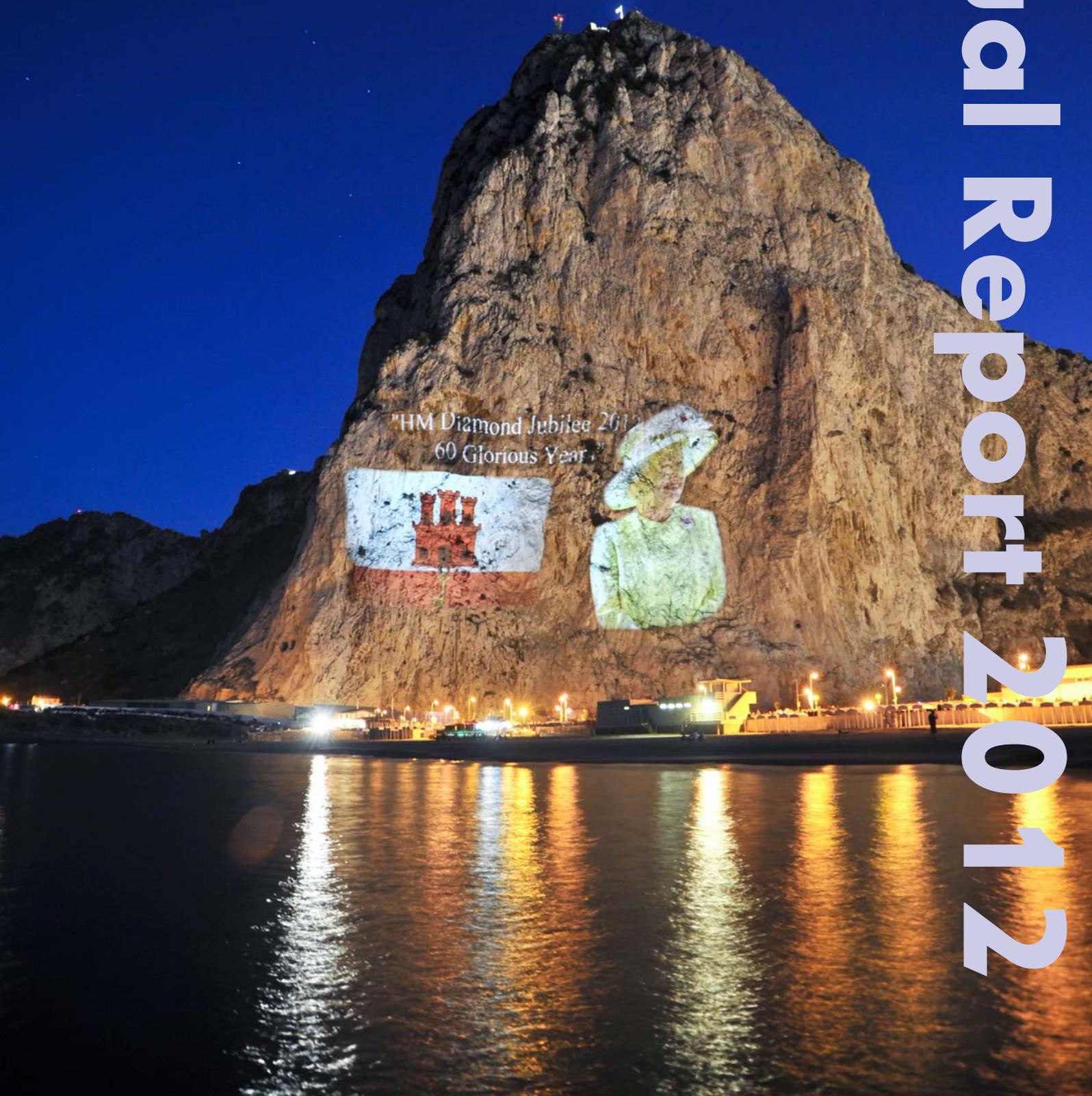




Financial Services
Commission
Gibraltar



Annual Report 2012

*To be seen by our
stakeholders as the model
international financial
services regulator*

Chairman's Report for the year ended 31 March 2012

Welcome to the Annual Report of the Gibraltar Financial Services Commission (the Commission). This report contains a description of the work of the Commission as well as its reports and accounts.

The Commission and its Statutory Duties

During the year, the Commission's primary focus has continued to be to deliver on its statutory duties. These duties are set out in the Financial Services Commission Act 2007 and include the following regulatory objectives:

- the promotion of market confidence;
- the reduction of systemic risk;
- the promotion of public awareness;
- the protection of the good reputation of Gibraltar;
- the protection of consumers; and
- the reduction of financial crime.

Gibraltar is a full member of the EU Internal Market in Financial Services and is subject to the full panoply, and benefits, of EU financial services directives. In respect of those areas of financial services business where EU law applies, the Commission is required to supervise and regulate financial services business in accordance with European Union obligations and, in those areas, to establish and implement standards and supervisory practices which match the standards and supervisory practices governing the provision of financial services in the United Kingdom.

The Commission is also required to advise the Government if, at any time, it considers that legislation does not provide it with sufficient powers or does not have such financial, technical and other resources, and such personnel, as are necessary to enable it to supervise and regulate financial services business to internationally accepted standards.

International Regulatory Reform

Following the global financial crisis which began in 2008, there have been, and continue to be, concerted moves by all the international financial regulatory bodies, as well as by many national governments, to strengthen financial regulation and supervision. The Commission has been active in keeping abreast of all the discussions and developments and, where possible,



participating in the formation of policy. The final architecture of the new regulatory system, both within the EU and more widely, has still to be determined; but there can be no doubt that in the years ahead it will impact as much on financial services firms in Gibraltar as in other jurisdictions. Some national governments, including the United Kingdom, are redesigning their financial regulatory structures and are introducing much more prescriptive forms of regulation and supervision. The regulatory burden on financial services firms globally is set to continue to increase for a number of years to come.

Matching UK Standards

If the Commission is to meet its statutory requirement to match UK standards, it is clear that in a rapidly changing regulatory environment, there will always be changes both in regulation and supervisory practices in Gibraltar. The Commission, however, will not simply copy the regulatory and supervisory practices of the United Kingdom. The Commission interprets its statutory requirement to match UK standards as delivering the same regulatory outcomes as

the Financial Services Authority (FSA) aims to do, but not necessarily in the same way. Indeed, the current change in the regulatory structure in the UK makes an identical approach both impossible and undesirable.

To focus on the regulatory and supervisory processes themselves is not, in the Commission's view, a productive approach. Given the differences between the UK and Gibraltar markets and social environments, the simplistic replication of regulatory processes may, in fact, lead to the end objective being missed or achieved to a lesser degree.

The difference between the Gibraltar and UK environments will occasionally mean that supervision in Gibraltar is tighter than in the UK. On other occasions the Commission will be able to adopt a case-by-case approach more than the UK does, but with no reduction in overall supervisory standards. The Commission has been, and continues to be, resolute in delivering sound and effective regulation to the highest international standards. Yet it is equally resolute in ensuring that regulation is delivered in a way which is conducive to, and encourages, financial services business in Gibraltar.

In the longer term, the criteria of matching the UK, which was designed at a time before the development of a significant EU wide regulatory framework and the current economic crisis, may no longer be fit for purpose. The Commission will therefore consider this issue in the year ahead before making recommendations to Government on potential changes to the statutory provisions in this area.

The Work of the Commission

Regulatory supervision forms the backbone of the Commission's work. This includes the assessment of applications from firms wishing to conduct regulated activities, ongoing supervision of regulated firms and the taking of disciplinary or enforcement action where necessary. Ongoing supervision of regulated firms is guided by the Commission's risk assessment process and includes the review of regular returns and a programme of on-site visits. The Commission also issues consumer-focussed guidance and issues alerts warning consumers of unregulated enterprises targeting businesses

in Gibraltar or purporting to be regulated in Gibraltar.

The Commission has a wide range of powers including the issuance of directions or the imposition of conditions upon a licensee. In extreme cases, a licence can be revoked.

It is important that the Commission uses its resources as efficiently and effectively as possible. We are aware that the burden of regulation is another cost imposed on business in what are already difficult economic times. In order to achieve this, we focus upon the risks faced both by the Commission and the firms it regulates and how these risks can be mitigated. We also concentrate on areas where the risks to consumers are the highest: with, for example, lighter regulatory regimes for experienced investors.

In addition to its supervisory duties, the Commission performs a number of other tasks, including advising Government on new financial services legislation, undertaking additional tasks requested by Government and monitoring and participating in the development of international financial services regulation.

The Commission's supervisory framework is not designed to ensure that any given institution cannot fail. That task is unattainable, and even to attempt to achieve it would stifle financial services business and be detrimental to consumers. Consumer protection remains a central goal of the Commission, but it is achieved in different ways. The Commission is committed to retaining a balance between seeking to mitigate risk while fostering innovation and competition. The primary responsibility for the management of a financial institution rests with its board and executive management. The Commission's supervisory framework is designed to be proactive in seeking to ensure that the board and the executive management of regulated firms properly discharge their responsibilities. As the Commission's funding is an industry cost, the allocation of Commission resources has to be on a risk-based and proportionate basis.

