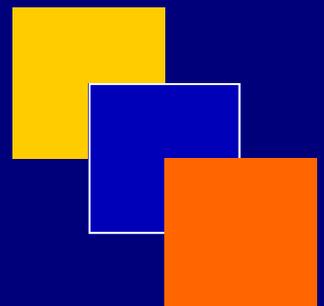




Financial Services Commission
Gibraltar

Annual Report
2006



Our Mission Statement

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

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Chairman's Report for the year ended 31 March 2006

Introduction from the Commissioner

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

The Commission has achieved a great deal over the last twelve months, much of it detailed in the following report. It could not have done so without the skill and dedication of its staff. To them and my fellow Commission members, I extend my heartfelt thanks.

The Commission and its Statutory Duties

The work of the Commission is focused on fulfilling its statutory duties. These duties are set out in the Financial Services Commission Act and include:

- (a) to keep under review both the operation of Gibraltar legislation relating to financial services and the effectiveness of the supervision of institutions licensed to provide any financial services.
- (b) in respect of financial services in those areas where Community law applies, to monitor the extent to which Gibraltar legislation and supervision of licensed institutions –
 - (i) comply with Community obligations; and
 - (ii) establish and implement standards which match those required by legislation and supervisory practice governing the provision of financial services within the United Kingdom.
- (c) to seek through the provision of effective services for the supervision of finance business to protect the public against financial loss arising out of dishonesty, incompetence or malpractice on the part of persons engaged in finance business in Gibraltar;
- (d) to advise the Government of Gibraltar and the Government of the United Kingdom on matters concerning financial services,

having regard, in particular, to any matter arising in the course of the discharge by the Commission of its duties under paragraph (b) above, and to the need for timely and effective implementation in Gibraltar law of Community obligations.

The Commission also takes into account the following regulatory objectives:

- (a) To promote market confidence;
- (b) The reduction of systemic risk;
- (c) To promote public awareness;
- (d) The protection of consumers; and
- (e) The reduction of financial crime, including the funding of terrorism.

Matching UK standards

The Commission interprets the statutory requirement to meet UK standards as meeting the regulatory objectives (which both the UK FSA and Commission share), to the same extent as the FSA does, but not necessarily in the same way. Our focus is therefore upon the outcome of those processes - for example do they achieve the same level of market confidence and consumer protection as do the practices in the UK?

To focus on the 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 a regulatory process may, in fact, lead to the end objective being missed or achieved to a lesser degree.

The differences between the FSA and FSC environments will occasionally mean that supervision in Gibraltar is tighter than in the UK; for example the UK does not operate a programme of on-site visits to all its regulated firms, nor indeed does it regulate as wide a range of financial service providers as does Gibraltar. On other occasions the Gibraltar regime can adopt a case-by-case approach more often than the UK does but with no reduction in overall supervisory standards.

The work of the Commission

The main work of the Commission is of regulatory supervision. This includes the assessment of applications from firms wishing to conduct regulated activities, ongoing supervision of regulated firms (both through the review of returns and by a regular programme of on-site visits) and the taking of disciplinary or enforcement action where required. The Commission has a wide range of powers including the issue of directions or imposing conditions upon a licensee. In an extreme case a licence can be revoked.

The Commission is organised by industry groups with three supervisory divisions covering banking and investment services, insurance and fiduciary services. These are supported by an enforcement division whose prime role is to detect and take action against firms conducting unlicensed financial services activities. The divisions are also supported by both administrative and strong IT resources.

It is important that the Commission uses its resources as efficiently and effectively as possible. In order to achieve this, we focus upon the risks faced both by the Commission and the firms it regulates, and how these risks may be mitigated. During the year the Commission has consolidated its risk-based supervisory approach across all its supervisory functions delivering an effective methodology under which it can exercise its responsibilities.

A regular programme of on-site visits to all licensed firms is now in place. The initial visits form part of the risk assessment process and the firm is then placed on the appropriate cycle for future visits. These cycles are normally 12, 24 or 36 months. Being on a short cycle does not automatically mean that the Commission has concerns with the firm. Its size, nature of business and customer type also impact upon how frequently we conduct our visits.

