

**All information contained in this Report is under strict embargo
until 0001 on Tuesday 27th Feb 2007.**

REPORT BY THE COMPTROLLER & AUDITOR GENERAL

JERSEY FINANCIAL SERVICES COMMISSION

FEBRUARY 2007

Introduction

1. In the early part of 2006, the Financial Services Commission (the FSC or the organisation¹) invited me to undertake a value for money review of the organisation and its activities. After discussion, I accepted that invitation and commenced the review that I had been invited to undertake. The terms of reference for this review are reproduced in Appendix 1.

Background

2. The FSC was formed in July 1998 under the Financial Commission (Jersey) Law 1998. Its key purpose is to maintain Jersey's position as an international finance centre with high regulatory standards by:
 - (1) reducing public risk of financial loss,
 - (2) protecting and enhancing Jersey's reputation and integrity,
 - (3) safeguarding Jersey's best economic interests, and
 - (4) contributing to the fight against crime.
3. Currently, the FSC has four major areas of activity and seeks to regulate entities involved in:
 - (1) banking,
 - (2) securities (both funds and investment business),
 - (3) trust company business, and
 - (4) insurance.
4. In each of these areas, the FSC aims to ensure that:
 - (1) all entities satisfy "fit and proper" criteria,
 - (2) regulated entities operate within accepted standards of good practice,
 - (3) the Jersey regulatory regime complies with international standards, and

- (4) abuses and breaches of regulatory standards are identified and deterred.
5. Apart from the Registry, the FSC has, since May 2004, been divided into four specialist business divisions whose work covers authorisation (licensing), and compliance (regulatory and supervisory examinations and oversight) of financial services entities. In furtherance of their objectives, each division undertakes off-site supervision reviews and checks as well as on-site supervision examinations including:
- (1) focused examinations into specific areas of the industry business;
 - (2) discovery examinations – to obtain more information about a particular entity or area of activity; and
 - (3) themed examinations into a particular industry's sector across a number of institutions.
6. During 2002/2003, the International Monetary Fund (IMF) carried out a voluntary assessment of the extent to which the FSC's regulatory and supervisory arrangements complied with internationally accepted standards and measures of good practice. The IMF Report was published in November 2003 and overall concluded that the financial regulatory and supervisory system of Jersey complied well with international standards. A number of recommendations were made for ways in which the legal regulatory and supervisory arrangements could be strengthened and lead to an action plan produced by the FSC in November 2003. The IMF will be undertaking a second assessment during 2007/2008.

Approach to the review

7. In selecting an approach for the review which the FSC had invited me to undertake, I was mindful of the imminent IMF review and thus sought an approach which would not simply duplicate the approach which the IMF would adopt.
8. I was also aware that regulatory practice within the United Kingdom has developed somewhat during recent years with the increasing adoption of risk-based regulation and the publication in 2005 of the Hampton Report. This review has led to the reconsideration of the organisation and activities of a number of regulators within the United Kingdom. The

¹ In this report, I will use the phrase 'the Commission' to refer to the group of people responsible for the governance of the FSC

principles of good regulation set out in the Hampton Review are also set out in Appendix 2 to this report.

9. Accordingly, it seemed to be helpful to organise the value for money review of the FSC in two stages. The first stage would review the FSC and its activities as if it were a mainland organisation subject to the expectations that mainland organisations would currently have to meet. The second stage would then consider the extent to which the peculiar circumstances of Jersey appeared to justify a variation from mainland practice.
10. The operations of the Registry were to be examined in the first phase of the review.
11. I commissioned the Audit Commission of England (the Audit Commission) to undertake the first stage of this review. The second stage was undertaken within my own office.

Structure of the report

12. The outcomes of the two stages of the review are set out in sections three and four of this report, but first, in section two, I will set out a summary of the principal conclusions and recommendations.

**SECTION TWO ~ SUMMARY OF PRINCIPAL CONCLUSIONS AND
RECOMMENDATIONS**

Introduction

13. The principal conclusions and recommendations of this review can be summarised in two groups: those relating to the FSC's administration and those relating to the FSC's regulatory activities.

