Jersey Financial Services Commission

Business Plan 2013

Published April 2013

Jersey Financial Services Commission

BUSINESS PLAN 2013

CONTENTS

BUSINESS PLAN SUMMARY

- The operating environment for Jersey is changing (e.g. the growth in international regulation, public opinion about "tax havens", competition from emerging competitor jurisdictions, volatile investor confidence, for example).
- The Commission has a track record of maintaining a robust and transparent regulatory framework which strengthens the Island's ability to compete internationally.
- Despite these challenges, the Commission's business-as-usual resource demands are expected to stay largely unchanged in 2013.
- The Commission will continue to dedicate key resources to cope with AIFMD and ICB/Vickers.
- The Commission will allocate resources to ensure appropriate compliance with IMF, IOSCO and MONEYVAL requirements.

INTRODUCTION

Our 2013-2015 Business Plan aims to set out the Commission's objectives and priorities in some detail over the next year and in less detail over the subsequent two years to help Islanders, businesses and Government to understand how we see the current challenges facing the Commission and its staff.

We have sought to explain the principal external pressures that are affecting the financial services industry ("**Industry**") and the consequential potential impact on the resources that we need to carry out our statutory functions and to be able to support the sound development of the Industry.

We would welcome opportunities to meet Industry participants, members of Government and the public to explain how we see these challenges and would welcome comments and constructive criticism.

CURRENT BUSINESS PRESSURES

Jersey's Industry is under pressure and it appears likely that these pressures will intensify over the next few years.

The consensus view of UK GDP growth in 2013 is 1% in 2013 and 1.7% in 2014, whilst Eurozone growth is expected to be broadly flat. The general outlook is for a period of low growth at best. Interest rates are likely to remain low and the pressures on the margins of our larger banks will continue.

Quantitative easing and similar asset inflation measures from the developed economies seem set to continue for some time to come. So the search for yield and the recent apparent return to growth in stock markets may support some growth in funds under management.

In Jersey, this suggests that there could be some growth in alternative investment classes where the Island has some strengths, but our plan assumes no increase in the number of banks, funds or trust companies operating in the Island in the short term nor any material change in their business activities.

The shift in the growth of private wealth from Western Europe to Eastern Europe and the Far East seems likely to continue to offer opportunities for our wealth management sector, although it will require practitioners to become comfortable with clients from new jurisdictions. Competition from emerging financial centres that are often geographically closer to the client will continue to put pressure on margins, which may make it difficult for risk to be properly rewarded.

The high budget deficits of developed nations are driving politicians to challenge transfer pricing and similar arrangements that enable corporates and individuals to mitigate legally their tax liabilities and this, combined with expectations of increased information sharing, may impact on certain Island businesses.

We seem set for a period where new tax planning arrangements could be deferred, whilst some existing arrangements could be terminated early as corporates and individuals seek to manage their overall tax affairs.

Our Business Plan and Budget assumes that these pressures do not lead to a significant loss of financial services regulated business activity or a noticeable increase in risk profile during the plan period.

MAJOR ISSUES AND RISKS

There are two, and they are both moving quite quickly.

In no particular order, one is the work the UK is doing on implementing the recommendations of the Independent Commission on Banking ("**ICB**"). Jersey, alongside the other Crown Dependencies ("**CDs**") has been making 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 current upstreaming model, to diversify by deploying their liability base elsewhere or to do a mixture of the two.

The position we arrived at by the end of 2012 was that HMT, in effect said to the CDs "Make your case". This we have done, working closely with Industry, Government and the other CDs. It is far from clear that we have been sufficiently persuasive however and one key priority will be to try once more to make that case convincingly. The Commission can effectively represent the position of the Island and the banks only up to a certain point however and it will be important that this final effort embodies the same co-operation between us as hitherto.

