and legislation	16	64	16	3	0	1
The professionalism of the Commission staff	18	57	22	1	1	1
Willingness to provide a response or information	9	36	36	11	7	1
Quality of response	6	40	40	10	3	1
Speed of response	5	34	43	12	6	0
Consistency of response	5	42	34	11	4	4
Willingness to listen	12	33	36	13	5	1
Clarity of explanations given	5	31	43	10	7	4

**Do you have any comments with regard to your organisation's interaction with the Commission?**

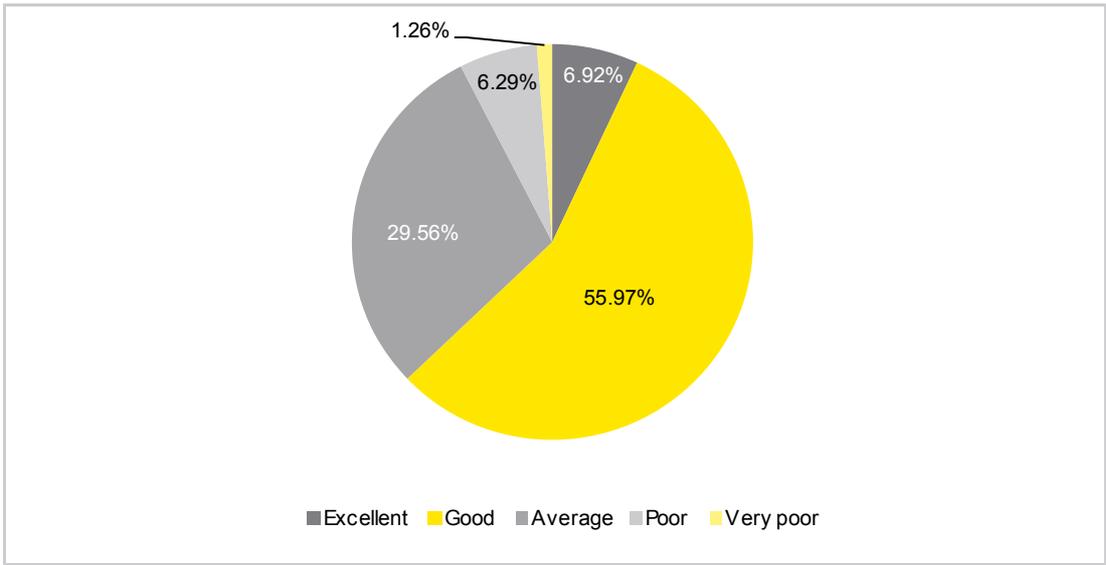
Again, an inconsistency in interaction between divisions was highlighted. One respondent commented that the Commission often acts as four different regulators, making it very difficult for a multiple licence holder to liaise with the Commission. There were further calls for a central relationship manager.

Many respondents highlighted different experiences between staff members, again suggesting an inconsistent approach across the Commission.

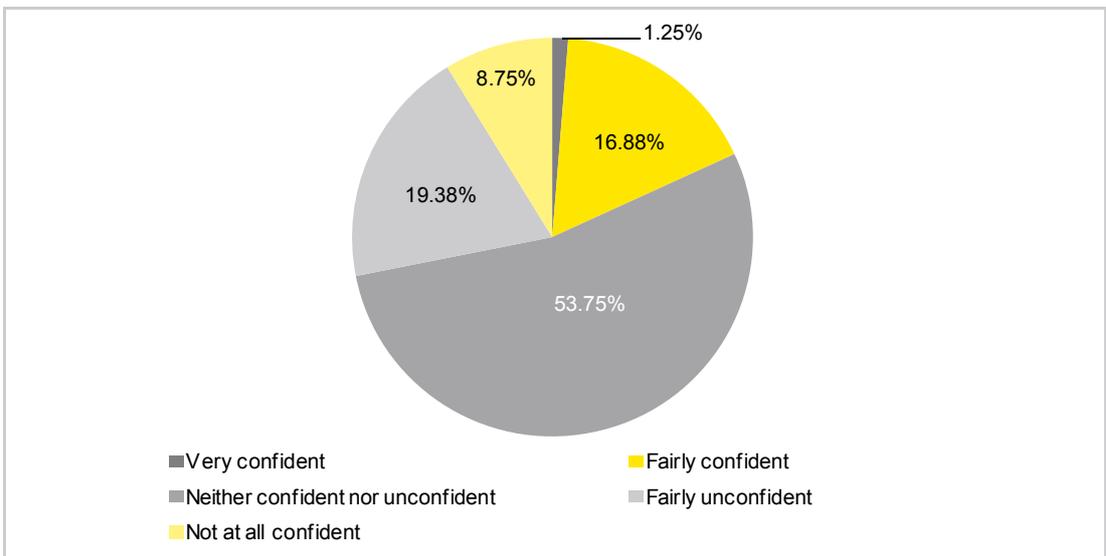
It was also felt that there was a difference between the tone of face to face meetings and the subsequent correspondence, which was often far more aggressive and not necessarily reflective of the meeting.

### General comments

**Overall, how would you rate your experience of dealing with the Commission?**



**Overall, how confident are you that the Commission is effectively regulating the Financial Services industry in the Bailiwick?**



**Is there anything that could be done differently or provided by yourselves to help improve communication and overall interaction with the Commission? Are there cost implications of this to yourself?**

A single relationship manager was seen as the most likely way to improve communication and interaction with the Commission. It was also felt that reverting to more regular informal communications and early discussions on matters would be a great benefit.

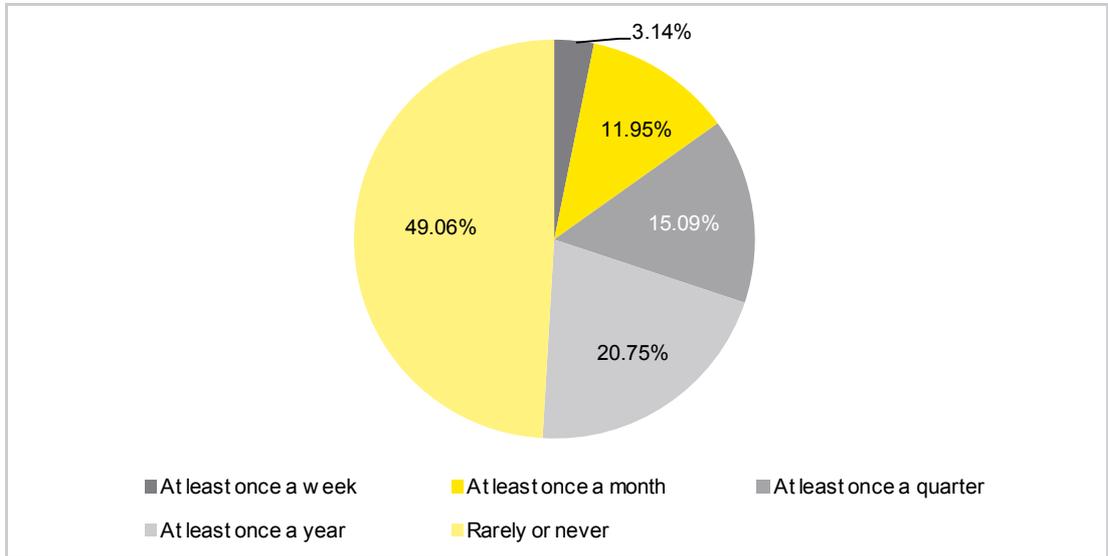
The silo nature of the divisions was seen as a key reason for the high costs of compliance locally, with a lack of information sharing and coordination resulting in increased time and money burdens.

