Jersey Financial Services Commission

Business Plan 2014

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BUSINESS PLAN 2014

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SUMMARY

- The operating environment for Jersey continues to be challenging. Significant pressures are expected in the near term from developments in international regulation, cross border taxation and competition from other jurisdictions.

- The Commission plans to reinforce its track record of maintaining a robust and transparent regulatory framework which strengthens the Island's ability to compete internationally and maintain a high reputation.

- In the near term the Commission is focused on recruiting a Chairman and three Executive Directors to address current vacancies. Except for these appointments, the Commission's business-as-usual resource demands are expected to stay largely unchanged when compared to 2013.

- The Commission will continue to dedicate key resources to support financial services initiatives, particularly those emanating from the McKinsey study and legislative changes arising from the UK and EU.

- Senior resources will also be allocated to maintaining compliance with our international obligations to the International Monetary Fund ("**IMF**"), International Organization of Securities Commissions ("**IOSCO**"), the Basel Committee on Banking Supervision ("**BASEL**"), the Financial Action Task Force ("**FATF**") and the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ("**MONEYVAL**").

INTRODUCTION

Our 2014 Business Plan and Budget sets out the Commission's objectives and priorities over the next year to help Islanders, the financial services industry ("**Industry**") and Government to understand how the Commission plans to address the current challenges facing it and its staff.

The Commission welcomes opportunities to meet Industry participants, members of Government and the public to explain how it sees these challenges and would appreciate comments and constructive criticism.

CURRENT BUSINESS PRESSURES

Jersey's Industry has remained under pressure throughout 2013 and, despite some recent indications of renewed growth, the overall climate for financial services worldwide suggests that the position will remain challenging into 2014.

The consensus view of UK GDP growth remains modest, whilst Eurozone growth is expected to turn positive but remain minimal. The general outlook remains for a continuing period of low growth relative to historical averages, with interest rates remaining low and the pressures on the margins of the Island's larger banks continuing in consequence.

The future of quantitative easing and similar asset inflation measures from the developed economies is at best uncertain and the Commission therefore expects a continuing search for yield and the potential for further growth in asset prices to support some increase in funds under management.

In Jersey, we may continue to see growth in alternative investment classes and trust based business where the Island has some strength, but bank deposits are likely to remain subdued in the low interest rate environment.

Our plan assumes no increase in the number of banks, funds or trust companies operating in the Island over the year, nor any material change in their business activities. Some further small reduction may be seen in overall numbers of businesses as larger groups reduce the number of separate entities they manage.

The shifting growth of private wealth from Western Europe to Eastern Europe and the Far East will continue to offer opportunities for Jersey's wealth management sector, although it will require practitioners to develop further their risk assessment practice to deal comfortably with clients from new jurisdictions.

Against this background, competition from emerging financial centres that are often geographically closer to the client will continue to put pressure on margins, which poses challenges for risk to be properly rewarded.

We expect that the high budget deficits of developed nations mean politicians will continue to pursue their challenge to transfer pricing and similar arrangements. An increase in information sharing arising from the Jersey-UK inter governmental agreement and similar automatic exchange of information agreements, may impact on certain Island businesses, not least in terms of increased operational cost burden.

The climate created in 2013 around G8 and G20 initiatives targeting what some see as unreasonable tax avoidance may mean that legitimate new tax planning arrangements continue to be deterred, whilst some existing arrangements could be terminated early as corporates and individuals seek to manage their reputational risk.

MAJOR ISSUES AND RISKS

The Business Plan and Budget assume that these pressures do not lead to a significant loss of financial services regulated business activity, a major default or a noticeable increase in overall risk profile during the plan period.

Within the Commission, the major challenge and risks arise from changes at senior level. A new Chairman will be appointed to replace Clive Jones, who retired in October 2013, and three current vacancies at director level will also be filled. Resources will need to be adjusted and time spent to support the new recruits to help them find their feet and become fully productive.

The Commission will devote significant time in 2014 supporting Government and Industry to take forward the programme for change resulting from the 2013 McKinsey consultants' report into the future of Jersey as a finance centre. This has triggered a number of project streams in which the Commission will have a key role, including a review of the Jersey funds offering.

Externally, the major issues and risks emanate from political and regulatory initiatives being taken outside the Island.

The work the UK is doing on implementing the recommendations of the Independent Commission on Banking ("**ICB**") has yet to be finalised. Jersey, alongside the other Crown Dependencies ("**CDs**"), has made representations to HM Treasury ("**HMT**") concerning the inclusion within the 'ring fence' of the Jersey subsidiaries or branches of banks based in the UK. Achieving this would allow those banks either to continue with their deposit upstreaming model, to diversify by deploying their liability base elsewhere or to combine a mixture of the two.

The developing legislation currently passing through the UK Parliamentary process now makes accommodation for relevant CD based banking institutions within the scope of the reform on the same basis as the European Economic Area jurisdictions. This is a welcome development, although important matters remain to be agreed. Once these arrangements have been agreed the Commission will need to consider in detail proposals made by the Jersey banks that are affected, including arrangements for depositor protection, and on working arrangements for cross-border resolution and recovery mechanisms.