Internal Governance

The Commission comprises eight (8) members including the CEO. The other members are all

non-executive. During the year, Brian Hilton stood down when his statutory 9-year term of office came to an end. Brian was the first independent chairman of the Commission introduced by the Financial Services Commission Act 2007. Throughout his tenure, both as member and chairman, Brian served the Commission with dedication and distinction and I would like to thank Brian for his enormous contribution to the development and operation of regulation during this formative period. I was elected to succeed Brian as chairman in September. Brian was replaced by Jonathan Spencer, a former distinguished senior UK civil servant with wide experience including the regulation of insurance. John Tattersall has taken on the important role of senior independent director and has also assumed the chairmanship of the Performance and Remuneration Committee.

A full list of all the Commission directors, the Commission's sub-committees, including their terms of reference and their membership, can be found on the Commission's web-site: www.fsc.gi.

Conclusion

The past year has been challenging both for the Commission and the industry. While the effects of the global financial crisis continue to make themselves felt, the next few years will not be any easier. The Commission, nevertheless, is determined and committed to work with the financial services industry to deliver cost-effective regulation to high international standards and to the benefit of both the industry and its customers.

Alan Whiting
Chairman
6 July 2012

To provide financial services regulation in an effective and efficient manner in order to protect the public from financial loss and enhance Gibraltar's reputation as a quality financial centre

Chief Executive's Report for the year ended 31 March 2012

From the edge of a cliff to the edge of a precipice.

I have made a habit, before commencing writing my annual report, to look at what I penned the previous year. This year I could have saved myself considerable effort by simply changing the date on last year's report and republishing it.

I first wrote on the ongoing crisis in the 2008 report. Little did I, or most people, expect the countries of the EU to have made so little progress towards resolution in the four subsequent years. Governments have changed, regulatory structures have been uprooted and replaced and trillions of euros, dollars etc. have been pumped into the global economy. Yet Greece teeters on the brink of oblivion, and Spain, Portugal, Cyprus and others are almost wholly driven by events outside their control. The issue now is, not when will things improve but how much worse will they get?

Despite all this, Gibraltar's economy remains firm, if vulnerable. Our finance sector has proved resilient and has continued to grow, albeit at a significantly slower pace than before the crisis began. Yet we are not immune - talks of Gibraltar being a "bubble" are as inaccurate as they are foolish. We may well be a safe haven but the tempest beyond our harbour walls still rages in earnest.

Within the Commission, the pressure of increased EU legislation has necessitated further growth in the size of the Commission yet we managed to produce a budget which limited fee increases to the rate of inflation for most licensees. We have already, and ahead of schedule, paid back the first half of the money borrowed from Government to cover the cost of the Gibraltar/Cabor administration. We continue to operate without cost to the taxpayer.

As with last year I have split my review of the year and the objectives for the year ahead into a number of sections. These are:

- The work of the Divisions in 2011/12;
- Other areas including finance, international engagement and our work with the industry; and
- Key themes for the year ahead.



I have also added a high level overview of our Risk Register. This sets out the key risks the Commission considers it faces in the oncoming year, which may prevent it from achieving its statutory duties. This is in line with modern corporate governance standards and will become a key feature of the subsequent Commission annual reports.

The work of the Divisions in 2011/12

Audit Supervision

General overview

The Audit Supervision team is responsible for regulating auditors and audit firms - "auditors"- who conduct statutory audits in Gibraltar.

The team has focused on enhancing the level of oversight and supervision in place for auditors, and significant progress has been made regarding the development and integration of quality assurance controls to ensure the Commission meets its statutory function. The team has increased its presence

in the international arena, raising the profile of Gibraltar's audit industry, and has also forged relationships with other independent audit regulators.

In 2010 the International Federation of Accountants ("IFAC") published the final set of clarified standards comprising 36 International Standards on Auditing ("ISAs") and the International Standard on Quality Control ("ISQC"). These standards are effective for audits of financial statements for periods ending on or after 15 December 2010 and auditors' compliance with these will be verified via the quality assurance visits.

In August 2011, the team published the auditors Annual Return. This return is completed on an annual basis by auditors and submitted no later than two months after the financial year end. An audit firm is required to submit the return on behalf of all its statutory auditors.

The return covers the following areas;

- Structure of Firm
- Audit Client Information
- Dismissal and resignation of a partner/director from an audit firm
- Auditing Standards
- Professional ethics, Independence, Objectivity, Confidentiality and Professional Secrecy
- Professional Indemnity Insurance
- Continuing Education
- Good Repute
- Registration with other authorities
- Information contained in the public register
- Transparency Reports

The submission of an annual return is an important part of the oversight supervision as it enables the team to monitor compliance with the Financial Services (Auditors) Act 2009.

The team has dedicated a high level of resources to identify, assess, and prioritise areas of risk faced by the industry, either externally or internally, to ensure that there is a suitable framework in place to mitigate any threat. This is reviewed on a quarterly basis.

The team issued a newsletter in December 2011 focusing on providing guidance to

those auditors who are required to complete the Accountants Report Form, to confirm that they have complied with the Solicitors' Accounts Rules "SAR" in Gibraltar. The purpose of this newsletter was to highlight common issues which had been identified by the Commission as part its review of the SAR work conducted by auditors. The findings served as a tool to enhance the quality of the reports submitted to the Supreme Court and also served to protect both the underlying client and the work conducted by the auditors. The team was pleased to report that there had been a change in culture and approach to these engagements and auditors worked closely with the Commission to complete their remediation programme.

Enhancing the supervisory and regulatory approach

At the beginning of 2012, strong emphasis was placed on the establishment of a rigorous quality assurance programme. The team worked closely with the Institute of Chartered Accountants England and Wales ("ICAEW"). The ICAEW has been seconded to assist the Commission and together a quality assurance programme has been developed and the initial assessment of all auditors is being implemented. The Commission will initially be focusing on assessing a firm's policies, procedures and systems and holding meetings with key personnel. This will allow the team to make an assessment of the auditors approach to audit quality and the risks within each of the auditor's practice. Furthermore it will lay the foundation upon which the team can establish its timetable for the full review visits which will commence in the latter part of 2012.

Enforcement actions

Inspections are permitted by the Commission under section 30 (7) of the Financial Services (Auditors) Act. During the year, the Commission appointed inspectors to conduct two separate inspections of auditors.

In one case the inspection sought to review the quality of the audits that were being undertaken and the adequacy of the audit procedures performed. The inspection was conducted as a result of concerns arising from the work undertaken in relation to the SAR. As a result of the inspection the Commission took regulatory action.

In the other case an inspector was appointed

to assess whether the processes and procedures designed to mitigate the shortcomings and deficiencies, which had been previously identified, had been effectively implemented and adhered to. The findings were such that the Commission considered the matter resolved and no further action has been taken.

There was also a case where the Commission undertook an investigation of another auditor without the appointment of inspectors.

Legislative and Regulatory Developments

The Division continues to monitor developments at EU level. There are currently two proposals under consideration. The first proposal amends the 8th company law Directive on statutory audits of annual accounts and consolidated accounts (Directive 2006/43/EC). The second proposal is a Regulation which provides for specific requirements regarding the statutory audit of public interest entities (PIEs): large listed companies, banks and insurers.

The European Parliament has indicated that the first reading of both the proposals will be in January 2013.

Stakeholder relations

The formation of the Advisory Panel continues to act as a beneficial platform via which industry is informed of updates within the Audit arena. The Advisory Panel met twice in May 2011 and October 2011. Through this forum, and the Gibraltar Society of Accountants, the team has maintained a close working relationship with the Industry. Minutes of the meetings are distributed throughout the audit profession.

In March 2012 the Commission was accepted as a member of the International Forum of Independent Audit Regulators ("IFIAR"). As a member of IFIAR, the Commission is provided with an opportunity to meet with independent audit regulators to share knowledge on the audit market environment and practical experiences of independent audit regulatory activity, with a focus on inspections of auditors and audit firms. It also promotes collaboration and consistency in regulatory activity and provides a platform for dialogue with other international organisations that have an interest in audit quality.

A core activity of the independent audit regulatory supervision is the ongoing inspection of audit firms. IFIAR provides a forum through the inspection workshops for audit regulators to meet and discuss inspection processes, learn and leverage from each other, and consider similarities and differences among their practices and methodologies. This information sharing leads to a better understanding of the Members' respective oversight regimes and the identification of better practices in inspecting audit firms. It also promotes greater consistency across regulators.

Banking and Investment Services Supervision

General overview

The Banking & Investment Services Supervision team is responsible for regulating banks, e-money firms and investment firms, as well as payment service providers and bureaux de change. The Division is currently responsible for supervising approximately 63 entities which are subject to risk assessments.

The team continues to see interest in various areas of these sectors and has processed a wide variety of applications during the course of the last financial year. The evolution of the risk based approach to supervision and changes effected to the Commission's risk assessment methodology has ensured that resources are suitably assigned to the work streams associated to this. This has included both on-site and off-site responsibilities.

12 Internal Capital Guidance (ICG) letters resulting from the supervisory review and evaluations of Internal Capital Adequacy Assessment Process reports (ICAAPs) have been issued. The team continues to review ICAAPs and is currently carrying out 18 such evaluations.