Administration

14. The review concluded that whilst, in a number of areas, the FSC could improve its efficiency and effectiveness, it was unlikely that implementation of the review's recommendations would lead to a significant reduction in the FSC's costs. Indeed, a review of the FSC's IT strategy may well lead to some additional expenditure in the short term.
15. The principal recommendations of the review are as follows:
- (1) Review its corporate planning process with a view to integrating the top-down corporate planning and the more detailed operational planning so that there is clarity over the purposes that each action is designed to serve (paragraph 26).
 - (2) Review its risk management process with a view to integrating top-down and bottom-up analyses of risk and risk mitigations (paragraph 29)
 - (3) Consider introducing a cycle of value for money reviews of all expenditure to ensure that all areas are covered methodically (paragraph 34).
 - (4) Review its staff planning process (paragraph 37).
 - (5) Prepare a consolidated IT strategy that seeks to ensure that wherever possible full benefit of the available technology is achieved (paragraph 40).
 - (6) Review its quality assurance process to ensure that appropriate checks are made consistently (paragraph 45).
 - (7) Review the role of the Audit Committee in oversight of the outcome of the internal value for money reviews (paragraph 49).

- (8) Consider the way in which the Board of Commissioners becomes involved in and reviews the effectiveness of the FSC's regulatory activities (paragraph 50).

Regulatory activities

16. As far as the FSC's regulatory activities are concerned, the fact that they are not driven solely by an assessment of the risk attaching to regulated entities and that the FSC's risk assessment practices could be improved (as suggested above) may be thought to suggest that it ought to be possible to reduce the level of those activities and thus their cost.
17. There are, however, a number of countervailing factors that must be taken into account:
- (1) the narrowness of the markets which the FSC seeks to regulate (which limits the effectiveness of the statistical approaches on which risk based approaches depend in other jurisdictions.
 - (2) the difficulty of establishing that all entities seeking entry to these markets are 'fit and proper'.
 - (3) the susceptibility of the reputation of the FSC and the Island to single regulatory failures, and
 - (4) the importance to the FSC and the Island of IMF recognition of the Island's compliance with international standards of AML/CFT.
18. In summary, the effect of this analysis is that:
- (1) Superficially, the application of risk-based techniques appears to offer the possibility of reducing the cost and burden of regulation.
 - (2) However, the narrowness and nature of the markets regulated by the FSC suggests that, if this approach were to be adopted, there would be an increased risk of regulatory failure.
 - (3) In view of the sensitivity of the Island's reputation to a significant regulatory failure, the increased risk of failure would be unattractive.
 - (4) Even if the FSC were to decide that the increased risk of failure should be accepted, it would only be wise to adopt a thorough-going risk-based approach if it were first to be clear that such an approach would be acceptable to the IMF.

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

19. The likelihood is that the FSC is unlikely to be able to realise significant savings through the application of risk-based techniques.

SECTION THREE ~ OUTCOME OF STAGE ONE OF THE REVIEW

Introduction

20. As has been explained in the section one, the first stage of the review was undertaken by the Audit Commission. The principal conclusions which were reached are set out in Appendix 3. They concern:

- (1) corporate planning,
- (2) corporate risk management,
- (3) support activities,
- (4) regulatory activities, and
- (5) corporate governance.

21. I will deal with each of these subjects and their implications in the following paragraphs.

22. It is important that the comments that are made as a result of the review are read in a proper context. All of the comments that are set out in the following paragraphs are concerned with the way in which the FSC goes about its business rather than with the outcome of its activities. In other words, whilst the review suggests opportunities for the FSC to improve its efficiency and cost-effectiveness, the review does not question about the overall success of the FSC in terms of the achievement of its objectives.

Corporate planning

23. The FSC's internal business and annual planning documents contain considerable detail of the organisation's key achievements in the preceding year and the direction of work for the following year. However, they do not easily link overall corporate aims and objectives to the steps which have been and are to be taken by the organisation to achieve them. This does not necessarily mean that the detailed plans are inappropriate but the links between individual actions and corporate objectives are not always obvious.

24. As a part of the corporate planning process, the FSC has set targets to demonstrate a commitment to delivery. However the performance management process is not based on the practical steps required to turn this vision into reality as a result of the lack of link between

corporate objectives and activities. Corporate aims have been broadly defined in plans but the performance management system does not place the activities of divisions and individual members of staff in their proper corporate context. Activities are not clearly related to the corporate aims which they are designed to achieve nor are there always clear success measures.