It was felt that interaction had become increasingly negative and unpredictable over time, resulting in Industry having reservations about interacting with the Commission.

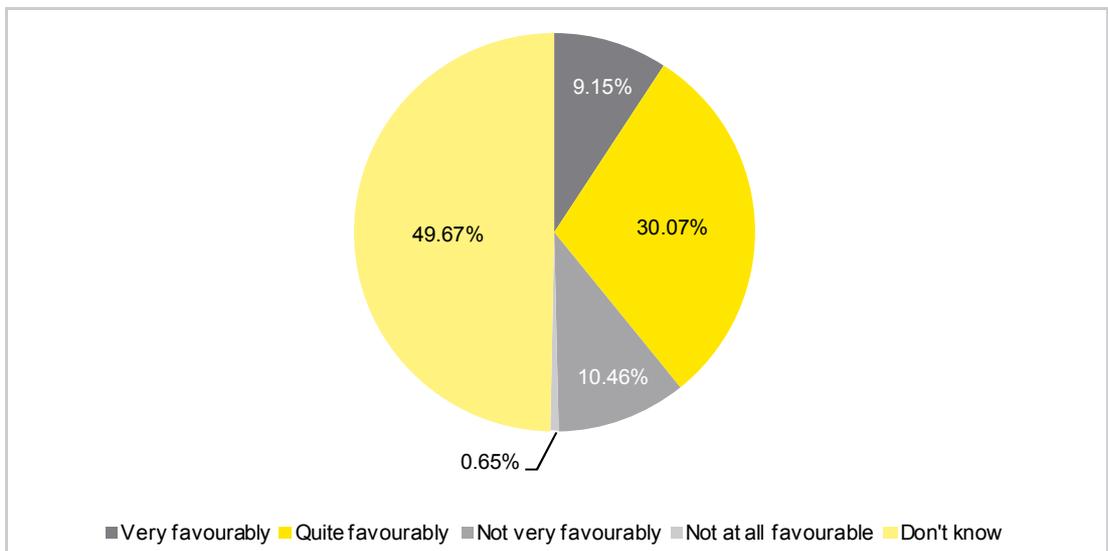
One respondent noted that most of their interaction was chasing applications. If an online tracking system were introduced it would save them the cost of chasing and would save the Commission the costs of dealing with their chasing. Electronic submission of documentation would also be welcomed.

Increased interaction with industry bodies and sharing clarification on certain aspects of rules and guidance would help limit the number of individual queries from businesses, saving time and money for both the Commission and the businesses.

**How often do you deal with regulators in other jurisdictions?**



**How does your experience of dealing with regulators in other jurisdictions compare with your experience with dealing with the Commission?**



**Please provide any other comments on the overall operation of the Commission?**

There was criticism from respondents of the cost of the new Commission premises and the defined benefit pension scheme while regulated businesses were struggling with the recession.

Concerns were expressed that the Commission was moving towards 'gold-plated' regulation which was more stringent than competitor jurisdictions. A number of respondents commented that they felt they were losing business due to regulatory arbitrage.

Respondents highlighted a lack of governance and accountability at the Commission, feeling there was no place to go if the Executive got things wrong. Some were concerned that there was too much power in the hands of individual directors when it came to sanctions or censures, suggesting a peer review as a minimum check.

## Appendix C Limitations of our work

Our work was performed in accordance with the terms of our contract dated 30 March 2011, and our procedures were limited to those described in that letter.

Our work was carried out to enable us to prepare this Report and Appendices ('the Report'). This work was not directed towards the discovery of weaknesses in control procedures performed by the Commission or the detection of fraud or other irregularities and should not, therefore, be relied upon to show that no other weaknesses exist or that no other areas require attention. Accordingly, this Report refers only to those matters that have come to our attention during the course of our enquiries and do not attempt to indicate all possible improvements which an examination of other areas might identify

Our work was not performed in accordance with generally accepted auditing, review or other assurance standards and accordingly does not express any form of assurance. None of the services or any Reports constitute any legal opinion or advice. We have not conducted a review to detect fraud or illegal acts.

The Report has been prepared for the sole use of the Commission. If the Commission wishes to disclose or publish the Report, it should not alter, edit or modify it from the form in which it is provided by us to the Commission without our written consent.

We are not privy to the interests, technical knowledge, and commercial or other objectives of third parties. Hence the specific needs and requirements of any such third parties have not been taken into account in preparing the Report. In addition, any third party who may have sight of the Report will not have the benefit of the detailed discussions and mutual exchange of information, which will inevitably occur between/Ernst & Young and the Commission in the course of preparation of the Report.

Ernst & Young therefore assumes no responsibility to any third party user of the Report. Any third party who chooses to rely on our Report does so entirely at their own risk.

We have relied on information as to systems and controls supplied to us by management including oral and written representations made by management. We have not performed independent verification of the financial and other information provided to us and have used the facts and information as they have been presented to us.

During the course of work, employees of the Commission provided us with documents, information, data and explanations to facilitate our work. We did not seek to verify the accuracy of the information provided to us in the course of our work, except the extent that we were able to do so based upon the documentation made available to us.

Our work was limited to a review of the Commission activities excluding the Guernsey Training Agency.

We have not completed any procedures subsequent to the date of the Report and therefore we accept no responsibility for events or circumstances occurring after that date.