Legislative and Regulatory Developments

The Division continues to develop its regulatory processes in relation to the newer areas of supervision such as payment services. Guidance regarding this was issued during the course of 2011. Further guidance, aimed at consumers, is planned for this coming year.

During 2011 the Division focused on the application of the Financial Services

(Electronic Money) Regulations which transposed the 2nd E-Money Directive. Specific e-money returns were rolled out and industry guidance was also issued.

Changes to Basel requirements arising out of Basel 2 and Basel 2.5 have continued to have been given effect. Primarily this has been via guidance and has included areas such as remuneration and reporting. Required changes to the returns submitted by firms as a result of these were effected. There were also further changes made to returns to better capture more meaningful data relating to mortgage lending and exposures in this area.

Over the next financial period, the Division will be concentrating on developments regarding Basel III and the further changes to the Capital Requirements Directive (CRD). It is expected that the new directive – CRD IV and the CR Regulation – will be published shortly by the EU Commission. CRD IV effectively implements Basel III. A major work-stream arising out of this is the new reporting requirements that banks and investment firms will need to comply with. This Common Reporting Format (COREP) represents a major exercise and undertaking for both the Commission and the industry. Work in order to prepare for this continues.

The Division continues to monitor developments with regards to MiFID II proposals. It is now expected that these will be ratified by the EU Parliament later on in 2012, with a view to the final Directive expected to be published by early 2013 at the latest. There are also a number of other initiatives at EU level that are linked to MiFID II. One of the principal areas is in relation to Packaged Retail Investment Products (PRIPs), which seeks to introduce legislative changes in the areas of pre-contractual disclosures and sales rules for packaged retail investment products, via the use of a standard key investor information document. The team is also monitoring these proposals.

The European Banking Authority (EBA) and the European Securities & Markets Authority (ESMA) have, in recent times, issued a number of consultative documents as well as guidelines covering different aspects of compliance with the various directives. It is expected that this will continue and will in fact gain momentum following the publication of CRD IV and MiFID II. Where

necessary, the Division has drafted guidance notes based on the guidelines issued by the European supervisory authorities. It is expected that this approach will continue in line with what emanates from the authorities.

Finally, assessments against the proposed revised Basel Core Principles and the published revised IOSCO Principles are currently underway. These assessments will help to ensure that our regulatory processes and requirements and our supervisory procedures continue to meet international standards.

Stakeholder relations

The Head of Division meets representatives of the Gibraltar Bankers' Association (GBA) and the Gibraltar Funds and Investments Association (GFIA) on a quarterly basis. This serves to maintain close contact with the industry and stakeholders in general.

Fiduciary Services Supervision

General overview

The Division is responsible for the supervision of 67 groups of company managers and professional trustees which are subject to risk assessments. The Division has performed well against its business plan for the year. All of the 21 firms identified for a risk assessment at the beginning of the year have been visited. In addition to this, 10 supervisory meetings (previously called prudential meetings) and 3 Focused Visits were conducted during the year.

The Division has also been involved with numerous subsequent meetings with licensees that have undergone a risk assessment or a Focused Visit, in order to ensure that progress has been achieved against the mitigation required in relation to areas/issues highlighted as part of the process.

The Division has continued to focus on the risk assessment of firms and on the scrutiny of returns submitted by licensees. There is a continuing emphasis placed on ensuring that firms are meeting their solvency requirements and the monitoring of the actual performance and comparisons with previous years. Following the review of the Return of Trusts and Companies under Management, which were due by 10 March 2012, the Division can report a reduction in

both the amount of trusts and companies under management by approximately 60 and 1200 respectively. This follows the trend observed from previous years. Performance within the industry is mixed, with some firms shedding clients and others gaining. Equally, some firms, despite the loss of clients, have still performed well financially.

Stakeholder Relations

The Division has established formal relations with the Association of Trust and Company Managers, with meetings set on a quarterly basis to discuss various matters of mutual interest.

Funds and Pensions Supervision

General overview

The Division is responsible for registering and supervising funds, namely Experienced Investor Funds "EIFs", as well as fund service providers: EIF directors, Fund Administrators, Collective Investment Scheme Managers and Depositaries. The Division is also responsible for the supervision of Occupational Pension Institutions and for the conduct of business requirements of firms offering consumer credit.

During the year, the Division was responsible for supervising approximately 17 entities subject to risk assessments. EIFs and EIF directors are not subject to risk assessments and other firms such as depositaries are primarily supervised by the Banking and Investment Services Division and therefore are not included in this figure.

Legislative and regulatory changes

The Division has provided regulatory input into the changes introduced by the Financial Services (Experienced Investor Fund) Regulations 2012 (EIF Regulations) including the introduction of a pre-establishment registration process, use of external fund administrators and further disclosure requirements. The Regulations will bring new regulatory challenges and new opportunities to the regime and the Division plans to work with the industry on the new EIF Regulations. A newsletter was issued setting out administrative arrangements and Commission's expectations on some aspects of the new EIF Regulations.

A large part of the Division's work is devoted to registering and supervising EIFs. The Division processes EIF fund notifications and

works with advisors and directors of funds to ensure that fund documentation is compliant with the EIF Regulations and best practice, for example, in providing further explanations as to the investment type and the associated risks. Furthermore, the team is developing its supervision of EIFs, for example, by developing the EIF annual return and is currently also working on an EIF director return.

The Division issued a newsletter setting out the common areas and main expectations in respect of EIFs during July 2011.

The Division has also been involved in the implementation of the Undertaking in Collective Investment Schemes (UCITS) IV Directive and is internally developing the regulatory processes required for supervising both UCITS and UCITS Managers.

The Division is monitoring developments in relation to the Alternative Investment Fund Managers Directive. On 11 November 2010, the European Parliament voted in favour of the Directive on Alternative Investment Fund Managers. The Directive came into force during the first quarter of 2011 and the transposition deadline has been set to 22 July 2013. A newsletter setting out the main requirements has been issued. Once the EU has agreed on the level 2 requirements it will be one of the Division's main themes of work during 2012/2013.

During 2011, the Division assumed responsibility for ensuring that firms offering consumer credit comply with the relevant conduct of business requirements. The Division is working with the firms concerned, to ensure that these comply with said requirements, and it is expected that this will continue during 2012/2013.

Stakeholder relations

The Division is increasing its interface with stakeholders and hopes to continue to develop this during the forthcoming period.

Insurance Supervision

General overview

The Insurance sector in Gibraltar continues to grow. During the period under review three new insurers were licensed, while one insurer surrendered its licence. In addition, three new insurance intermediaries and one insurance manager were licensed, with two

insurance intermediaries surrendering their licences.

The number of licensed insurers now stands at 65. Following the major growth in the number of insurers in prior years, we are now seeing significant growth in the volume of business that those insurers underwrite. Premiums and assets both grew by 33% in 2010 over 2009 and we expect to see further strong growth when the final returns for 2011 are submitted in the middle of 2012.

Of the 65 insurers currently licensed, 58 have exercised their right to passport into the United Kingdom. Gibraltar motor insurers that underwrite UK risks are now estimated to account for more than 10% of the UK market.

Legislative and regulatory changes

The key issue that the Gibraltar insurance industry and the Commission continue to address is the implementation of Solvency II. The ongoing delays at EU level in finalising dates for the transposition and implementation of the Directive cause frustration to all. These delays are likely to reduce the time available to prepare for implementation, as the deadline for finalising implementing measures, technical standards and guidance is moving back at a faster rate than the implementation date. While having additional time to complete a significant project is, on the face of it, no bad thing. The extended delays and lack of clarity of the final requirements is leading insurers to question when they should commit the resource and expense of ensuring regime compliance.

Stakeholder Relations

The Commission continues to maintain regular dialogue with all Gibraltar insurers, or their insurance managers, regarding their preparations to meet Solvency II Directive requirements; meeting each firm at least once every six months. It also continues to review Pre-Applications for Internal Model Approval. In a number of cases, this involves liaison with supervisory colleagues in other EU Member states, where insurers are developing Group models. The Commission recently joined its first European Supervisory College; for the XL Group. It will be joining other colleges soon, one of which the Commission will act as the lead supervisor. In preparing ourselves to regulate under the new Solvency II regime, members of the

Insurance Division have been participating in numerous training seminars organised by the European Insurance and Occupational Pensions Authority (EIOPA).

In addition to 65 insurers, the Insurance team also supervises 30 insurance intermediaries and 8 insurance managers. During the last financial year it undertook and completed 22 risk assessments of those firms and conducted a further 16 Prudential and Focused Visits.

The Commission has continued to strengthen the insurance supervisory team by focusing new recruitment on individuals with strong financial analysis skills, who will be able to support the team as it faces the challenges of meeting Solvency II disclosure and report analysis requirements. The Commission is committed to maintaining a team that is acknowledged for its technical excellence, with relevant accounting, actuarial and insurance professional qualifications, and strong inter-personal skills. By doing so it will ensure that in its ongoing supervision it keeps abreast of emerging market issues as well as identifying regulatory issues that might affect individual entities.