25. The consequence of the absence of these links is likely to be:

- (1) An undue complication of the planning process through the difficulty of relating individual actions to overall aims and through the consequent difficulty of ensuring that all aims have been covered by planned actions.
- (2) A lack of clarity in the minds of staff about the corporate aims which their work is intended to achieve.
- (3) A greater difficulty in monitoring performance in achieving the corporate aims.

26. To deal with this issue, the FSC should review its corporate planning process with a view to integrating the top-down corporate planning and the more detailed operational planning so that there is clarity over the purposes that each action is designed to serve.

Corporate risk management

27. Risk management is a central process of the FSC's strategic management arrangements. Corporate risks have been assessed and the FSC has identified and refined the appropriate steps needed to mitigate those risks. This process works well.

28. As will be seen, however, the links between corporate risk assessment and more detailed risk assessments within the FSC's divisions could be strengthened.

29. As a part of the review of its planning process, the FSC should also review its risk management process with a view to integrating top-down and bottom-up analyses of risk and risk mitigations.

Support activities

Introduction

30. The key areas which were reviewed were:

- (1) financial management,
- (2) corporate support services,
- (3) human resource management,
- (4) information technology infrastructure

Financial management

31. The evidence of the both the internal and external audits suggests that good financial controls appear to be in place. The financial position of the FSC appears to be sound. The corporate policy that fees should cover the FSC's costs includes provision for the creation of a small reserve for unforeseen events (including litigation costs).
32. Income and expenditure figures are regularly reviewed. Cost benefit analyses are prepared for major projects and business divisions can provide examples of efficiencies being made.
33. However, there does not appear to be a structured approach to reviewing expenditure areas on a systematic basis to identify opportunities for improving value for money.
34. The FSC should consider introducing a cycle of value for money reviews of all expenditure areas to ensure that all areas are covered methodically.

Corporate support services

35. The FSC does not have a clear strategy on how corporate services should be structured to support the delivery of the FSC's aims. The corporate services division has changed its name and structure on a number of occasions during the past three years. Major projects are being managed appropriately and in accordance with recognised good practice to ensure that they are completed within defined scope time costs constraints. However cost and evidencing of projected savings could be further developed. Further, projects are not consistently projected on a whole life basis with the possible result that costs are being overlooked.

Human resource management

36. The FSC's staff costs and numbers have been rising but staffing levels remain below the level which the FSC has estimated it needs to meet all of its planned activities. There is no formal workforce plan or similar document supporting the FSC's corporate aims and objectives. The FSC takes steps to manage the imbalance in overall demand and supply of resources through what it hopes will be continue to be effective short term action.

37. The FSC should review its staff planning process.

Information technology

38. As far as information technology is concerned, the FSC is increasingly reliant upon the IT systems working reliably and although the organisation has put in place and tested its disaster recovery plan, there is no general information communications and technology strategy.
39. Moreover, there is some evidence that the FSC could do more to encourage on-line communication with regulated entities and to make current information about itself and its activities available through its website on a user-friendly basis.
40. The FSC should prepare a consolidated IT strategy that seeks to ensure that wherever possible full benefit of the available technology is achieved.

Operational management

41. The level of regulatory activity has been increasing since 2003 in accordance with the FSC's corporate goals and the recommendations made by the last IMF review.
42. However, the operational risk model is not working robustly in all areas and consequently staff do not have sufficient confidence in the system to base their regulatory work programmes on its output and thus they are to establish the required minimum levels of regulation. The correlation between the overall risk rating and the examination activity is weaker in some divisional areas and factors other than the risk rating are key drivers when identifying examination programmes. The risk model does not always accurately reflect the current risk rating for an entity and exception reporting will only be a useful management tool if the information contained in the system is accurate. The use of different thresholds across divisions for the identification of high, medium and low risks may result in insufficient resources being focussed in those areas where the greatest risks lie.
43. Some divisions do not have the staff necessary to achieve their examination targets. It has therefore been necessary to use external consultants to supplement resources in certain areas. These are the short-term human resource measures to which reference has already been made.
44. In 2004 the divisions were restructured to encourage technical specialisation and now there is little if any cross-working to address resource shortages. The exception to this is that the boundary between compliance and enforcement which has become blurred. Managers

should be routinely undertaking quality assurance checks on staff activities but performance is inconsistent.