The second major issue is the European Union ("**EU**") Alternative Investment Fund Managers Directive ("**AIFMD**"). The Commission has placed considerable resources against this project throughout 2012 and has further reinforced them this year with the addition of another Senior Manager. The decision has been taken to work towards both enabling continued private placement into the EU as well as being in a position to achieve an AIFMD 'passport' when that regime comes into force in 2015.

Our hopes of being, along with Guernsey and the Isle of Man, among the first to sign a co-operation agreement with the European Securities and Markets Authority ("**ESMA**") seem unlikely to be fulfilled. This is not, as far as we can tell, because of any shortcomings of ours but rather because ESMA chooses to tackle countries that it regards as a higher priority (Switzerland and the USA being just two examples). Early recognition of our compliance would help facilitate what is, it must be remembered, as much a political process as a technical one and efforts will be made with the support of HMT and The Financial Services Authority ("**FSA**") to progress matters with ESMA. Work will also begin on the considerable amount of subordinate legislation and on the new codes of practice that will be required.

HOW THE COMMISSION SETS ITS PRIORITIES

During the second half of 2012, the Commission carried out an extensive review of all the projects that it considered to be necessary during the next three years. More than one hundred such projects were identified, and these have been allocated priorities 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.

As far as we can, we attempt to prioritize projects in the order that the criteria are set out above. The ICB and the AIFMD 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 the planning period

Facilitating Industry access to markets

- ICB, as noted above.
- AIFMD, as noted above.
- Bank Licensing Policy. Stimulated by the issues that arise out of its work in respect of the ICB, the Commission has since last Autumn given thought to possible changes in the Bank Licensing Policy in order to be able to admit additional banks. This will be taken further in 2013 via consultation with Industry and Government concerning, among other things, the interrelationship between bank licensing and the current Depositor Compensation Scheme.
- Industry has indicated a desire for a "drains up" review and possible revision of the regulatory regime for funds. We support this idea. It is hoped we can begin in the second half of the year.

Matching international standards

- Continue to update anti-money laundering and countering the financing of terrorism ("**AML/CFT**") legislation to plug gaps identified at last International Monetary Fund ("**IMF**") review. The next IMF review could be as early as late 2014.

- The three CD's were admitted to the Council of Europe's MONEYVAL in late 2012. Membership of a regional body such as MONEYVAL is a prerequisite for the type of continuing evaluation of the Island's AML/CFT regime that will satisfy the IMF. Along with membership comes a need for all three CDs to be assessed and we expect to prepare during 2013 for such an assessment late in the year which will consider the Island's progress against the recommendations of Jersey's 2009 IMF review and then further work in preparation for a subsequent fuller review in late 2014 or 2015.
- The International Organisation of Securities Commissions ("**IOSCO**") is the organisation that puts the seal of approval on our securities, funds and investment business regulation. It recently revised its Principles and released an updated methodology for assessing compliance with them. In 2013 we intend to perform a self-assessment accordingly.

Meeting legal and other requirements

- Review our powers to enforce compliance with the Companies (Jersey) Law 1991 and other product laws in order to try to reduce the Island's reputational risk.
- Continue with feedback and consultation on the proposed civil penalties regime.
- Following publication of a feedback paper, finalise and issue revised Codes of Practice for all Industry sectors, excluding certified funds.

Removing impediments to the delivery of the Commission's statutory function

- The Supervision Divisions to review how our risk model works in the light of lessons learned following the financial crisis.
- Continue the work begun last year on a Commission-wide records management system designed to meet not only our own future needs but also those relating to data protection and potential freedom of information legislation.
- Begin work on a Commission-wide competency framework for our staff which will help us to recruit more skilfully, evaluate more objectively and develop more thoroughly.

There is already a lot of work inherent in these 13 projects, some of which will take longer than 2013 to bring to fruition. But of course, as the Business Plan indicates, there is a lot more besides, which is why a word about the Commission's resources is now relevant.

Resources

As with any similar organisation, the Commission's principal resources are human and financial.