The European Union ("**EU**") Alternative Investment Fund Managers Directive ("**AIFMD**") will continue to demand dedicated resources. The Commission applied considerable effort to this project throughout 2012 and 2013, which appears to have paid off with the signing of all necessary co-operation agreements with the European Securities and Markets Authority ("**ESMA**") and with EU member states. This has enabled the continued private placement of Jersey domiciled funds into EU markets, as well as retaining the possibility to achieve an AIFMD 'passport' when that regime comes into force in 2015.

It is this latter objective which will be in major focus in 2014 in what is as much a political process as a technical one. Efforts will be made with the support of HMT and the UK Financial Conduct Authority, as well as with certain key EU member states with whom Jersey maintains good relationships, in order to progress matters further towards full passport capability.

Other substantial current international activity and development matters remain of relevance to the Commission and the Industry, and will consume considerable time and specialist resource in 2014. These include changing requirements set by international standard setting organisations such as BASEL, IOSCO, the FATF and MONEYVAL.

There are also a number of EU initiatives such as the European Central Bank becoming the common bank supervisory agency for large Eurozone banks, and substantial new consumer protection proposals emanating from the EU and UK which will need careful consideration as they affect our European owned banks.

HOW THE COMMISSION SETS ITS PRIORITIES

The Commission has reviewed all on-going projects and introduced some new high priority projects, principally work streams arising from the Government's Financial Services Framework ("**FSF**") (arising out of the McKinsey report) to produce the Business Plan for 2014 with an eye on preparation for 2015 and 2016. Approximately one hundred such projects were identified and prioritised using four main criteria:

- facilitating Industry access to markets, removal of business impediments and other benefits to Industry;
- matching international standards;
- meeting legal and other requirements; and
- removing impediments to the delivery of the Commission's statutory function.

The reviews of the Funds Regime and the Bank Licensing Regime are two good examples of that. However, from time to time trade-offs have to be made because the Commission has to allocate its finite resources to the entire range of its regulatory responsibilities. It must also continue to invest in its international relationships, including representation at the meetings of international standard setting bodies.

Our major priorities for 2014

- Review the Funds Regime - work with Industry and other key stakeholders to undertake a comprehensive review of the current Jersey Funds and Fund Services Business regime. Consideration will be given to the regime's current effectiveness, and opportunities that may exist to enhance or simplify it, whilst still ensuring that it complies with the relevant international standards.
- Further development of the Bank Licensing Policy, which we commenced in 2012, in light of:
  - a continuing fall in bank licences;
  - potential outcomes of the UK's planned implementation of the recommendations of the ICB; and
  - a widely stated desire to see a higher level of new bank entrants.

  Our 2013 Discussion Paper will underpin a new work stream led by Government and supported by Industry and the Commission.
- In advance of a 'fourth-round' mutual evaluation report ("**MER**") to be undertaken by MONEYVAL in the second half of 2014, work will continue on updating Jersey's anti-money laundering and countering the financing of terrorism ("**AML/CFT**") legislative and regulatory provisions to remediate issues identified by the IMF in its last review of the Island's compliance with the FATF 40 + IV Recommendations. The fourth-round MER will have a

particular emphasis on assessing how effective, in practical terms, Jersey's implementation of the FATF Recommendations has been.

- IOSCO sets international standards for securities, funds and investment business regulation. It recently updated its standards (called **"Principles"**) and the methodology by which compliance with them is determined. The Commission will perform a self-assessment to evaluate what changes to Jersey's regulatory framework may be needed to ensure that the Island continues to meet its commitment to match international standards.
- The Commission will continue its work reviewing Jersey legislation, and will bring forward proposals to address gaps in legislation that may prevent the reputational risks associated with the use of a Jersey company from being properly managed throughout its lifetime.
- Law drafting instructions on the subject of providing the Commission with the power to impose civil financial penalties will be submitted to the Law Draftsman. Once the draft law has been prepared it will be subject to public consultation in Q3/Q4 2014 before being finalised.
- Following publication of a feedback paper in late 2013, revised Codes of Practice for all Industry sectors (excluding certified funds) will be brought into force in Q1 2014 in order to assist Industry more generally in relation to consistency and clarification.
- The Commission plans to undertake a comprehensive review of the supervisory processes and procedures adopted when supervising regulated entities to identify opportunities to improve their effectiveness and increase their efficiency for both the Commission and regulated businesses.
- Finally, the Commission will continue its work to review, analyse, improve and, where necessary, restructure its filing systems, document retention policy and information retrieval processes. This project is to enable more efficient and timely identification and provision of information that may be requested under the provisions of freedom of information legislation or by regulatory authorities elsewhere for supervisory or enforcement purposes.

There is already a lot of work inherent in these major priorities, most of which will take longer than 2014 to bring to fruition.

Conclusion

Regulation is far from an exact science, but the Commission will continue to strive to maintain financial stability and good conduct within the financial services community. The Commission will work with Government and Industry to support appropriate initiatives in the best economic interests of the Island, and act to preserve and enhance Jersey's international reputation.