45. Detailed issues concerning the application of risk-based techniques will be considered in section four. Apart from this, the FSC should review its quality assurance process to ensure that appropriate checks are made consistently.

Corporate governance

46. The FSC is committed to achieving good standards of corporate governance and follows good practice through its adoption of the United Kingdom Combined Code on Corporate Governance where appropriate. To date, however, the Audit Committee has mainly focused on the activity of the external auditors, the approval of annual accounts and other corporate governance arrangements.
47. The internal audit unit's activities have been underdeveloped as a result of the unit's resource capacity. In consequence, the Audit Committee's review of risk management arrangements within the FSC generally appears to have been limited.
48. The Commission (i.e. the Board of Commissioners) still retains to itself the right to make certain regulatory decisions. This involvement in regulatory decision making may militate against the Commission's ability to review the general effectiveness of the organisation's activities and may also have the effect of slowing the organisation's ability to make appropriately prompt regulatory decisions.
49. As a part of the review of its risk management process to which reference has already been made, the role of the FSC's Audit Committee in oversight of the process and of the outcome of the internal value for money reviews should be re-considered.
50. Moreover, the Commission should consider the way in which it becomes involved in and reviews the effectiveness of the FSC's regulatory activities.

Implications

51. It is important that these observations should be placed in their proper context. There is no suggestion here that the FSC has been ineffective in achieving its principal aims. Far from it.

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

The evidence suggests that the FSC has been effective in enforcing high regulatory standards within the Island's financial services markets.

52. However, the review suggested that there are opportunities for the management of the FSC to be more stream-lined, more efficient and possibly less expensive.
53. The most important of these opportunities relate to the basis on which the FSC's regulatory activities are managed. As has been explained above, the level and focus of the FSC's regulatory activities are not solely determined on a risk basis and this implies that the cost of these activities (and the burden that they impose upon regulated entities) may appear to be greater than they need be.
54. In other jurisdictions, it would be regarded as a fundamental principal of risk assessment that scarce resources should not be used to inspect or require data from businesses that are low risk either because the work they do is inherently safe or because their systems for managing regulatory risk are good. One might conceive of a hierarchy of regulatory and enforcement mechanisms through which regulators would progress depending upon the seriousness of the regulatory risk posed by a regulated business and extent, if any, of its non-compliance. In the literature of risk-based regulation, it is often suggested that regulatory compliance is best secured by persuasion in the first instance, with inspection, enforcement notices and penalties being used for more risky businesses.²
55. By comparison, the FSC's programme of visits seems high and is not flexed in all areas by the organisation's perception of the risks posed by particular regulated entities.
56. For example, the programme of visits to banking entities during 2005 and 2006 can be summarised in the following way:

<i>Risk category</i>	<i>Number of regulated entities</i>	<i>Number of visits</i>	<i>%age of entities visited</i>
High	17	14	82
Medium	25	20	80
Low	7	4	57
Total	49	38	

² See 'Responsive Regulation' by Ian Ayres and Braithwaite (1992) and 'Risk, Responsibility and Regulation: Whose risk is it anyway?' Better Regulation Commission, October 2006: www.brc.gov.uk

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

57. Thus, although there is a suggestion that visits to regulated banking entities that were regarded as low risk were visited less frequently, there were in fact relatively such entities and there was no differentiation in approach between high and medium risk entities.

58. An analysis of activity levels in the other regulated areas shows that there is no overall pattern.

<i>Risk category</i>	<i>Trust company businesses %age visited</i>	<i>Securities businesses investment business %age visited</i>	<i>Securities businesses funds management %age visited</i>
High risk	89	63	48
Medium risk	46	67	24
Low risk	9	44	0
Total			
Number of entities	205	109	133

59. The implication of this analysis is that the pattern of regulatory activity is not the product of a Commission-wide policy and is not consistently based upon the risk assessment of regulated entities. This is consistent with the outcome of the review which showed that, for a number of reasons, operational divisions within the FSC are not prepared to rely consistently upon the risk assessments of regulated entities as the driver of the level of regulatory activity.

60. Unless risk assessment is carried through into resource allocations and regulatory practice, it is to some extent wasted effort. Risk assessment needs to be comprehensive and to inform all aspects of the regulatory life cycle from the selection and development of appropriate regulatory and policy instruments through to the regulator's work including data collection, inspection and prosecution.