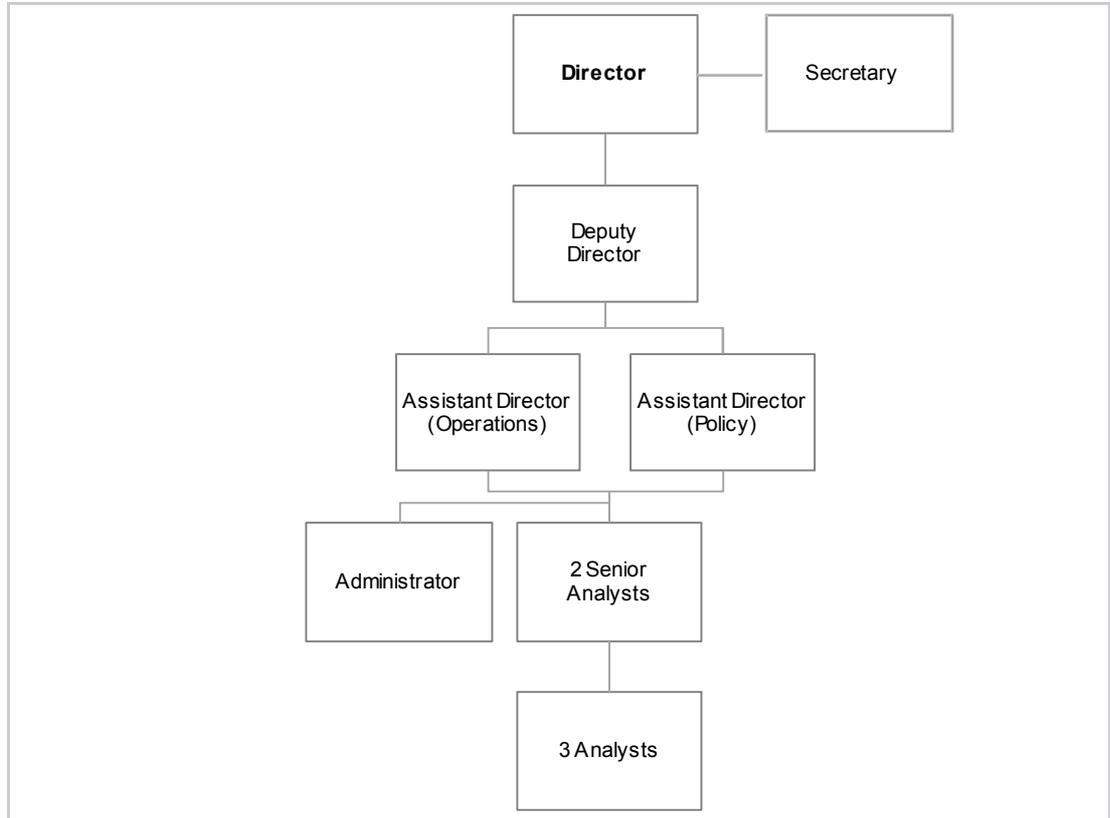
We have not obtained third party confirmations of any facts derived from our work or information obtained during the course of our work.

## Appendix D Glossary

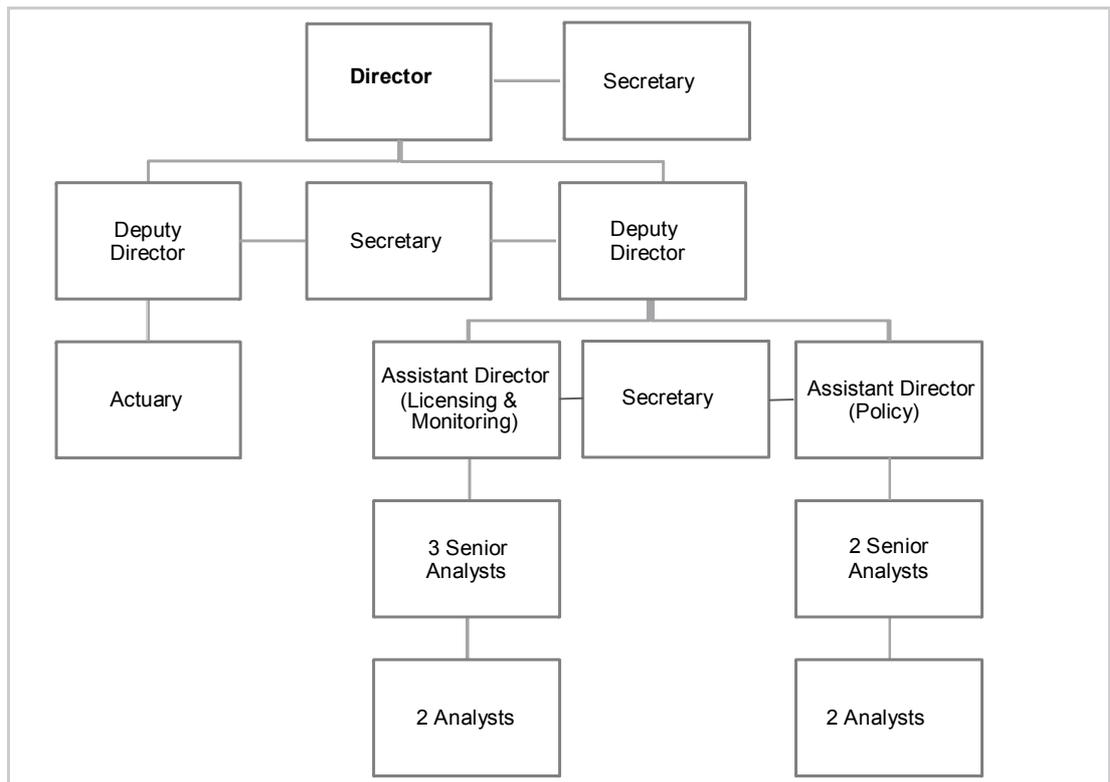
AML	Anti-Money Laundering
C&E	Commerce and Employment Department
CRM	Customer Relationship Management
FIU	Financial Investigations Unit
FSA	Financial Services Authority
IOM FSC	Isle of Man Financial Supervision Commission
JFSC	Jersey Financial Services Commission
PQ	Personal Questionnaires
Prescribed Business	Legal Professionals, Accountants and Estate Agents
T&R	Treasury & Resources Department
The Commission, GFSC	Guernsey Financial Services Commission
The Handbook	Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing
The Report	Report entitled 'Independent Evaluation Review – Guernsey Financial Services Commission', dated 07 December 2011, all Appendices attached to the main report body (including any portion, abstract and/or summary thereof)
We, us,/Ernst & Young	Ernst & Young LLP