Internal Operations

The number of staff has risen from 43 in 2011 to 46 in July 2012. This small increase in head count will allow the Commission to continue to effectively supervise the finance sector and ensure that service level standards are being met. This recruitment will also provide the additional resources required to undertake increased workloads resulting from the Commission's revised risk assessment programme particularly in the insurance sector.

The new staff members are:

- Philippa Baldwin (Audit Supervision)
- Stuart Barea (IT)
- Brett Bass (Insurance Supervision)
- Sharon Forster (Insurance Supervision)
- Melaine Garcia (Insurance Supervision)
- Lianne Moreno (Insurance Supervision)
- Rhoda Reyes (Reception)

This year has also seen a number of long serving employees depart from the organisation and we wish them success in their future endeavours. The leavers are: Jackie Caetano, Shirley Samtani, Eugenie Cottrell and Suzanne Bant.

There have also been a number of internal changes including Neill Perera assuming the role of Deputy Head of Fiduciary Services Supervision working alongside the acting Head of the division, David Parody. Michelle Garcia has transferred from the Insurance Division and been appointed Legislative Drafter within the Operations division. This role will be responsible for working alongside the Finance Centre Director, Government of Gibraltar's legal drafters and the private sector in order to facilitate the drafting of certain pieces of Financial Services Legislation for the Government of Gibraltar. The recruitment of Philippa Baldwin as Manager of Audit Supervision will lead to Bethan Perera, who has been temporarily managing the role since 2010, focusing purely on her role within the Commission as Policy and Risk Manager.

Further internal changes have been made within the Operations Division in the form of creating a centralised Accounts team which will be responsible for all invoicing duties as well as the daily accounts. This will serve to ensure that the growing Operations team continue to support the regulatory divisions.

The Commission continues to be committed to working with the finance sector in order to increase its own skills and understanding and therefore inwards secondment opportunities are available to professionals from within the local industry to join the Commission's team for a period of six months. This scheme has proven to be a beneficial learning opportunity to the involved parties over the last twelve months. Jonathan Borg from KPMG and Christian Caetano from Isolac both spent 6 months with the Insurance Division and Ernest Lima has recently joined the Banking & Investment Services Division from Hassans.

This year has seen the development of a "Grey Panther" scheme aimed to time enhance and increase the effectiveness of the Commission's supervisory regime. In order to do this it wishes to seek the co-operation of individuals, "Grey Panthers" with extensive industry experience, who no longer hold an executive role within a regulated firm, to offer guidance and assist in the work programmes of individual divisions. This outreach should serve to enhance our relationship within the industry in a similar fashion to the secondment programme. The first "Grey Panther" joined

the Commission in 2012.

The Commission is also keen to provide students, the potential regulators and licensees of the future, with the opportunity to join the Commission for a period of two weeks as part of a summer intern programme. This programme aims to provide students with interesting work experience and provide an insight into the functions and role of a regulator.

The Commission is also working closely with the Commonwealth Secretariat in assisting regulatory development in a number of Commonwealth countries. This year I attended the "Commonwealth Regulatory Workshop" in Trinidad, where I had been invited by the Secretariat to address the workshop on the Governance of International Regulation. I also led a series of workshops to the Rwandan National Bank and the Zambian Pension and Insurance Authority in order to complete assignments designed to assist in international improvements in financial sector supervision. The Deputy Chief Executive Officer, David Parody, has also worked closely with the Secretariat by contributing to a workshop in Kampala, Uganda earlier in the year in addition to visiting Mombasa, Kenya, where he delivered a workshop for the Board of the Kenyan Insurance Regulatory Authority (IRA). This was funded by the IRA itself.

The Commission continues to be committed to the development of its own staff and in ensuring that they are trained in a range of areas. This is not uncommon for small jurisdiction regulators in which the existence of already experienced regulatory staff is limited. Therefore, a total of 47 internal and external courses have been attended by staff during the course of the year. The chart below provides details of our employees' qualifications. The increase in the qualifications since last year serves to demonstrate the Commission's and the staff's commitment to increasing their knowledge and skill base.

1st Degree (e.g. BA, BSc)	36
2nd Degree	7
Professional qualification (incl. Accountant, Lawyer, Actuary)	16
Industry qualification (Incl. STEP, ICSA, CISI, CII, CMI, AAT, CEFA, CLT International)	21

The Commission strives to limit the negative effects it may have on their environment by adopting a number of practices. Records are kept of electricity and cooling consumptions and employees are advised if this increases substantially so that preventative action can be taken. Where possible therefore we utilise timers on our electronic appliances.

The Commission also ensures that it keeps paper usage to the minimum by publishing our Annual Returns, Newsletters and Press Releases on our website as opposed to printing these.

The Internal Operations Manager has also recently completed a CIEH* Level 2 Award in Environmental Principles and Best Practice in order to ensure that we continue to adhere to Environmental legislation and keep abreast of best practice in this area. Enforcement, International Engagement and work with the Industry

Enforcement

During the past year, the Commission's Enforcement team conducted a significant amount of casework and made a number of related press statements, which are copied below:

June 2011: The Commission in a joint operation Royal Gibraltar Police carried out a number of targeted actions against retail outlets believed to have been undertaking unlicensed Bureau de Change business.

As a result nine premises have been searched and 17 persons have been arrested on suspicion of having committed offences under the Financial Services (Investment and Fiduciary Services) Act 1989.

The arrested persons were later bailed by the police and following further investigations, nine retailers paid substantial compromise penalties to the Commission.

September 2011: In 2008 the Commission had obtained an Injunction at the Supreme Court in Gibraltar, restraining Starlight Marine Limited and its beneficial owners from undertaking unlawful activities and awarded an interim Restitution Order in the sum of £250,000 to the Commission. Subsequently that order was made final and the company was wound up in the public interest.

Since the original order, the Commission had continued to act in the interests of investors who may have suffered financial loss as a consequence of their dealings with Starlight Marine Limited.

Steps were taken to obtain the registration of the Gibraltar Order in the High Court in England so it could be enforced in that jurisdiction. A new Order was issued by the High Court of Justice, Queen's Bench Division in the United Kingdom on 12 September 2011, which recognised the 2008 judgment of the Supreme Court of Gibraltar and registers the same for enforcement purposes.

It ordered that Grant Selby and David Bennett ('the defendants') pay the Commission the sum of £250,000 and that they paid the costs of that application registered in the Queen's Bench Division of the High Court of Justice under the Civil Jurisdiction and Judgments Act 1982. Steps have since been taken to seek to enforce the order in UK.

October 2011: On Friday 21 October 2011, lawyers acting for the Commission obtained a winding-up order in the Supreme Court against RLS Insurance & Financial Consultants Limited.

Consequently, Mr Edgar Lavarello and Mr Charles Bottaro were appointed as joint liquidators.

RLS Insurance & Financial Consultants Limited was previously licensed by the FSC to provide insurance mediation business in Gibraltar. Following enforcement action the FSC petitioned the court to wind-up the company in order to recover fees due to it.

April 2012: In its continuing efforts to enforce the judgement by which the Supreme Court made an award of damages in the sum of £6.3 million in January 2011, lawyers acting for the Commission obtained bankruptcy orders against two of the former directors of Rock Financial Services Limited ('RFSL').

In this latest action Anthony Everard Whitting and Michael James Gregory Whitting were declared bankrupt at the High Court and Chelmsford County Court respectively.

Although the recent bankruptcies would indicate that there is a low likelihood of securing the sums awarded, the Commission is continuing to pursue this matter.

As part of its mission to protect the public from suffering financial loss, the Commission issued 7 public warnings during the period covered by this report. The subject of these warnings included unlicensed entities holding themselves out as carrying on investment business, internet payment services activities and a bogus online bank.

One of the warnings concerned the utterance of a forged FSC letter and another a bogus certificate of insurance. Another warning concerned advance fee fraud.

Enforcement is also responsible for handling requests from and to other regulators. The Commission received 17 requests for assistance during 2011. Only one of these had not been resolved at the time of writing. The Commission itself made 9 requests during the same period. In addition to requests for assistance, Enforcement also deals with a far greater number of routine due diligence requests from international regulators.

Commission Finances

It is the Commission's view that, in future, it should be in a position to absorb the financial costs of major regulatory action such as the Gibrand/Cabor administration without the necessity of a Special Levy. This cushion will be achieved in two ways. Firstly, the creation of a contingency fund via legislation which is currently being drafted within Government. Secondly, the rebuilding of the Commission's own reserves. As can be seen from the financial report we have made good progress in respect of the latter and have increased our reserves from last year by over £ 240,000. In achieving this we benefited from the delays in the implementation of Solvency II and also from Gibraltar's remarkable resilience to the financial crisis which saw more firms than anticipated applying and becoming licensed.

Professional services

With the exception of actuarial services provided by the UK Government Actuaries Department the most significant external professional services provided to the

Commission came in respect of legal work. The fees paid for this work during the year, broken down by firm, was as follows:

	£
Attias & Levy	44,426
Triay & Triay	10,419
Triay Stagnetto Neish	10,244
Hassans International Law Firm	7,500
Isola & Isola	6,960

International Fora

As a small jurisdiction it remains vital that we "punch above our weight" in the international regulatory community. As such we have been highly successful although it is a resource intensive activity particularly amongst the senior members of the team.