61. The fact that the outcomes of the risk assessment process are not consistently used in this way may be related to the FSC's failure to amend the software that is used to record risk assessments. For example, the system needs to be enhanced to ensure that only relevant entities are identified as requiring a risk rating³ and to ensure that for all reviews undertaken, the system picks up and accurately records the data.

³ In practice, a single business may register a number of separate companies to provide a single service. In such cases, where the differences between the separately registered entities are largely matters of administrative convenience, the FSC will conduct only a single risk rating assessment.

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

62. If the risk assessment were to be carried through to its full extent, this analysis suggests that, unless there are countervailing factors, some reduction in regulatory effort and thus cost should be possible.
63. Whether such countervailing factors exist and to what extent they militate against such savings in regulatory costs are the principal subjects of section four.

SECTION FOUR ~ OUTCOME OF STAGE TWO OF THE REVIEW

Introduction

64. The second stage of the review involved considering whether the issues that had been raised in the first stage and outlined in section three are relevant to the management of a regulator in Jersey.

General observations

65. In general terms, most of the conclusions seem directly relevant. Mostly they relate to normal business practice and indicate the possibility of improvement in the FSC's processes. Thus, the Commission should consider implementing the recommendations outlined in section three relating to:

- (1) corporate and business planning,
- (2) performance management, and
- (3) human resource management.

66. In two cases, however, other considerations arise:

- (1) the application of risk based techniques to the management of the FSC's regulatory activities, and
- (2) the development of a coherent IT strategy.

67. I will deal with these two issues in detail below:

Risk-based regulation

Introduction

68. As explained in section three, in stage one of the review it became evident that the FSC's regulatory activities are not consistently risk-based. In other words, the nature and extent of the FSC's regulatory activities are not flexed according to the FSC's assessment of the extent of risk of non-compliance attaching to individual regulated entities. The implication of this

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

conclusion is that there ought theoretically to be a possibility of reducing the cost and burden of regulation or alternatively reducing the cost of the risk assessment process.

69. Whether this theoretical possibility could be realised would be affected by a number of factors relating to Jersey's position as an 'off-shore' jurisdiction including:

- (1) the narrowness of the markets which the FSC seeks to regulate,
- (2) the difficulty of establishing that all entities seeking entry to these markets are 'fit and proper',
- (3) the susceptibility of the reputation of the FSC and the Island to single regulatory failures, and
- (4) the importance to the FSC and the Island of IMF recognition of the Island's compliance with international standards of AML/CFT.

70. I will review each of these factors in turn below.

Narrowness of the markets

71. The number of regulated entities within the markets regulated by the FSC is relatively small:

<i>Regulated market</i>	<i>Number of regulated entities</i>
Banking companies	46
Insurance companies	175
General insurance mediation	100
Long term insurance broking	0
Regulated investment businesses	119
Trust company businesses	904
<i>Total</i>	1344

72. One effect of the narrowness of these markets is that the mathematical techniques that might otherwise be used to assess the relative risk attaching to an individual entity would be likely to be subject to a wide margin of error. In most situations where these techniques are used, the numbers of regulated entities would be considerably greater.

73. Such techniques would in any case be subject to the risk that they would not identify all cases of potentially high risk, but where the markets are narrow, the risk of a failure to identify

high risk regulated entities might be significant. This risk would represent the cost of the saving of costs which a thorough-going application of risk-based techniques might appear to offer.

Assessment of new applicants

74. The position is made more complicated by the difficulty of establishing that all new applicants seeking entry to the Island's markets are 'fit and proper'. Although there are well-established international practices concerning the transfer of information between regulators, there remains a risk that new applicants may seek to take advantage of the Island's position.

Effect of regulatory failure

75. These possibilities also undermine the theoretical effectiveness of risk-based techniques by increasing the risk of error or misjudgement on the part of the regulator. The chance that application of risk-based regulation would increase the risk of regulatory failures is significant to Jersey.
76. The growth of the Island's economy is sensitive to the success or failure of its financial services business. As in all off-shore jurisdictions, the reputation of the Island and thus its ability to attract further quality businesses is sensitive to the incidence of regulatory failures which might suggest that the Island is not a secure environment in which to transact business. In this sense, the Island is more vulnerable than many jurisdictions to isolated failures.
77. There is another, more domestic issue. At present, the Island does not have a compensation scheme which might mitigate the effect of losses through the failure of a regulated entity.
78. In short, not only is there reason to suppose that the Island's circumstances suggest that a substantial reduction in regulatory activity (perhaps as a result of a simplistic application of risk-based techniques) might lead to a higher risk of regulatory failure, the reputation of the Island (and the FSC) seems particularly vulnerable to a significant failure.