Our human resources will be at full stretch in 2013. This is partly due to the projects that are outlined above. That is not to overlook however the significant amount of work the Commission does in respect of authorisation, enforcement and supervision on a day-to-day basis.

There will be other demands that emerge that cannot clearly be identified.

The Commission's costs are almost wholly paid for by its licence holders, albeit that a proportion of the annual return fees charged by the Registry is remitted to Government under the relevant legislation.

It has long been our policy that the fees we charge licence holders in each sector of Industry relate directly to the costs of supervising that sector, with no cross subsidy from elsewhere. (There is one minor exception, where the costs of supervising Designated Non-Financial Businesses and Professions for AML/CFT are paid partly by the sector itself, partly by the rest of Industry and partly by Government.) We intend to continue with that policy.

We have also tried to keep to a three-yearly cycle of reviewing the level of fees in order to provide Industry with some degree of predictability, but recognise that in some areas, notably Banking and TCB, an annual revision may be more appropriate.

The Commission does not aim to make a profit – indeed, the planned surplus for 2013 is only £27,000 – but it does aim to maintain adequate reserves to cushion the impact of any dramatic fall in fee income or the costs of significant investigation and litigation. The policy on reserves is to maintain a reserve equivalent to six months' operating expenditure plus the average of the last five years' investigation and litigation costs. At the end of 2013 we anticipate the reserve to be £7,274,000: the policy would indicate a level of £7,049,000.

It is too early to say whether the work on the ICB and potentially on bank licensing will easily be accomplished within the resources of the Banking and Insurance Division, but it is probably likely the financial impact will fall in 2014, if it falls at all.

On the other hand if, in addition to work on the AIFMD, the Securities Division needs to engage in a root and branch review of our regulatory regime for funds, there is no doubt that significant outside resources will have to be engaged, at least for the duration of the project. (Indeed, there are arguments to commend a degree of outside involvement.) It remains to be seen how that will be paid for, although it may be necessary for the sector's fees (which were revised in 2012 for the first time in ten years) to be revisited.

Investigation and litigation costs the Commission between three quarters of a million and a million pounds a year. Although measures have been taken to limit the costs falling onto the Commission and hence licence holders (such as the use of reporting professionals paid for by the subject of the investigation and the use of settlement agreements), there are few signs that the work of the Enforcement Division is abating.

Anyone who anticipates the proposed civil penalties regime will significantly mitigate the impact of these costs is perhaps being misled by the reports of the sizeable fines levied in London by the FSA and the even more breath-taking sums levied by regulators in the USA. If the regime is eventually introduced, the Commission will continue to take a proportional view of how it exercises its enforcement powers.

Conclusion

Most Industry participants see relatively little of the work that the Commission does. As a reader of this Business Plan will see, it is wide, deep and varied. It is also not cheap. However, it is necessary if the Island is to continue to meet the international standards that facilitate the industry's access to the markets it serves or wishes to serve. This Business Plan sets out in some detail the Commission's objectives for 2013 and its outline financial forecasts for the following two years and it is to be hoped that Government, Industry and others will find it helpful and informative.

Clive Jones
Chairman

BUDGET 2013

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.
- 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

As shown by the Income and Expenditure Account, the outcome for 2012 was an operating surplus of income over expenditure of £859,000 before accounting for investigation and litigation costs, compared with a budget surplus of £521,000. For 2013, the equivalent budget surplus is £827,000.

After accounting for investigation and litigation costs, 2012 showed a surplus of £114,000 compared with a budget deficit of £479,000 (largely due to the lower than anticipated level of expenditure on investigations. There is a forecast budget surplus for 2013 of £27,000.

Income

Fee income in 2012 was £12,996,000, £200,000 above budget. The increase came primarily from banking and funds fees.

Total fee income in 2013 from most sectors is anticipated to be similar to the 2012 level. The exceptions are funds fees, which show the first full year effect of the fee increase that took effect from July 2012. The overall forecast is a budget income of £13,650,000, an increase of £654,000 over the 2012 level.