## Appendix E Current division structures

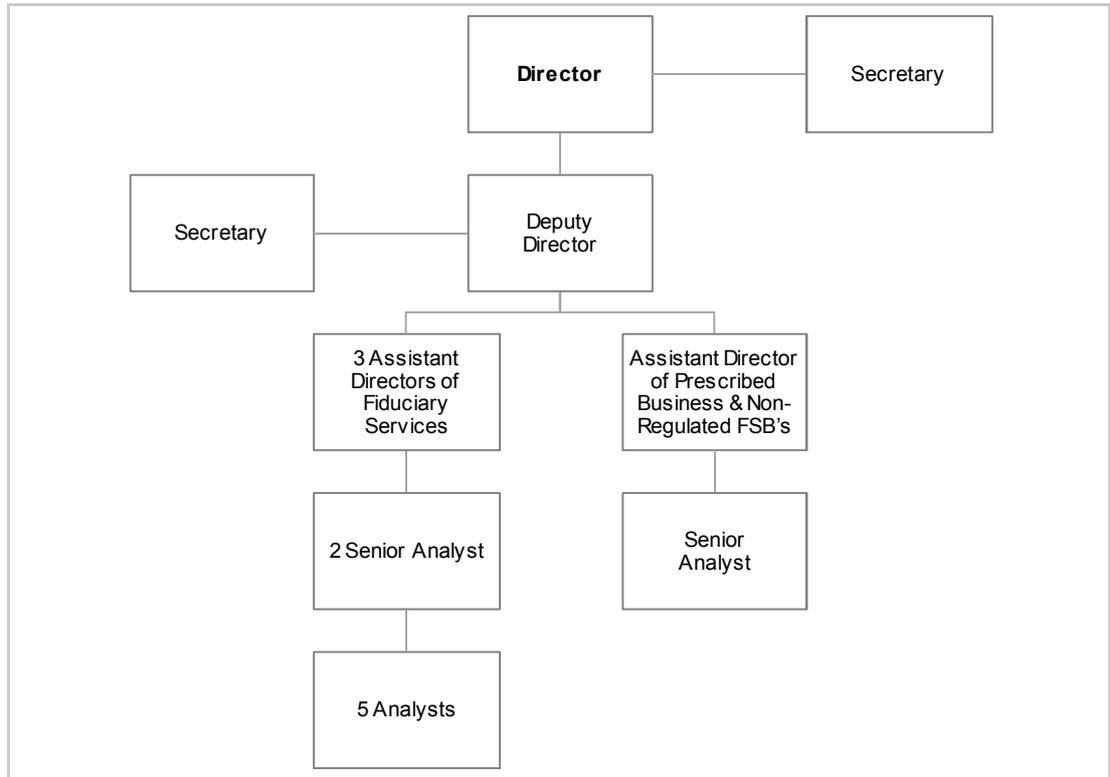
### Banking



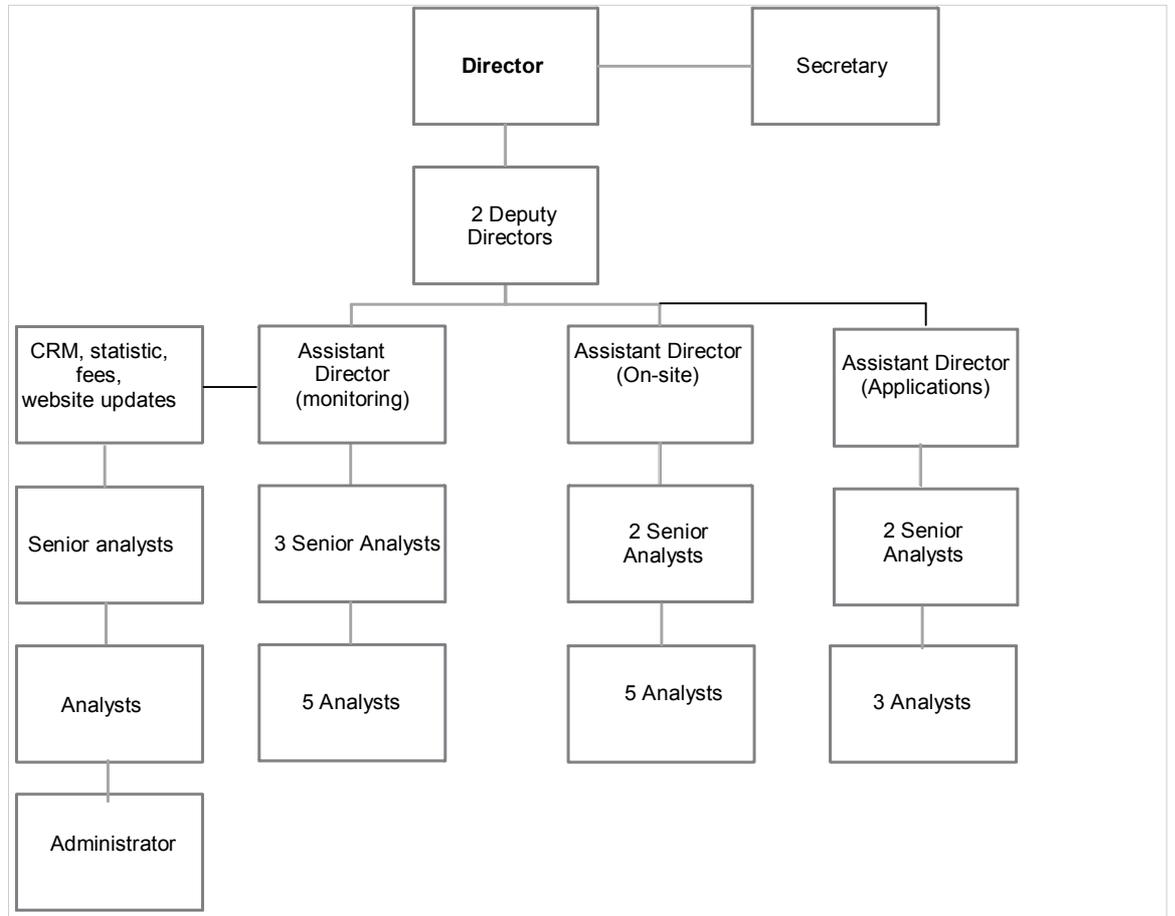
### Insurance



## Fiduciary



## Investment business



## Appendix F Financial information

Income	Income statements(extracted from annual reports)						Annual movements				
	2010 s£	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
Fees receivable	11,362,101	9,854,609	9,384,773	8,838,199	7,988,020	7,241,704	15%	5%	6%	11%	10%
Deposit interest	106,676	246,503	585,893	477,436	214,678	162,249	-57%	-58%	23%	122%	32%
Miscellaneous income	0	0	0	16,067	7,379	23,421	0%	0%	-100%	118%	-68%
Other finance income	0	0	42,224	151,686	152,154	103,781	0%	-100%	-72%	0%	47%
Contributions from the States of Guernsey	0	0	0	200,000	300,000	300,000	0%	0%	-100%	-33%	0%
	<b>11,468,777</b>	<b>10,101,112</b>	<b>10,012,890</b>	<b>9,683,388</b>	<b>8,662,231</b>	<b>7,831,155</b>	<b>14%</b>	<b>1%</b>	<b>3%</b>	<b>12%</b>	<b>11%</b>
<b>Expenses</b>											
	2010 £	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
Salaries, pension costs, staff recruitment and training	7,671,235	7,269,471	7,261,524	5,973,768	5,586,517	5,045,024	6%	0%	22%	7%	11%
Commissioners' fees	118,000	117,762	104,822	94,500	95,420	73,500	0%	12%	11%	-1%	30%
Legal and professional fees	310,143	841,813	1,267,901	395,286	399,073	445,675	-63%	-34%	221%	-1%	-10%
Premises and equipment, including depreciation	1,058,709	851,647	834,090	719,875	768,194	810,257	24%	2%	16%	-6%	-5%
Other operating expenses	737,928	757,474	588,326	514,866	470,555	416,118	-3%	29%	14%	9%	13%
Other finance costs	205,818	143,228	0	0	0	0	44%	0%	0%	0%	0%
Auditor's remuneration	10,720	11,000	10,165	10,000	10,000	10,000	-3%	8%	2%	0%	0%