IMF

79. Finally, recognition by the IMF has been an important foundation for the FSC's efforts to develop and sustain a high reputation for the Island. Some concern has been expressed to me that a thorough-going application of risk-based regulatory techniques would only be wise if the IMF were demonstrably a supporter of their application in an off-shore environment. At

⁴ Statistics taken from the FSC website in January 2007.

present, such an approach appears inconsistent with the reports that the IMF has previously issued following reviews of the FSC and, indeed, of other off-shore financial regulators.

Summary

80. In summary, the effect of this analysis is that:

- (1) Theoretically, the application of risk-based techniques appears to offer the possibility of reducing the cost and burden of regulation.
- (2) However, the narrowness and nature of the markets regulated by the FSC suggests that, if this approach were to be adopted, there would be an increased risk of regulatory failure.
- (3) In view of the sensitivity of the Island's reputation to a significant regulatory failure, the increased risk of failure would be unattractive.
- (4) Even if the FSC were to decide that the increased risk of failure should be accepted, it would only be wise to adopt a thorough-going risk-based approach if it were first to be clear that such an approach would be acceptable to the IMF.

81. The likelihood is that the FSC would be unlikely to be able to realise significant savings through the application of risk-based techniques.

82. This does not mean that there are no benefits to be gained as a result of this part of the review:

- (1) The current state of the risk assessment of regulated entities is obviously unsatisfactory. It would be helpful to review the process with a view to eliminating the backlog in assessments and matching the time invested in them to the use to which the FSC puts them.
- (2) The inconsistencies between the approaches adopted by different divisions seem inappropriate. The FSC should review its general policy with regard to regulatory visits and other activities to ensure that all divisions can demonstrate that they are consistently applying the FSC's general policy about the frequency of regulatory visits and their extent.

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

- 3) Even though the FSC may reasonably decide that through-going application of risk-based techniques may not be appropriate in all of the circumstances, it would still be appropriate to review the information which the FSC requires regulated entities to supply with a view to considering whether differing risk assessments may be used to vary the frequency and extent of requests for information.

C Swinson
Comptroller & Auditor General
Morier House
Halkett Place
St Helier JE1 1DD

APPENDIX 1 ~ TERMS OF REFERENCE

Introduction

The purpose of this paper is to propose arrangements for a review of the Jersey Financial Services Commission .

Background

Jersey is a Crown Dependency with a population of approximately 80,000 with its own system of government and laws.

Its government is in the hands of a democratically elected Parliament, the States Assembly, which is presided over by the Bailiff. With effect from December 2005, the business of government is managed politically by a Council of Ministers led by a Chief Minister. The day to day business of government is managed by a civil service, known as the States, under the leadership of a Chief Executive through the Corporate Management Board which consists of the Chief Officers of the principal departments.

The States' expenditure exceeds £400 million annually and covers most of the areas that in the United Kingdom would fall within the responsibility of central government as well as local government.

Machinery of government

After a long period of debate, various reforms of Jersey's machinery of government have been implemented with effect from December 2005. In particular:

- (1) Ministerial government has been instituted.
- (2) A Public Accounts Committee has been appointed which will consider reports prepared by a newly appointed Comptroller and Auditor General.
- (3) A new Public Finances Law has come into effect.

Jersey Financial Services Commission

The economy of Jersey depends to a great extent upon the financial services industry. At the end of 30 June 2005:

- (1) bank deposits amounted to £173.0 billion.
- (2) the value of collective investment funds in the Island was £112.6 billion.
- (3) total funds under management amounted to £36.9 million.

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

(4) 50 banks and 608 insurance companies were licensed in the Island.

The Jersey FSC is responsible for the regulation, supervision and development of the financial services industry in the island. The Commission is the body corporate, set up under the Financial Services Commission (Jersey) Law 1998. The law provides for a board of Commissioners to be the governing body of the Commission.

The Commission is established as an independent body, fully responsible for its own regulatory decisions. The Commission is accountable for its overall performance to the States of Jersey through the Economic Development Minister.