The Commission's Head of Insurance Supervision sits on the Executive Committee of the International Association of Insurance Supervisors ("IAIS"). I have recently taken over as Chairman of the Offshore Group of Insurance Supervisors, soon to be known as the Group of International Insurance Centre Supervisors. The Commission continues to play an active role in IOSCO and the Group of International Financial Centre Supervisors. We have also been accepted into the membership of the International Forum of Independent Audit Regulators "IFIAR".

Commission Members

I would like to add my welcome to the Chairman and to Mr Edgar Lavarello and Mrs Emma Perez who will join our board later this year and thank Mr Franco Cassar and Mr Pepe Caruana who will be leaving us having served their statutory maximum nine years. Both Franco and Pepe have been valuable board members and we will miss their contribution.

I also would like to congratulate our former board member, Mr Robert Vasquez on his well deserved appointment to be a Queen's Counsel.

Key themes for 2012/13

Introduction

Clearly our work on existing and forthcoming EU directives will involve a considerable amount of Commission time. Similarly, as part of developing our business plan for 2012/2013 the Commission identified a number of risk areas on which focus must be placed.

Each year the Commission goes through a formal process of identifying the risks to which it is exposed and proposed mitigation. Prepared initially by the Executive, it is then presented to the Board for consideration. Following Board endorsement the individuals then build the mitigation into their draft Divisional business plans. These too are then submitted to the board which makes such changes as it considers appropriate. The Divisions then incorporate those changes before a finalised plan is submitted for final Board approval. Once this has been done, the Divisions prepare their programme for the following business year and the Commission's budget is set.

Clearly, exogenous events may impact delivery of the plan or require changes to be made. However, it does allow the Commission to plan for, resource and prioritise, to mitigate the threats to its ability to meet its statutory duties.

In my 2011/12 report, I highlighted areas that we considered would be of material benefit, not only to the effectiveness of regulatory supervision but also to consumers, the industry and the growth of the finance sector of Gibraltar as a whole. Regretfully, a number of them required legislative backing and therefore the desired progress was never made. We therefore repeat them and trust in better things this year.

These are:

- Improved Corporate Governance and Enterprise Risk Management in the industry
- Enhancing professionalism in the industry
- A formal mechanism for dealing with consumer complaints
- The introduction of an Approved Persons regime
- Extending the Commission's

enforcement and regulatory cooperation powers

- Updating of regulations
- The creation of a formal process for reviewing Commission decisions

Improved Corporate Governance and Enterprise Risk Management in the industry

Whilst significant emphasis has been placed on issues of capital and solvency, these are insufficiently effective without a business having an effective corporate governance regime and, in particular, the board having full and up to date understanding of the risks involved in the firm's activities.

If the crisis has taught us anything, it was that failure to understand risk was a fundamental root cause. Governments did not understand the risks involved in their macro-economic and social policies (e.g. encouraging home ownership for those who ultimately had no means to repay their mortgages). Bank boards failed to appreciate the risks involved in their proprietary trading. AIG's board did not grasp the potential threat in their involvement in activities outside their vast, traditional insurance operation. Regulators underestimated the risks being taken by their licensees and failed to take action before it was too late.

Understanding of the cumulative effect of a number of risks as well as individual risks needs to be considered. Recent events show that risks come, like sorrows, "not as single spies, but in battalions."

Ensuring effective corporate governance must therefore be a priority in our work. This includes the role of non-executive directors (including their independence where appropriate), the adequacy of the information provided by the executive to the board, the quality of the board itself, and the manner in which the board ensures that the firm establishes and maintains effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

In the case of non executives, these need to make sufficient time available to discharge their responsibilities effectively.

Enhancing professionalism in the industry

The issue of the adequacy of advice and information provided to clients when they invest in or purchase financial products has again come to the fore. This international issue cannot be ignored in Gibraltar.

Whether it is the concern expressed by the Central Bank of Ireland about some Contract for Differences (CFD) providers “failing to fully inform and provide adequate risk warnings to consumers about the risks that CFD and financial spread betting carries before they begin trading” or the recent UK FSA review of wealth managers which found that 14 out of 16 firms assessed were judged to pose a high or medium-high risk of detriment to their customers, based on the number of client files which had a high risk of unsuitability or where the suitability could not be determined.

It remains the Commission’s view that the key to preventing such concerns arising in Gibraltar is the activation of the 2006 legislation which created the Financial Services Skills Council.

The Commission continues to support the excellent work of the Gibraltar Association of Compliance Officers “GACO” in improving the quality of training in Gibraltar; including its Foundation Course, which was run with the support of the Department of Education. This combined with the work of the Gibraltar Fund Industry Association “GFIA”, Gibraltar Insurance Association “GIA”, Gibraltar Insurance Institute “GII”, which is now an Affiliate of the Chartered Insurance Institute, and the Chartered Institute of Securities and Investments “CISI”, to name but a few, has laid an excellent foundation for the Council’s work. However, the work must now be coordinated and proper standards set and enforced.

Consumers have a right to know that the person on whose advice they entrust their pension or life savings is properly trained and suitably competent. We expect this of our doctor and accountant and therefore we should expect no less from our financial adviser. Indeed, whilst much is spoken, not least by me about the importance of reputation, reputation itself is impossible without such professionalism.

In addition to the Skills Council, consideration should be given in financial terms between those firms that invest in such training and those that do not. Firms, who do invest, present fewer risks of regulatory breaches, have fewer complaints and are less resource intensive for the Commission. Why should such firms effectively subsidise those who fail to make such an investment? Therefore, during the next 18 months the Commission will investigate whether it is possible to provide a real benefit for such firms in terms of their regulatory fees. Such an approach is wholly consistent with the concept “the polluter pays”.

In the end, however, the best way that appropriate qualifications will become the norm will be because the professionals in the sector see the benefits for themselves and their firms. The Associations have done much to develop this belief; an effective Skills Council would improve matters still further.

A formal mechanism for dealing with consumer complaints.

There is no formal mechanism for the investigation and adjudication of complaints regarding services and products provided by licensees. With the exception of complaints relating to payment services, the Commission is not empowered to conduct this role. Whilst we investigate complaints, this is from the perspective of assessing whether a regulatory breach has occurred rather than to seek redress for the complainant.

We are delighted, therefore, at the new Government’s commitment to introduce a complaints handling system.

Approved Persons Regime

We will continue to seek Government approval for our proposals to introduce an Approved Persons Regime. Government consulted on this concept some years ago and feedback was provided to Government. We consider that the ability to approve persons for defined functions within the regulated sector is an important tool towards protecting the customer, increasing technical competence of practitioners and facilitating good corporate governance. This would also provide redress to those individuals directly affected by the Commission’s decisions (for example in respect of our conclusion on their

fitness and propriety), which is currently not provided for in the legislation.

Extending the Commission's enforcement and regulatory cooperation powers

With the increased range of activities which the Commission has become responsible for, and the additional supervision of the regulated sector, the Commission will also be seeking greater powers to impose administrative sanctions and penalty fees for breaches of regulatory requirements. At present, for most of these occurrences, the Commission can only seek draconian measures (e.g. cancellation or suspension of an authorisation) or seek a criminal prosecution. We believe that there is a halfway house that can be achieved which will provide adequate sanction as well as deterrence without the need for criminal proceedings to be instituted. Such measures, if accepted by Government, would need to have sufficient safeguards that would prevent the Commission from using penalty fees as revenue raising measures, as well providing a formal and transparent appeals process (see our proposals for a formal review process below).

The Commission's time and resources tend to be dedicated to firms who, through their risk profile, present a greater risk to our regulatory objectives and, in particular, preventing the public from suffering financial loss. With this principle in mind, we will also be seeking to address how fees payable under the supervisory acts can be more closely linked to those firms that pose a greater resourcing requirement for the Commission. One of the considerations (as referred to above) that we are seeking to explore further is recognition of those firms whose officers and front line staff possess qualifications which would mitigate the risk of financial loss to the public.

In respect of regulatory cooperation, the importance of this can be seen from the fact that it was one of the G20 five main principles to guide reforms as part of their "Declaration of the Summit on Financial Markets and the World Economy" released after their Washington meeting in November 2008. Our proposals for draft legislation to bring our ability to cooperate up to international expectations are currently before Government.

Updating of regulations

Whilst focus necessarily has been placed on directives and other EU initiatives, the Commission is currently working on a number of non-EU statutory and regulatory provisions that are in need of updating. Some have been unchanged since 1991 and are no longer fit for purpose. We will therefore be recommending changes to Government in respect of these.

Similarly, some transpositions of Directives were poorly drafted and need amendment. We will continue to highlight these to Government as and when we identify these.

The creation of a formal process for reviewing Commission decisions

At present, regulatory decisions, whether in respect of licensing or enforcement, only have an appeal mechanism via the Supreme Court. Such a process is inevitably slow and expensive. Persons aggrieved by a decision should not have to go to judicial review; rather we need to develop a swift, effective appeal mechanism. No regulator should be frightened of having its decisions challenged; indeed such a capability enhances the quality of the decision making process itself. It also further demonstrates our commitment to be independent but accountable.

This will become of greater necessity if our request for greater enforcement powers (including those of fining) is granted by Government.