In addition to its supervisory duties the Commission performs a number of other tasks including advising Government on new financial services legislation introduced to comply with EU requirements. It also undertakes any additional tasks including preparation of Anti Money Laundering

Guidance Notes as required under the Criminal Justice Ordinance.

The Commission has also continued to play its role in the development of international regulatory standards, through its participation in the International Association of Insurance Supervisors (IAIS) the International Organisation of Securities Commissions (IOSCO) and the Off-shore Group of Banking Supervisors (OGBS).

Other work includes the giving of assistance where appropriate to other regulators in the conduct of their regulatory responsibilities. The Commission also "patrols the perimeter," including monitoring of the media and the internet in order to identify possible unlicensed financial service activity. Where this is detected, swift action is taken to resolve the position. If necessary the Commission will seek the Attorney General's permission to bring criminal charges against those found to be conducting licensable activity without authorisation.

The Commission also receives complaints about licence-holders. These complaints primarily related to alleged miss-selling of investment products. The Commission's remit does not extend to adjudicating on complaints. Such action, under Gibraltar law, falls under the responsibility of the Courts and this action, of course, continues to be available to consumers. Notwithstanding this, the Commission takes an active interest in such complaints as these may point to regulatory breaches on the part of the firm.

Review of our activities 2005-2006

2005/06 has seen yet further growth in Gibraltar's financial sector. This growth has been across a wide range of areas, but particularly in insurance and investment services. The introduction of the Experienced Investor Fund regime has also seen a welcome growth in the fund industry here.

Turning to the issue of anti money laundering and combating the financing of terrorism, it remains internationally acknowledged that Gibraltar has done a good job in implementing an AML/CFT regime and keeping up with international developments

Early 2006 also saw the latest IMF review of Gibraltar. This review was part of the IMF's programme of visiting all financial centres to assess the level of compliance with international regulatory standards. The final report is due for publication in early 2007 and will be more fully commented upon in next years report. However we see no reason why the findings will not be as, if not even more, positive than previous assessments of ourselves.

Other activities during the year have included work to assist the Government to revise and bring up to date several pieces of legislation.

During the year to the end of March the following financial services related EU directives were introduced by the Government of Gibraltar;

- UCITS II (2001/107/EC)
- UCITS III (2001/108/EC)
- Market Abuse Directives & Regulations (2003/6/EC 2003/124/EC
- 2003/125/EC 2004/72/EC 2273/2003)
- Prospectus Directive (2003/71/EC)
- Reorganisation and Winding up of credit institutions (2001/24/EC)
- International Accounting Standards Regs N/A
- Distance Marketing of Consumer Financial Services (2002/65/EC)
- Annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (2003/51/EC)

Like Regulators around the world, the Commission has been and continues to be faced with a significant increase in its workload. In addition to the expansion of the on-site inspection programme and the increase in work to improve public awareness, the Commission will be working with firms in the year ahead to further enhance the level of training and competency in the finance sector.

The increased work of the Commission has required additional resources and during the year we were delighted in welcoming four new members of staff. This took our complement of staff to twenty-two by the end of March. Further recruitment will take place in 2006/07.

The year ahead

We do not foresee a reduction in the pace of growth of the financial sector in Gibraltar over the year ahead. Indeed we are aware of plans to introduce a Stock Exchange here and other sectors including funds, insurance and investment services continue to progress. Discussions on the viability of introducing financial products based around Shari'a law are also taking place.

During the forthcoming year the Commission will continue to assist the Government in its work to transpose a significant new swath of EU legislation relating to financial services, the most important of which include, the Capital Requirement Directive, 3rd Money Laundering Directive and the Markets in Financial Instruments Directive (MiFID).

Internally we will also continue to build the strength of an already strong regulatory team at the Commission through our participation in the pilot "Investors in People" programme and our continued commitment to ISO9001:2000.