## Expenses

	2010 £	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
Commission's contribution to GTA	440,000	435,000	425,500	411,000	411,000	399,781	1%	2%	4%	0%	3%
	<b>10,552,553</b>	<b>10,427,395</b>	<b>10,492,328</b>	<b>8,119,295</b>	<b>7,740,759</b>	<b>7,200,355</b>	<b>1%</b>	<b>-1%</b>	<b>29%</b>	<b>5%</b>	<b>8%</b>
<b>Surplus/(deficit) for the year</b>	<b>916,224</b>	<b>(326,283)</b>	<b>(479,438)</b>	<b>1,564,093</b>	<b>921,472</b>	<b>630,800</b>	<b>381%</b>	<b>32%</b>	<b>-131%</b>	<b>70%</b>	<b>46%</b>

	2010 £	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
GFSC – head count	105	91	89	88	88						
GFSC – total regulated entities	2,960	2,967	2,958	2,737	2,471	2,230					
GFSC – Depreciation	341,345	302,846	185,850	133,231	149,154						
Pension costs	1,038,556	840,674	855,392	724,812	867,375						
GFSC – Legal and professional	310,143	841,813	1,267,901	395,286	399,073						

## Key ratios

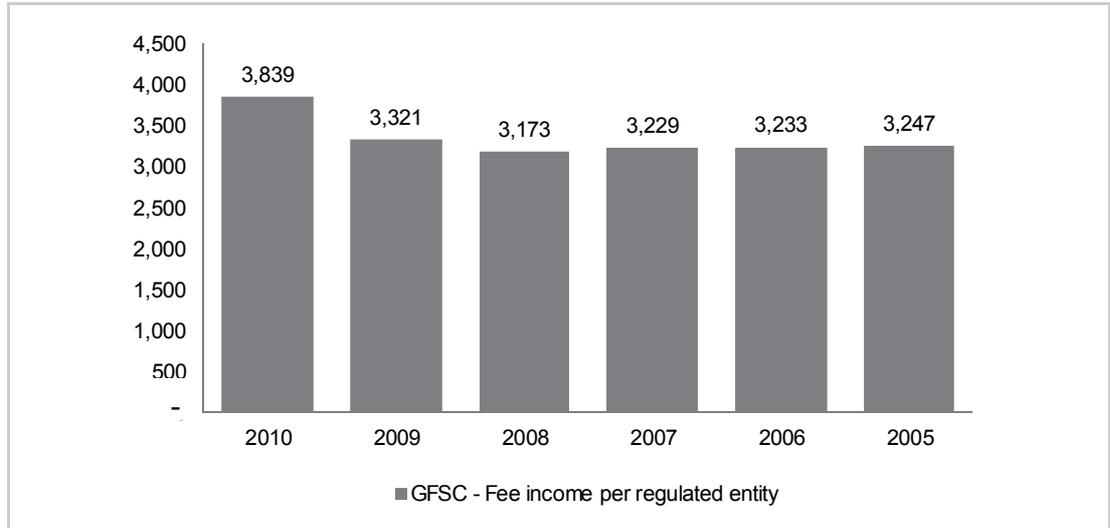
	2010 £	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
GFSC – Staff costs/fees	68%	74%	77%	68%	70%	70%					
GFSC – Staff costs per head	74,183	81,178	82,768	68,958	64,567	–	-9%	-2%	20%	7%	0%
GFSC – Fee income per regulated entity	3,839	3,321	3,173	3,229	3,233	3,247	16%	5%	-2%	0%	0%
GFSC – Premises and equip per head	10,083	9,359	9,372	8,180	8,729	–					
GFSC – Regulated entities per head	28.190	32.604	33.236	31.102	28.080	–					
GFSC – Fee income per staff head	108,210	108,292	105,447	100,434	90,773						

Financial information

	2010 £	2009 £	2008 £	2007 £	2006 £	2005 £	2010	2009	2008	2007	2006
GFSC – Pension costs as % of staff costs	14%	12%	12%	12%	16%						

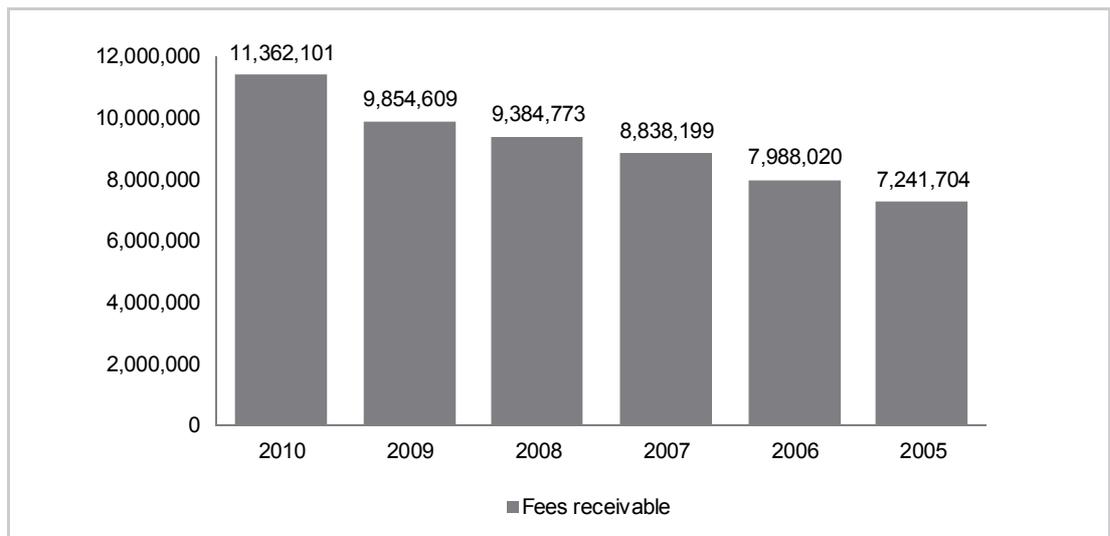
## Fee income

GFSC – Fee income per regulated entity

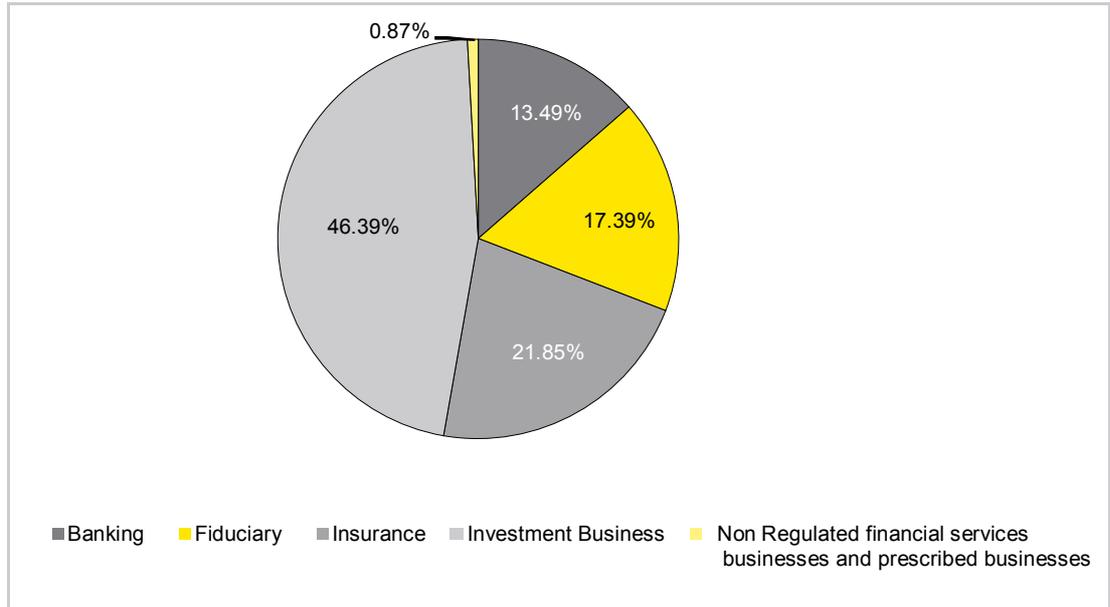


Regulatory fees increased in Jan 2010.