This process could be combined with one covering complaints against the Commission itself. For example, in the UK, rules made under the Financial Services & Markets Act 2000 require the creation of a Complaints Commissioner who is independent of the FSA and is able to conduct impartial investigations.

Marcus Killick
Chief Executive Officer
6 July 2012

The Risk Register

In line with good corporate governance the Commission maintains a risk register. This is a description of the key risks faced by the Commission in the attainment of its objectives together with an assessment of the likelihood of these risks occurring and their likely impact. It also sets out the proposed action to mitigate the risks identified.

The risk register enables the Commission's board to identify those risks that pose the biggest threats to the achievement of our objectives and enable those risks that pose

the most significant threats to be given priority.

It is an evolving document, regularly reviewed by the Executive and on an annual basis by the Board, and it acts as the foundation of our annual business plan and, from this, our budget.

A number of strategic risks are currently the subject of active mitigation. These include:

Risk	Impact	Mitigation
Economic Crisis	The current international economic crisis poses a substantial risk to the finance sector in Gibraltar	The Commission will shortly approach the finance sector representative bodies and formally raise the need for material players to analyse their level of risk and exposure within the euro zone. In addition the Commission will consider whether the firms have suitably addressed their perceived exposure.
Collapse of Insurer or major firm	The financial crisis highlighted that authorities are ill-equipped to deal with ailing firms operating in today's global markets.	The Commission is actively monitoring the EU proposals adopted by the European Commission for EU-wide rules for bank recovery and resolution. Whilst there are no developments relating to the collapse of an insurance company, the Commission is currently considering prioritisation of legislation to be enacted in this area. The outcome of which will be followed up with Government.
Previous delays in the enactment of needed financial services legislation	A significant backlog had developed. This was impeding the ability of the Commission to fulfil its statutory duties.	This issue has been fully recognised by Government and the Commission is working with Government to reduce the backlog. However, given the scale of this, key legislation has been prioritised.

Risk	Impact	Mitigation
Previous poor transposition of a number of directives.	There have been a number of drafting errors that have resulted in difficulties in implementation of key EU directives.	The position should improve with the introduction of additional drafting resources in Government. The Commission has identified a number of these errors to Government and will continue to do so. The Commission has also appointment an internal legislative draftsman to assist in this area.
Key new EU Directives	Ensuring these are introduced on time in Gibraltar with appropriate consultation with stakeholders to ensure they are fit for purpose for the needs of the Gibraltar finance sector. These include, but are not limited to, Solvency II and the Alternative Investment Fund Managers Directive.	Government is prioritising these and will be responsible for the consultative process. The Commission is working closely with Government in this area.
The lack of effective supervision in some areas	The volume of supervisory returns required by the EU will increase dramatically in the near future putting a significant cost and resource burden on the Commission and the industry.	The Commission is working to introduce an effective reporting mechanism.
The lack of effective supervision in some areas	This poses a risk to the reputation of Gibraltar.	Whilst pension funds are within our supervisory ambit, regulation only currently applies to those with 100 members or more. We consider this to pose a risk to members of smaller schemes and creates a two-tier system. We will therefore be bringing proposals to Government to regularise the position.
The lack of effective supervision in some areas	This poses a risk to the reputation of Gibraltar.	There are also a number of professions that fall outside the remit of effective regulatory supervision. Most notable of these is the legal profession. The Commission will continue to push for supervisory standards to be introduced in these areas.

Risk	Impact	Mitigation
International regulatory cooperation	Whilst the Commission has an excellent track record for international regulatory cooperation, we lack some of the statutory powers expected by international standards. As a result we have been unable to become an "A" signatory of the International Organisation of Securities Commissions "IOSCO" Multilateral Memorandum of Understanding "MMoU".	Whilst the legislative changes required are comparatively small and have never posed a problem in cooperation in practice, they are needed. We are therefore submitting to Government proposals for change that will allow us to become "A" signatories.
The imminent withdrawal of the UK Government Actuaries Department (GAD)	Creates a gap in our actuarial capability which affects the Commission's ability to conduct an analysis of the financial soundness of insurers.	The Commission will consider the appointment of additional actuarial resources in the near future.
Membership within the European Supervisory Authorities	<p>Due to Gibraltar's unique status within the EU (i.e. it is not a Member State in its own right) it is not currently recognised or considered as a member of the European System of Financial Supervisors ("ESFS"), which comprises the three ESAs.</p> <p>This restriction has meant that Gibraltar and more importantly the Commission, has been in breach of key EU Directives governing the financial sector.</p>	The Commission will continue to press this matter with both the Financial Services Authority and the ESAs.

Corporate Governance Report for the year ended 31 March 2012

The Commission is a statutory body established under the Financial Services Commission Act 2007 (the Act).

The Commission consists of the Chief Executive as ex-officio member and seven other persons appointed by the Minister with responsibility for Financial Services. At least two of these persons must have significant experience of regulation and supervision of financial services business in another jurisdiction.

The Commission appoints one of its members to be the Chairman of the Commission. Appointment of Chairman is for a period of one year. Members may be reappointed Chairman any number of times consecutively.

Commission members are appointed for three years and upon such terms as may be specified in the instrument appointing them. This is renewable. However, with the exception of the Chief Executive, Members may not be reappointed if they have served a term of nine years or more.

When there is a vacancy to be filled the Commission must, within four weeks of the creation of the vacancy, nominate no fewer than three persons to the Minister. Should the Minister decline to nominate a person from the nominations made by the Commission, the Commission shall, within a period of a further four weeks, nominate no fewer than three further persons.

Should the Minister decline to appoint a person from the nominations made by the Commission, the Minister may then appoint any person whom he believes to be suitability qualified to be a member of the Commission. If he does so, such appointment is subject to ratification by a resolution to Parliament.

The Commission currently has eight members. Following the departure of Mr Brian Hilton who had served a term of 9 years, Dr Jonathan Spencer joined the Commission in September 2011. At this time Mr Alan Whiting was appointed as

Chairman. Mr Alan Whiting previously served as the Senior Independent Member. This position is now fulfilled by Mr John Tattersall.

Commission Members are;

Marcus Killick
Chief Executive Officer
Franco Cassar
1 October 2003 – 30 September 2012
Joseph Caruana
30 July 2003 – 29 July 2012
Nigel Feetham
28 May 2007 – 27 May 2013
Jonathan Spencer
6 October 2011 – 5 October 2014
John Tattersall
1 October 2009 – 30 November 2012
Melo Triay
4 March 2011 – 3 March 2014
Alan Whiting
27 January 2005 - 25 January 2014

Functions of the Commission

Under Section 6(1) of the Act, the functions of the Commission are:

- (a) to supervise Authorised persons in accordance with this Act and the Supervisory Acts;
- (b) to consider and determine applications for authorisations, licences, recognitions and registrations made under the Supervisory Acts;
- (c) to monitor compliance by Authorised persons with such legislation, rules, codes and guidance made under this Act or any Supervisory Acts;
- (d) to monitor compliance by Authorised persons with legislation, rules, codes and guidance relating to the prevention of financial crime;
- (e) to monitor financial services business carried on in or from Gibraltar and to take such appropriate action as it is

empowered to do against persons carrying on such business without the necessary authorisation, licence or registration;

- (f) to carry out the duties and discharge the functions imposed on, or given to, it under this or any other Act;
- (g) to determine subject to the approval of the Minister the terms of service of the Chief Executive;
- (h) to determine the number and skill mix of employees required by the Commission to carry out its functions and to determine their terms and conditions of employment;
- (i) to monitor and oversee the performance by the Chief Executive of all functions delegated to him by the Commission;
- (j) to approve the annual estimates of income and expenditure to be furnished to the Minister; and
- (k) in respect of those areas of financial services business where Community law applies, to supervise and regulate financial services business carried on in or from Gibraltar in accordance with Community obligations and in those areas to establish and implement standards and supervisory practices which match the standards and supervisory practices governing the provision of financial services within the United Kingdom.

The wide range of skills contributed by the individuals above enables the Board to achieve the appropriate balance of skills, experience, independence and knowledge to ensure the Board discharges its respective duties and responsibilities effectively.

The Commission has met 4 times in the last year. The Chairman, with the support of the executive directors and the CEO, sets the agenda for board deliberations. The board agenda is focused on strategy, performance, value creation and accountability, and ensuring that issues relevant to these areas are reserved for board decision. The board agenda and supporting documentation is provided to members in advance of the scheduled meeting in a timely and

appropriate manner by the Secretary to the Board.

All Divisional Managers and Heads provide an update to the Board on performance against the business plans at each meeting. The Commission scrutinises management performance, including the attainment of agreed goals and objectives.

All newly appointed members to the Commission undertake a formal and tailored induction carried out by the Chief Executive, Secretary to the Board and Heads of each Division at the Commission. In September 2011 the formal induction for Dr Jonathan Spencer took place.

To ensure that the Board members have the skills and knowledge required to fulfil their role on both the board and on board committees, the Commission ensures that they receive regular industry and regulatory update briefings. In addition, Board members are invited to attend breakfast briefings on a quarterly basis with Divisions. Furthermore, all Board members are apprised on a quarterly basis of forthcoming legislation and regulatory developments. In some cases, presentations are given by the relevant Division.