The Commission is also responsible for appointing a person to exercise certain statutory responsibilities as the Registrar of Companies, Limited Partnerships, Limited Liability Partnerships and Business Names. The Commission has appointed the Director General of the Commission as the Registrar.

Further information is set out in the 2004 Annual report of the Commission which can be found on the Commission's website (www.jerseyfsc.org).

The review

The review is to be undertaken by the C&AG at the invitation of the Commission which is concerned that it should be able to demonstrate that its charges are reasonable in all of the circumstances.

The purpose of the review is:

- (1) to consider the overall organisation of the Commission and of its principal schemes of regulation.
- (2) to consider to what extent the overall organisation and the schemes of regulation are fit for their purpose and provide the most cost-effective means of achieving the Commission's purposes.
- (3) to make appropriate recommendations.

Report

The factual content of the report of the review should be confirmed with those officials whose advice and information has contributed to the review.

The report will be made public by the C&AG in the normal manner.

APPENDIX 2 ~ PRINCIPLES OF REGULATORY ENFORCEMENT

The principles of regulatory enforcement set out in the paragraph 2.92 of the Hampton Report are as follows:

- (1) Regulators and the regulatory system as a whole should use comprehensive risk assessment to concentrate resources on the areas that need them most.
- (2) Regulators should be accountable for the efficiency and effectiveness of their activities while remaining independent in the decisions they take.
- (3) All regulations should be written so that they are easily understood, easily implemented and easily enforced and all interested parties should be consulted when they are being drafted.
- (4) No inspection should take place without a reason.
- (5) Businesses should not have to give unnecessary information nor give the same piece of information twice.
- (6) The few businesses that persistently break regulations should be identified quickly and face proportionate and meaningful sanctions.
- (7) Regulators should provide authority to the accessible advice easily and cheaply.
- (8) When new policies are being developed explicit consideration should be given to how they can be enforced using existing systems and data to minimise the administrative burden imposed.
- (9) Regulators should be of the right size and scope that no new regulators should be created where an existing one could do the work.
- (10) Regulators should recognise that a key element of their activity will be to allow or even encourage economic progress and only to intervene when there is a clear case for protection.

APPENDIX 3 ~ AUDIT COMMISSION REVIEW ~ SUMMARY OF CONCLUSIONS

1. Overall - The FSC has set a clear documented aim to ensure that it operates effectively and efficiently which helps to ensure that there is both a strategic and operational focus on continuous improvement. There is also strong senior management and Commissioner commitment to further improve the organisation's value for money. A number of business activities and projects have been completed and are on-going which contribute to the organisation demonstrating that it is improving its own value for money.
2. Corporate arrangements and business planning framework - The business and annual planning documents contain considerable detail on the organisation's key achievements in the previous year and the direction of work for the forthcoming year. They would further benefit clarity of message if they more clearly demonstrated the explicit links on how the overall corporate aims and objectives have been delivered and achieved, particularly in the medium to longer term. Achieving the appropriate balance between international drivers and locally set priorities is recognised as a challenging environment for the FSC and within this framework it is important that clarity is given on the requirement for minimum supervisory activity levels whilst allowing freedom to exercise local discretion. Effective leadership is a key determinant of the success of any organisation and with the arrival of a new Director General towards the end of 2006 it is timely to reconsider the production of a strategic plan, or similar document, as a means of communicating a clear longer-term vision which will also help to sustain support both internally and externally in a period of change.
3. Risk management - Risk management is a central process of the FSC's strategic management arrangements. In accordance with notable practice corporate risks have been assessed and the FSC has identified and refined the appropriate steps needed to mitigate the risks to an acceptable level. Operationally the risk model is based on best practice from other regulators but the system is not working fully effectively and consequently staff do not have sufficient confidence in the system to base their supervisory work programmes on its output and help establish the required minimum supervisory activity levels. The correlation between the overall risk rating and the examination activity is weaker in some divisional areas and factors other than the risk rating are key drivers when identifying examination programmes. The risk model does not always accurately reflect the current risk rating for an entity and exception reporting will only be a useful management tool if the information contained in the system is accurate. The use of differential thresholds across divisions for the identification of high, medium and low risks may result in insufficient resources being focused in those areas where the greatest risks lie. There is scope for the FSC to revisit the operational risk model to enable a clearer focus on bodies assessed as high risk coupled with achieving minimum standards of supervision.
4. Performance management - The FSC has set targets to demonstrate a commitment to delivery. However, the performance management process does not represent the practical steps required to turn its vision into reality due to the lack of linkages between the corporate objectives and activities. Corporate aims and high level priorities have been broadly defined in plans but the performance management system does not put divisional and individual staff activities into the corporate context, demonstrate how activities support achievement of corporate aims or help document success measures. Consequently gaps between the strategic intentions and the implementation of policies are less likely to be easily identified and the lack of formal prioritisation of activities, at a divisional level, could result in resources not being