## Fees receivable

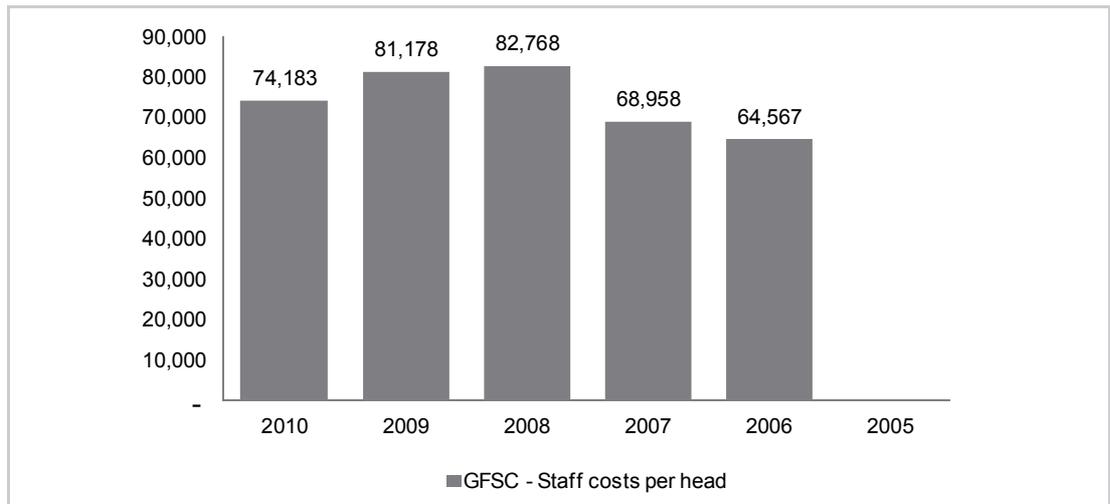


## Fee income

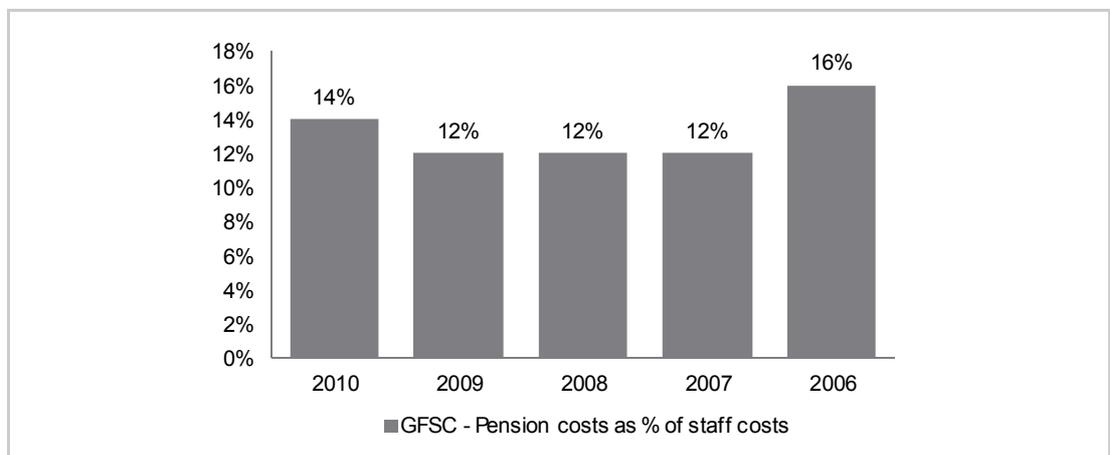


## Staff costs

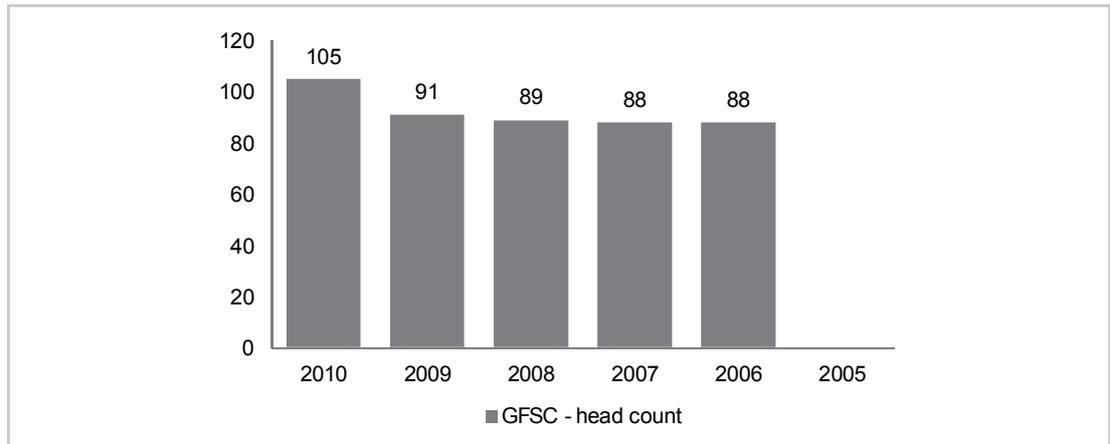
### GFSC – Staff costs per head



### GFSC – Pension costs as % of staff costs

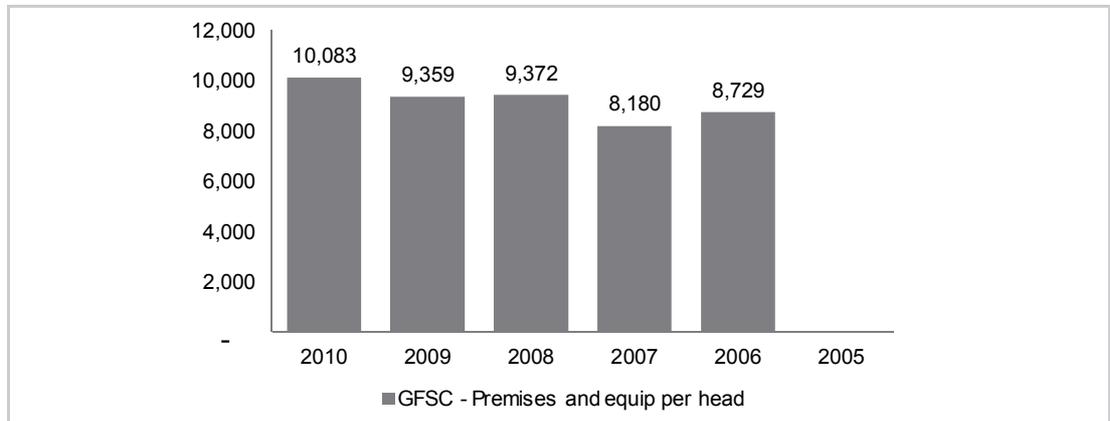