The Commission is committed to transparency and open regulation. It is therefore important that our stakeholders are aware of how we seek to ensure that key principles of good governance are applied within the Commission.

One method of achieving this is by publishing our self-assessment on the extent to which we comply with the "UK Corporate Governance Code" (the Code). Whilst the Code is primarily aimed at listed companies rather than regulators, and therefore is not directly applicable to the Commission, it nevertheless contains many useful principles which do have an application within the Commission.

The Code (formerly the Combined Code) sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. In May 2010 the Financial Reporting Council issued a new edition of the Code. This followed a review of the Code carried out during 2009.

In September 2011 the Commission reviewed its adherence to the Code and produced an updated summary paper on its website.

The summary report available on the Commission's website focuses on how both main and supporting principles are applied. In doing so the Commission either confirms that the Commission complies with the Code's provisions or, where it does not, provides an explanation.

The Commission is fully aware that boards continually need to monitor and improve their performance and as a result has committed to reviewing and enhancing its level of corporate governance. The Commission has already set time aside to consider this area in greater detail in September 2012.

Committees of the Commission

Whilst the Board is responsible for making the final decision, it utilises subcommittees to assist in its consideration of audit and remuneration matters. The subcommittees meet on a regular basis and report to the Board. The terms of reference of all the Committees are published on the Commission's website.

Audit Committee

The key duties of the Committee are:

- To monitor the integrity of the financial statements
- To review the Commission's system of internal controls.
- To monitor and review the effectiveness of the Commission's internal audit function.
- To make recommendations to the Commission regarding the appointment, re-appointment and removal of the external auditor; approve their remuneration and monitor their independence and objectivity.

The members of the Audit Committee during the year ended 31 March 2012 were Mr Joseph Caruana (Chairman), Mr John Tattersall and Dr Jonathan Spencer (who replaced Mr Alan Whiting in December 2011).

The Audit Committee met on three occasions during the year under review during which time:

- They reviewed the Commission's financial statements, met with the external auditors and considered their reports.
- They assessed the performance of the external auditors.
- They agreed the scope of work of the internal audit team and considered their reports and recommendations for the improvement of the Commission's system of internal control.

Performance and Remuneration Committee

The Remuneration Committee reviews the performance of the most senior executives against the aims and objectives set for them and determines their remuneration (including any bonus structure) accordingly. It is chaired by Mr John Tattersall and its members are the Chairman of the Commission (Mr Alan Whiting) and Mr Franco Cassar. The Committee will also, when necessary, make changes to senior executives' terms and conditions. The Committee met twice in the year.

Nomination Committee

The Nomination Committee leads the process for the appointment of the posts of Chief Executive and Commission Members and makes recommendations to the Commission as appropriate. It is chaired by the Chairman (Mr Alan Whiting) of the Commission and its members are the Chief Executive (Mr Marcus Killick) and two other members of the Commission (Mr Nigel Feetham and Mr Joseph E (Melo) Triay). By statute the power to remove the Chief Executive rests jointly with the Minister and the Commission. The Committee also looks at succession planning. The Nomination Committee met once in the year.

Budget Review Committee

The Budget Review Committee's role is to provide an independent challenge to the Commission's budgetary process and to recommend the annual budget to the Commission. Membership consists of Mr Franco Cassar, Mr Joseph Caruana, Mr Alan Whiting and Mr Joseph E (Melo) Triay. The

Chief Executive Officer and the Deputy Chief Executive Officer also form part of the Committee.

The duties of this committee are;

- To review the draft annual financial budget prepared by the Executive
- To challenge the underlying assumptions and forecasts with a view of determining the accuracy of the same
- To direct the executive to reconsider any item of forecast income or expenditure
- To recommend, or otherwise, the draft budget to the Commission.
- The Budget Review committee met in once in the year.

Risk

The Commission recently agreed that the responsibility for oversight and advice on the current risk exposures and future risk strategy should be assigned to a member of the Board. The Commission has therefore appointed Mr John Tattersall to carry out this role. Mr Tattersall will work closely with Mrs Bethan Perera who will be responsible for

managing risk within the Commission. Mr Tattersall will report to the Commission on a quarterly basis and will work with the Executive to embed and maintain a supportive culture in relation to the management of risk.

Board Evaluation

The Board evaluates the Chairman's performance on an annual basis. The Board evaluation provides a valuable feedback mechanism for improving the effectiveness of the Board. The outcome of the evaluation is shared with the whole Board.

In September 2011 the Board conducted an evaluation of the material supplied in the Board pack to ensure that it was relevant and allowed Board members to effectively carry out functions as Commission Members.

The next evaluation will be conducted ahead of the Board meeting in September 2012 so that development areas may be highlighted and incorporated into the corporate governance review.

Attendance at the Commission Meetings;

	107 th Meeting	106 th Meeting	105 th Meeting	104 th Meeting
Marcus Killick	✓	✓	✓	✓
Joseph Caruana	✓	✓	✓	✓
Franco Cassar	✓	✓	✓	✓
Nigel Feetham	✓	✓	✓	✓
Brian Hilton			✓	✓
John Tattersall	✓	✓	✓	✓
Joseph (E) (Melo) Triay	✓	✓	✓	✓
Alan Whiting	✓	✓	✓	✓
Jonathan Spencer	✓	✓		



Independent Auditors' Report to The Financial Services Commission

Report on the financial statements

We have audited the accompanying financial statements of the Financial Services Commission for the year ended 31 March 2012 which comprise the income and expenditure account, the balance sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Commission's responsibilities for the financial statements

The Commission is responsible for the preparation and true and fair presentation of these financial statements in accordance with applicable law in Gibraltar and Gibraltar Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibilities

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements give a true and fair view, in accordance with Gibraltar Generally Accepted Accounting Practice, of the state of the Commission's affairs as at 31 March 2012 and its profit for the year then ended.

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Independent Auditors' Report to The Financial Services Commission –continued

Report on other legal and regulatory requirements

In addition to reporting on the financial statements, Gibraltar legal and regulatory requirements also require us to report to you our opinion as to whether the Commission has kept proper accounting records, whether the Commission's balance sheet and accounts dealt with by this report are in agreement with the accounting records, if we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit, whether the balance sheet of the Commission's finances as at the end of the financial year and the profit for the financial year in income and expenditure account give a true and fair view and whether the Commission has discharged with diligence its obligations in relation to the collection of its revenues.

Opinion

In our opinion:

1. proper accounting records have been kept by the Commission;
2. the Commission's balance sheet and accounts dealt with by this report are in agreement with the accounting records;
3. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
 1. the balance sheet of the Commission's finances as at the end of the financial year and the profit for the financial year within the income and expenditure account give a true and fair view base on the information and explanation given to us; and
 2. the Commission has discharged with diligence its obligations in relation to the collection of its revenues.

Other matters

This report, including the opinions, has been prepared for and only for the Commission as a body in accordance with Section 16 of the Financial Services Commission Act and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Colin Vaughan
Statutory Auditor
For and on behalf of
PricewaterhouseCoopers Limited

13 July 2012

Income and Expenditure Account For the year ended 31 March 2012

	Notes	2012 £	2011 £
INCOME			
Fees receivable	3	3,155,541	2,606,511
Interest receivable		3,312	2,465
		<hr/>	<hr/>
TOTAL INCOME		3,158,853	2,608,976
		<hr/>	<hr/>
EXPENDITURE			
Staff expenses	4	2,157,736	1,911,496
Establishment costs		248,710	240,059
Other operating expenses		119,432	105,483
Commission members' fees	5	122,949	117,000
Legal and professional fees		188,445	328,790
Auditors remuneration		8,000	8,000
Depreciation	6	49,265	44,903
Other professional charges		22,187	17,416
Authorised Administrator	7	(2,912)	178,963
Loss on Disposal of Fixed Assets		281	1,488
		<hr/>	<hr/>
TOTAL EXPENDITURE		2,914,093	2,953,598
		<hr/>	<hr/>
OPERATING PROFIT/(LOSS)	£	244,760	£ (344,622)

There are no recognised gains or losses other than as disclosed above and there have been no discontinued activities or acquisitions in the current or preceding year.

There is no difference between the operating profit stated above and their historical cost equivalents.

The notes on pages 30 to 35 form part of these financial statements.

Balance Sheet

As at 31 March 2012

	Notes	2012 £	2011 £
FIXED ASSETS			
Tangible assets	6	81,568	98,492
CURRENT ASSETS			
Debtors and prepayments	8	602,792	910,771
Cash at bank and in hand		503,794	206,078
		1,106,586	1,116,849
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	9	320,895	792,842
NET CURRENT ASSETS		785,691	324,007
TOTAL ASSETS LESS CURRENT LIABILITIES	£	867,259	422,499
CREDITORS : AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	10	200,000	-
NET ASSETS	£	667,259	£ 422,499
FINANCED BY:			
GENERAL FUND	11 £	667,259	£ 422,499

The financial statements on pages 28 to 35 were approved by the Commission on 6 July 2012 and signed on its behalf by:

Marcus Killick
Chief Executive Officer

Alan Whiting
Chairman

Notes to the Financial Statements

1. PRINCIPAL ACCOUNTING POLICIES

Basis of accounting

The financial statements are prepared in accordance with Gibraltar Accounting Standards. The particular accounting policies adopted by the Commission are described below.