John Averty
Deputy Chairman

BUDGET 2014

Policy

The Commission's policy with respect to the Budget is to manage its finances so as to be able to meet its key purposes as prescribed in the Financial Services Commission (Jersey) Law 1998, as amended.

- Set fees at such a level as to cover the costs of regulating the finance industry and administering the Companies Registry, and to make an appropriate contribution to reserves;
- keep regulatory fees to a minimum by maintaining strict control of costs; and
- build up an accumulated reserve equal to six months' operating expenditure plus the average of the last five years' cost of investigations and litigation, in order to meet contingencies.

Summary

Forecast for 2013 and 2014 Budget

2013 is forecast to produce an excess of income over expenditure of £129,000. The level of the Commission's reserves should therefore be £7,376,000 at the end of the year.

For 2014, the budget shows a deficit of £406,000, with the consequent level of reserves at the end of that year decreasing to £6,970,000, which is below our policy objective.

The Commission's reserves are maintained to be available to fund the costs associated with any major investigations or litigation cases that may arise in the future and to provide working capital.

Income

Fee income in 2013 is forecast at £13,617,000, £33,000 below budget. The shortfall comes primarily from investment business and trust company fees. Total fee income in 2014 is projected to be £13,908,000.

In the current economic climate, the Commission has deliberately attempted to keep fee increases to a minimum. For the second year in succession, a conscious decision has been taken not to raise the fees for trust companies, despite such an increase being due.

The budget assumes an increase in banking and investment business fees, although by amounts below what would normally be expected. Some additional income can also be expected from the introduction of the Security Interests Register in the Companies Registry.

Expenditure

Operating expenditure in 2013 is forecast at £12,632,000 against a budget of £12,903,000. The reduced spend of £271,000 has arisen primarily from staff costs, which are expected to be £157,000 below budget because of staff vacancies and the time needed for the recruitment process. There are other anticipated savings on premises costs, external professional services and learning and development, but additional expenditure on computer systems, particularly in relation to the document retention and storage project, and also the establishment of an additional data centre as part of the Commission's security and disaster recovery policy.

In 2014, the budget shows an increase in operating expenditure of £1,154,000 to £13,786,000, of which the overall increase in staff costs is £749,000. The main causes are the replacement of the two vacant director positions, and the recruitment of additional staff to manage the Commission's increasing international responsibilities, including the significant requirements of MONEYVAL membership.

Computer system costs are anticipated to rise again next year. The increase comes partly from higher maintenance charges and partly from the continuing technical consultancy services required in connection with the document retention and storage project. There will also be new maintenance costs for the Security Interests Register.

The cost of investigations and litigation in 2013 is forecast at £926,000, the highest level for some years, caused by two significant cases. The budget for the year was £800,000. For the 2014 budget, £600,000 has been included, in the expectation that the bulk of the costs relating to those two cases will have already been incurred, and the hope that no new significant cases will crystallise in the period.

Income and Expenditure for the Years 2012 to 2014

	2012 £ooo Actual	*2013 £ooo Budget*	2013 £ooo Forecast	**2014 £ooo Budget**
Income				
a) Fee Income				
Registry	2,509	*2,600*	2,600	**2,750**
Banking	1,328	*1,275*	1,272	**1,385**
Insurance	759	*760*	755	**760**
General Insurance Mediation	98	*98*	108	**105**
Funds	4,041	*4,650*	4,700	**4,650**
Investment Business	1,239	*1,240*	1,210	**1,280**
Trust Company Business	2,492	*2,500*	2,444	**2,450**
Recognised Auditors	23	*20*	20	**20**
Money Services Business	9	*9*	10	**10**
AML Unit	498	*498*	498	**498**
	12,996	*13,650*	13,617	**13,908**
b) Other Income				
Bank Interest	87	*80*	70	**72**
Total Income	13,083	*13,730*	13,687	13,980
Operating Expenditure				
Staff	9,214	*9,444*	9,287	**10,036**
Premises	767	*786*	770	**814**
Computer systems	613	*904*	942	**1,140**
Other operating expenditure	1,630	*1,769*	1,633	**1,796**
Total Operating Expenditure	12,224	*12,903*	12,632	**13,786**
Operational surplus	859	*827*	1,055	**194**
Investigations/regulatory intervention/litigation	745	*800*	926	**600**
Surplus/(deficit) for the year	114	*27*	129	**(406)**
Accumulated Fund at beginning of year	7,133	*7,247*	7,247	**7,376**
Accumulated Fund at end of year	7,247	*7,274*	7,376	**6,970**

Projected Balance Sheet as at 31/12/2013 and 31/12/2014

		Forecast 2013		Budget 2014
	£000	£000	£000	£000
Fixed Assets		838		1,046
Current Assets				
Sundry debtors	55		60	
Prepayments	320		330	
Bank balances	11,493		10,919	
		11,868		11,309
Total Assets		12,706		12,355
Current Liabilities				
Fee income received in advance	4,480		4,510	
Sundry creditors and provisions	850		875	
		5,330		5,385
Total Assets less Current Liabilities		7,376		6,970
Accumulated Reserve		7,376		6,970