### GFSC – Head count



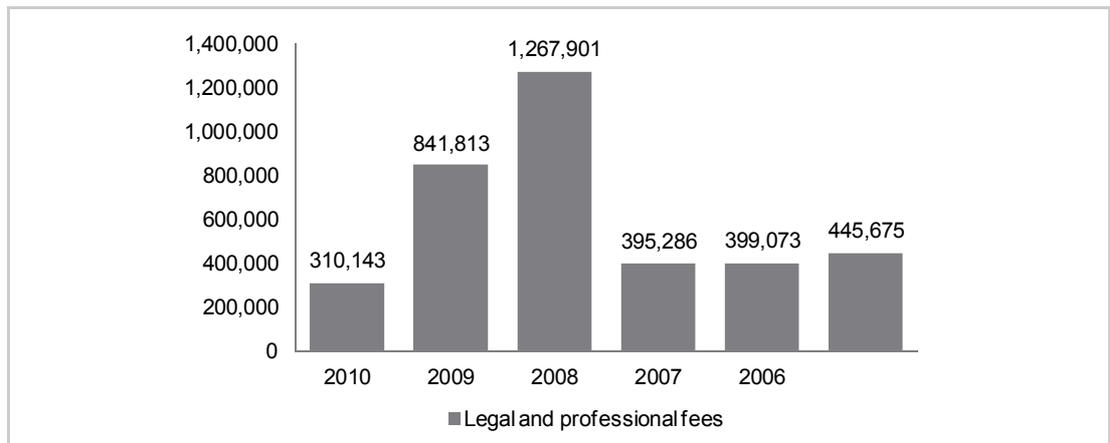
### Premises and equipment costs

GFSC – Premises and equipment per head



Commission moved premises in Sept 2010.

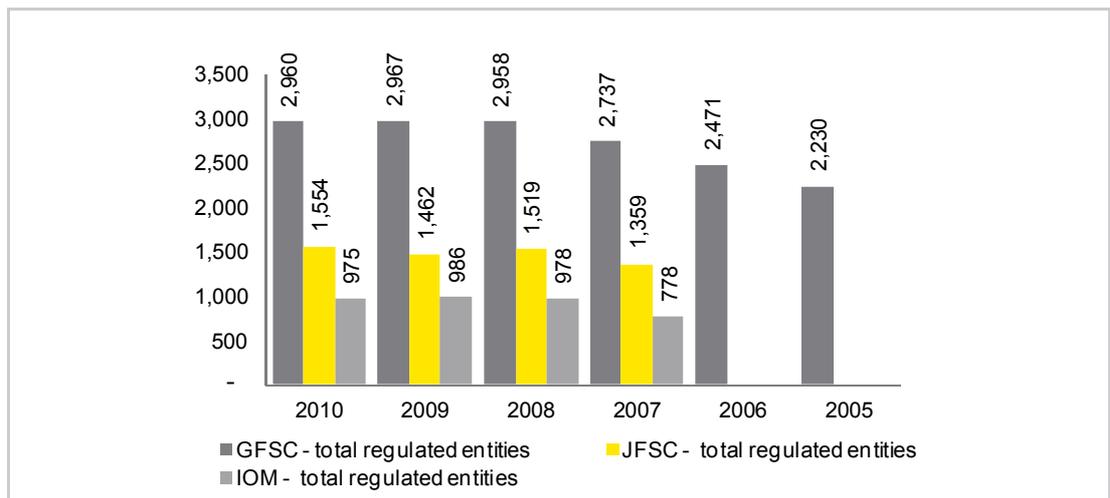
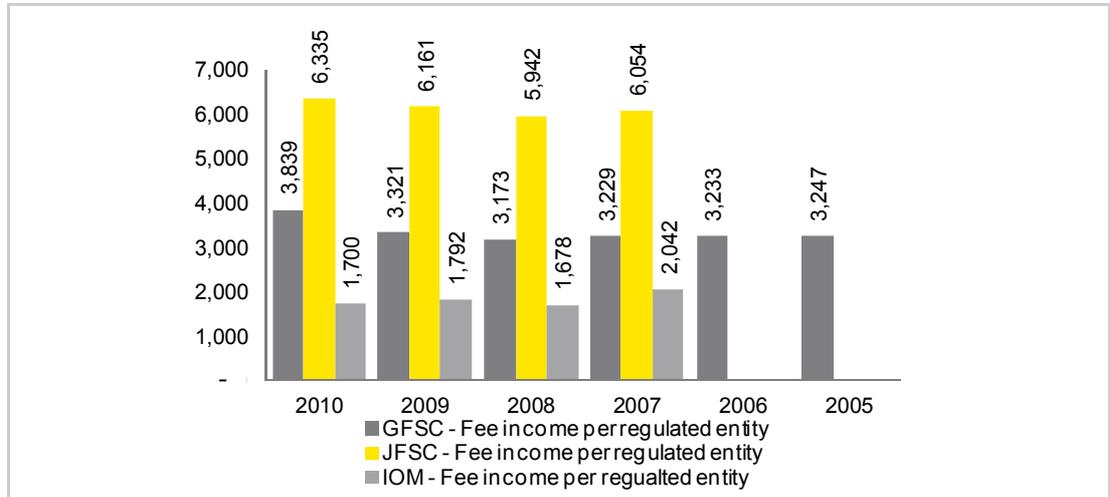
### Legal and professional fees