Accounting convention

The financial statements are prepared under the historical cost convention.

Cash Flow Statement

The Commission is exempt from the requirement to prepare a cash flow statement under the provisions of Gibraltar Financial Reporting Standard 1 (Revised) on the grounds of the Commission's size.

Income

Annual Renewal Fees due under the Banking, Insurance, Auditors, Occupational Pensions and Financial Services Acts are recognised on an invoiced basis, whilst all other fee income is recognised on a receipts basis.

Interest receivable is accounted for on an accruals basis.

Depreciation

Depreciation has been calculated so as to write off the cost of fixed assets on a straight line basis over their expected useful economic lives at the following annual rates:

Motor Vehicles	20%
Office Furniture and Fittings	20%
Office Equipment:	
General	20%
Computers	33 1/3%

Leasehold Improvements

As in previous years, leasehold improvements are written-off in the year in which they occur.

Pension costs

The Financial Services Commission makes contributions to the Gibraltar Provident Trust (No. 3) Pension Scheme. Costs are accounted for on an accruals basis and are recognised in the income and expenditure account in the year in which they are incurred.

General Fund

The General Fund represents the retained earnings of the Commission.

Authorised Administrator Debtor Balance

The authorised administrator debtor balance represents the authorised administrator fees less:

- a) The amounts recovered from licensees in the form of a special levy chargeable to entities who benefitted from a transfer of companies and trusts, and
- b) An annual contingency fee payable by all licensees, which amounts to 10% of their annual licence fees.

Both of these fees are excluded from the income of the Commission.

Notes to the Financial Statements

Restitution Orders

The Commission recognises restitution orders awarded by the Courts as income on a cash receipt basis.

2. TAXATION

Under the provisions of the Financial Services Commission Act, the income of the Commission is exempt from income tax.

3. FEES RECEIVABLE

	2012 £	2011 £
Financial Services Acts	1,426,814	1,210,972
Banking Act	345,000	267,500
Insurance Companies Act	1,155,000	958,250
Others	228,727	169,789
	<u>£ 3,155,541</u>	<u>£ 2,606,511</u>

There have been no recovery of funds from restitution orders during the course of the financial year.

4. STAFF EXPENSES

	£	£
Salaries	1,801,120	1,582,823
Social security costs	70,346	64,345
Pension costs	173,951	151,476
Other staff costs	112,319	112,852
	<u>£ 2,157,736</u>	<u>£ 1,911,496</u>

The Chief Executive Officer received total remuneration, including pension and life insurance contributions of £254,570 (2011: £250,000).

The average number of employees for the year was 43 (2011: 40).

Regulatory	32	33
Administration	11	7
Total staff employed	<u>43</u>	<u>40</u>

Notes to the Financial Statements

5. COMMISSION MEMBERS' FEES

Fees paid to the Members of the Commission were as follows:

		2012 £	2011 £
Brian Hilton	Retired 30 September 2011	13,364	26,000
Joseph Caruana		16,037	15,600
Franco Cassar		16,037	15,600
Alan Whiting		21,382	15,600
Robert Vasquez	Resigned 18 January 2011	-	11,700
Nigel Feetham		16,037	15,600
John Tattersall		16,037	15,600
Joseph Triay	Appointed 4 March 2011	16,037	1,300
Jonathan Spencer	Appointed 6 October 2011	8,018	-
		£ 122,949	£ 117,000

The Chairman and Commission Members' fees normally increase annually in line with the average increase in Commission staff salaries.

6. TANGIBLE ASSETS

	Office Furniture & Fittings £	Office Equipment £	Motor Vehicles £	Total £
Cost				
As at 1 April 2011	93,855	187,417	921	282,193
Additions	-	32,622	-	32,622
Disposals	-	(4,965)	-	(4,965)
As at 31 March 2012	93,855	215,074	921	309,850
Depreciation				
As at 1 April 2011	59,074	123,707	920	183,701
Charge for the year	10,761	38,504	-	49,265
Disposals	-	(4,684)	-	(4,684)
As at 31 March 2012	69,835	157,527	920	228,282
Net book value				
As at 31 March 2012	£ 24,020	£ 57,547	£ 1	£ 81,568
As at 31 March 2011	£ 34,781	£ 63,710	£ 1	£ 98,492

Notes to the Financial Statements

7. AUTHORISED ADMINISTRATOR

Total costs to date in respect of the Authorised Administration are as follows:-

Expenditure	2012	2011
	£	£
Authorised Administrator - Cabor	977	76,795
Authorised Administrator – Gibland	-	295,391
Legal Expenses – Cabor	(456)	347,235
Legal Expenses – Gibland	-	189,738
Legal Expenses – Meridian	-	8,626
Specialist Counsel	-	15,738
Staffing Costs	-	156,947
Disbursements – Gibland	-	4,284
Premises Costs	-	2,208
Storage and Removal	-	4,825
Stationery and Office Supplies	63	6,592
Cleaning	-	3,616
Telephone	-	5,127
Electricity	-	8,378
Bank Charges	100	583
	<u>684</u>	<u>1,126,083</u>
Amounts recovered		
Gibland	-	124,764
Cabor	3,596	22,356
	<u>3,596</u>	<u>147,120</u>
	(2,912)	978,963
Amounts to be recovered from licensees	-	800,000
	<u>(2,912)</u>	<u>178,963</u>

Under section 11 of the Financial Services (Temporary Administration of Companies) Act 2011, all the fees and costs of the Authorised Administrator in the carrying out of his powers and functions under this Act shall be defrayed out of the monies and assets of the Companies under Authorised Administration.

If the Companies shall not have sufficient monies, the said fees and costs shall be borne by the Authority.

The Authority may, with the consent of the Minister, levy a special fee upon all the holders of licences under the Principal Act, on such terms as to division between them as it shall consider equitable, to recover any costs incurred by it under this Act.

Both of these fees are not recognised as income in the income and expenditure account but are taken directly to reduce the authorised administrator as shown in note 8.

Notes to the Financial Statements

8. DEBTORS

	2012 £	2011 £
Authorised Administrator fees and costs to be recovered (see below)	485,918	800,000
Trade debtors	12,057	4,200
Other debtors and prepayments	104,817	106,571
	£ <u>602,792</u>	£ <u>910,771</u>

Movement on Authorised Administrator fees and costs to be recovered.

As at 1 April 2011	800,000
Recovered as part of annual fees	(244,194)
Recovered from firms to whom companies and trusts transferred	<u>(69,888)</u>
As at 31 March 2012	£ <u>485,918</u>

9. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	£	£
Payments in Advance	-	237,742
Trade creditors	21,408	15,085
Other creditors, including taxation and social security	38,755	40,055
Accruals and deferred income	60,732	499,960
Government of Gibraltar Loan	200,000	-
	£ <u>320,895</u>	£ <u>792,842</u>

10. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	£	£
Government of Gibraltar Loan	200,000	-
	£ <u>200,000</u>	£ <u>-</u>

Notes to the Financial Statements

The Government of Gibraltar has from 24 March 2011 made available to the Commission an unsecured, interest free advance of £400,000 in respect of costs incurred in relation to the Authorised Administrator costs of Gibland/Cabor/Meridian group of companies. This advance was drawn down during the financial year commencing 1 April 2011 at the Commission's request. Repayment is to be effected in two equal instalments. The first instalment in the financial year commencing 1 April 2012 and the second instalment in the year commencing 1 April 2013 from recoveries made by the Commission from the Contingency Fund to be established for these purposes. The first instalment was repaid on 6 June 2012.

11. GENERAL FUND

	2012 £	2011 £
	Retained Earnings	Retained Earnings
As at 1 April 2011	422,499	424,048
Result for the year	244,760	(344,622)
Transfer from Special Reserve	-	343,073
As at 31 March 2012	£ 667,259	£ 422,499

12. LEASE COMMITMENTS

	£	£
The Commission leases a property for its own occupation. Annual rentals payable under this lease are as follows: Operating leases which expire:		
Less than one year	-	-
After five years	186,379	185,022

13. RELATED PARTY TRANSACTIONS

During the year ended 31 March 2012, Deloitte Limited, of which Joseph Caruana is a director, provided certain services totalling £5,950 (2011: £37,020) to the Commission. At 31 March 2012, £ Nil (2011: £2,700) was owed by the Commission to Deloitte Limited.

During the year ended 31 March 2012, Triay and Triay, of which Joseph Triay is a partner, provided certain legal services totalling £10,419 (2011: £6,598) to the Commission. At 31 March 2012, £3,474 (2011: £ Nil) was owed by the Commission to Triay and Triay.

During the year ended 31 March 2012, Hassans, of which Nigel Feetham is a partner, provided certain legal services totalling £7,500 (2011: £ Nil) to the Commission. No amounts were outstanding at 31 March 2012 or 31 March 2011.

During the year ended 31 March 2012, PricewaterhouseCoopers Limited provided certain non-audit services totalling £1,700 (2011: £26,992) to the Commission. At 31 March 2012, £ Nil (2011: £26,660) was owed by the Commission to PricewaterhouseCoopers Limited.

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