Bank deposit interest received in 2012 was £87,000, which was £37,000 higher than budget. This was due to the conversion of some deposits to longer fixed terms, attracting higher interest rates.

Interest for 2013 has been estimated at £80,000, because the Commission's cash position will be depleted by the level of expenditure on computer systems.

Expenditure

Operating expenditure in 2012 was £12,224,000 against a budget of £12,325,000. The reduced spend of £101,000 has arisen partly from staff costs, which were £59,000 below budget because of staff vacancies and the time needed for the recruitment process. There were other savings on premises costs, business travel and learning and development, but additional expenditure was incurred on professional services in relation to the document retention and storage project which was not included in the budget.

In 2013, the budget shows an increase in costs over 2012 of £679,000 to £12,903,000, of which the overall increase in staff costs is £230,000. The cause of this increase is the annual staff salary settlement adjusted by associated pension costs and the anticipated movements in headcount.

Computer system costs are anticipated to rise significantly next year. The increase comes partly from higher maintenance charges and partly from technical consultancy services required in connection with the CAM project. The Commission also expects to make significant investments in computer systems during 2013, with a consequent increase in depreciation charges.

The gross cost of investigations and litigation in 2012 was £821,000, reduced by recoveries of £76,000 to a net expense of £745,000. The budget for the year was £1,000,000. For the 2013 budget, £800,000 has been included, reflecting the anticipated level of work required in this area during the next year.

Results for the years 2012 and 2013

2012 produced an excess of income over expenditure of £114,000. The Commission's reserves at the end of the year amounted to £7,247,000.

For 2013, the budget shows a surplus of £27,000, with the forecast level of reserves at the end of that year increasing to £7,274,000.

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.

Income and Expenditure for the Years 2011 to 2013

	2011 £ooo Actual	*2012 £ooo Budget*	2012 £ooo Actual	**2013 £ooo Budget**
Income				
a) Fee Income				
Registry	2,497	2,494	2,509	**2,600**
Banking	1,303	1,250	1,328	**1,275**
Insurance	784	760	759	**760**
General Insurance Mediation	95	88	98	**98**
Funds	3,428	3,970	4,041	**4,650**
Investment Business	1,288	1,300	1,239	**1,240**
Trust Company Business	2,528	2,410	2,492	**2,500**
Recognised Auditors	20	15	23	**20**
Money Services Business	10	11	9	**9**
AML Unit	497	498	498	**498**
	12,450	12,796	12,996	**13,650**
b) Other Income				
Bank Interest	63	50	87	**80**
Total Income	12,513	12,846	13,083	**13,730**
Operating Expenditure				
Staff	8,612	9,273	9,214	**9,444**
Premises	769	827	767	**786**
Computer systems	623	574	613	**904**
Other operating expenditure	1,474	1,651	1,630	**1,769**
Total Operating Expenditure	11,478	12,325	12,224	**12,903**
Operational surplus	1,035	521	859	**827**
Investigations/regulatory intervention/litigation	398	1,000	745	**800**
Surplus/(deficit) for the year	637	(479)	114	**27**
Accumulated Fund at beginning of year	6,496	7,133	7,133	**7,247**
Accumulated Fund at end of year	7,133	6,654	7,247	**7,274**

Projected Balance Sheet as at 31/12/2012 and 31/12/2013

		Actual 2012		Budget 2013
	£000	£000	£000	£000
Fixed Assets		753		1,868
Current Assets				
Sundry debtors	54		90	
Prepayments	318		340	
Bank balances	11,610		10, 319	
		11,982		10,749
Total Assets		12,735		12,617
Current Liabilities				
Fee income received in advance	4,531		4,468	
Sundry creditors and provisions	957		875	
		5,488		5,343
Total Assets less Current Liabilities		7,247		7,274
Accumulated Reserve		7,247		7,274