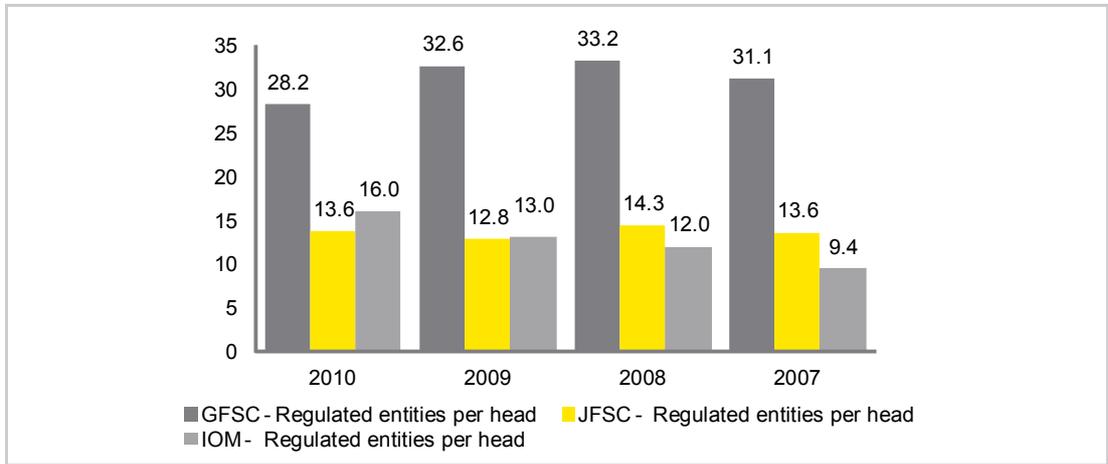
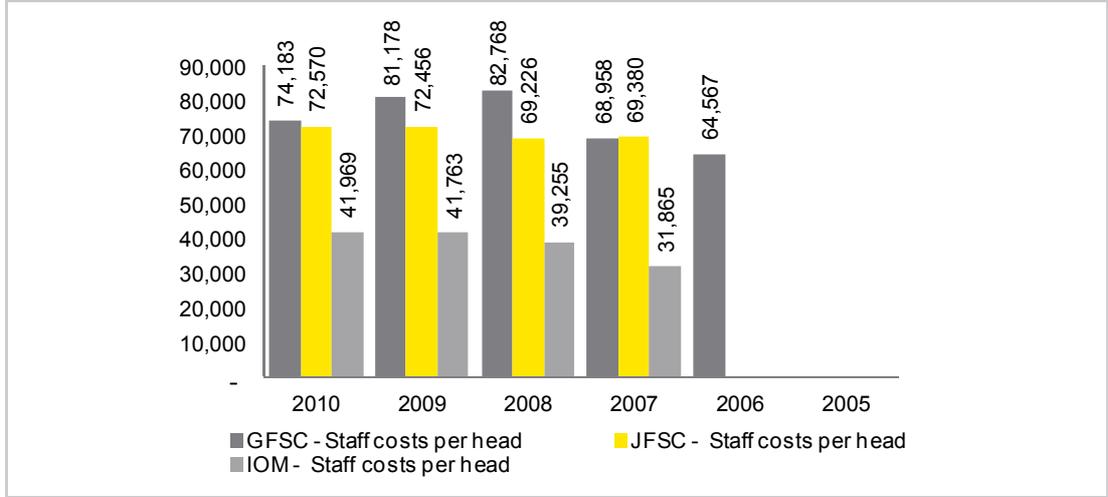
2010 – appointed an in house counsel therefore reducing the legal and professional fees incurred. 2008 spiked due to increase activity during the financial crisis, 2009 continues to have high fees as a result of the financial crisis.

## Guernsey Financial Services Commission Comparative Analysis

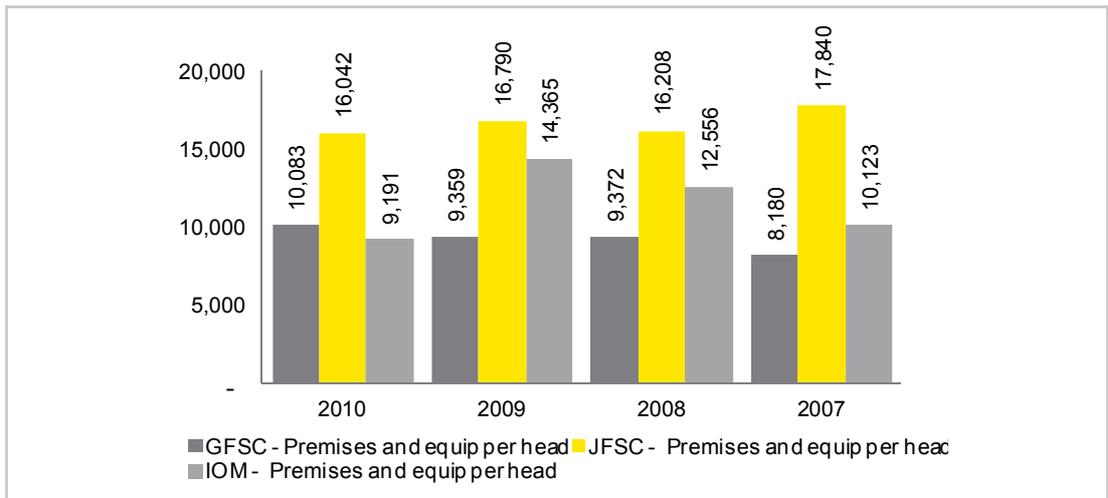
### Fee income



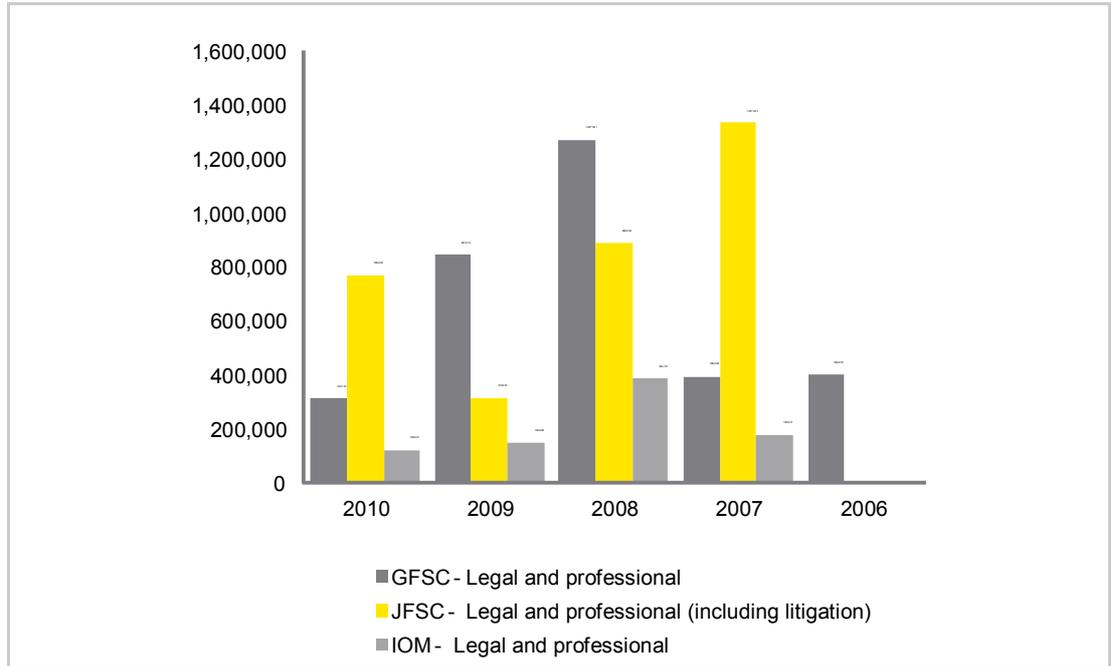
### Staff costs



### Premises and equipment costs



## Legal and professional fees



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