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

directed towards key issues in the most appropriate or timely manner. The performance management framework is positively linked to aspects of corporate governance such as risk management and longer-term financial planning.

5. Corporate governance - The FSC is committed to achieving good standards of corporate governance and follows notable practice through its adoption of the UK's Combined Code on Corporate Governance where appropriate. To date the Audit Committee has mainly focused on the activity of external audit work, accounts sign off and corporate governance arrangements. The internal audit activities, undertaken by the Risk Unit, and associated work plans have been underdeveloped due to the Unit's resource capacity. An accepted international definition of internal auditing is that it is an independent, objective, assurance activity designed to add value through improving an organisation's operations, evaluating and improving the effectiveness of risk management, control and governance processes. The Risk Unit has had a keen focus on the corporate risk management model but it is difficult to see how the other aspects of internal auditing are being adequately met within the limitations of the resources available.
6. Financial management - Good financial controls are in place, as assessed by both external and internal audit, and the financial position is sound. The corporate policy for fees to cover costs and to create a small reserve for unforeseen events, including litigation costs, is being achieved. This policy is not always being met at all divisional levels. Income and expenditure figures are regularly reviewed, major projects include cost and benefit analyses and business divisions have examples where efficiencies are being made. However, the organisation could benefit from a more targeted approach of reviewing expenditure areas to identify value for money opportunities. There are examples where the FSC uses procurement practices to secure competitive tendering. Nevertheless, there is a view within the FSC that procurement opportunities are limited in Jersey, with little scope to realise savings, and that it is best to focus on process improvements to achieve value for money. Key efficiency agenda areas in the United Kingdom have targeted both procurement practices and partnership working and these are areas which the FSC should reconsider particularly as they could help to address some of the capacity issues which the organisation experiences.
7. Corporate support services - There is not a clear documented strategy on how corporate services should be structured to support the delivery of FSC aims. The corporate services division has changed its name and structure a number of times in the last 3 years. Major projects are being managed appropriately and in accordance with recognised good practice to ensure that they are completed within defined scope, time and cost constraints. Costing and evidencing of projected savings need to be further developed in terms of their initial assessment and on-going monitoring. Also projects are not always projected on a whole-life basis and so there may be costs which are being overlooked.
8. Human resources - Overall, staff costs and numbers have been rising but staffing levels remain below the level which the FSC has estimated that it needs to meet all of its planned activities. There is no formal workforce plan or similar document supporting the FSC's corporate aims and objectives and outlining the organisation's strategy around workforce planning in the medium or long term. The FSC takes steps to manage the imbalance in overall demand and supply of resources through effective short-term action. However, the remedy to the shortage of resources is inevitably long term and may well require partnership working to find appropriate solutions.
9. Information technology - The FSC is increasingly reliant on the IT systems reliably working reliably and although the organisation has put in place and tested its disaster recovery

*JERSEY FINANCIAL SERVICES COMMISSION
Report of the Comptroller & Auditor General
Friday 23 February 2007*

plan there is no documented information, communications and technology strategy and this is not in accordance with good practice.

10. Divisions - The level of supervisory activity has been increasing since 2003, in accordance with corporate goals and IMF recommendations, but the activity levels are not expected to increase further unless developing international standards demand otherwise. However, there is no clear strategic view on what the activity levels for each of the divisions should be to establish the balance between achieving minimum international and local standards of supervisory activity levels and visiting all high risk rated entities in a defined period. Some of the divisions have been experiencing capacity issues impacting on the achievement of examination targets and external consultants have been used to supplement resources in targeted areas. In 2004 the divisions were re-structured to encourage technical specialisation and although there is some limited cross working resource shortages remain a key issue for the organisation. The exception to this is the boundaries between compliance and enforcement which are blurred.