Statement of the Commission's responsibilities

The Commission is required by the Financial Services Commission Act 1989 to keep proper books of account of its income and other receipts and expenditures during each financial year and to prepare accounts which give a true and fair view, in the case of the balance sheet of the finances as at the end of the financial year and in the case of the income and expenditure account, of the surplus or deficit for that financial year.

In preparing those accounts, the Commission:

- selects suitable accounting policies and then applies them consistently;
- makes judgements and estimates that are reasonable and prudent;
- states whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepares the accounts on the going concern basis unless it is inappropriate to presume that the Commission will continue in operation.

The Commission also makes available to the auditors, as and when required, all the accounting records and all other relevant records and related information, including minutes of all Commission meetings. It also safeguards the assets of the Commission and takes reasonable steps for the prevention and detection of fraud, error or non-compliance with law or regulations.

Auditors

The auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office.

I commend the report to you.

Marcus Killick
Commissioner & Chairman
Financial Services Commission
Gibraltar

12 February 2007



PricewaterhouseCoopers Limited
International Commercial Centre
Casemates Square
Gibraltar
Telephone +350 73520
Facsimile +350 48267
www.pwc.com/gi

Independent Auditors' Report to the Financial Services Commission

Report on the financial statements

We have audited the financial statements of the Financial Services Commission for the year ended 31 March 2006 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 control 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 2006 and of its profit for the year then ended.



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 books of account, whether the Commission's Balance Sheet and Income and Expenditure account dealt with by this report are in agreement with the books of account, 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, and whether the Commission has discharged with diligence its obligations in relation to the collection of its revenues.

Opinion

In our opinion:

1. proper books of account have been kept by the Commission;
2. the Commission's Balance Sheet and Income and Expenditure account dealt with by this report are in agreement with the books of account;
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;
4. the Commission has discharged with diligence its obligations in relation to the collection of its revenues.

Other matters

This report, including the opinion, has been prepared for and only for the Commission as a body in accordance with Section 15 of the Financial Services Commission Act, 1989 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.

PricewaterhouseCoopers
Registered Auditors

Gibraltar,

14 February 2007

The maintenance and integrity of the Gibraltar Financial Services Commission web site is the responsibility of the Commission; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in Gibraltar governing preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income and Expenditure Account For the year ended 31 March 2006

	Notes	2006 £	Restated 2005 £
INCOME			
Fees receivable	3	1,389,057	1,285,790
Interest receivable		31,794	27,933
		1,420,851	1,313,723
TOTAL INCOME			
EXPENDITURE			
Staff expenses	4	980,382	821,901
Establishment costs		130,266	101,242
Other operating expenses		108,652	84,076
Commission members fees	5	81,000	68,000
Legal and professional fees		170,796	134,700
Auditors remuneration		2,400	2,400
Depreciation	6	32,766	27,810
Review team costs		-	80,104
Other professional charges		14,850	14,725
		1,521,112	1,334,958
TOTAL EXPENDITURE			
OPERATING LOSS		(100,261)	(21,235)
Gibraltar Government Contribution		170,000	150,000
RESULT FOR THE YEAR	£	69,739	£ 128,765

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.

The notes on pages 12 to 18 form part of these financial statements.

Balance Sheet

As at 31 March 2006

	Notes	2006 £	Restated 2005 £
FIXED ASSETS			
Tangible assets	6	68,660	60,471
CURRENT ASSETS			
Debtors and prepayments	7	63,272	44,013
Cash at bank and in hand		513,821	483,949
		577,093	527,962
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	8	101,392	113,811
NET CURRENT ASSETS		475,701	414,151
NET ASSETS	£	544,361	£ 474,622
FINANCED BY:			
GENERAL FUND	9 £	544,361	£ 474,622

The financial statements on pages 10 to 18 were approved by the Commission on 12 February 2007 and signed on its behalf by:

Marcus Killick
Financial Services Commissioner

The notes on pages 12 to 18 form part of these financial statements.

Notes to the Financial Statements

1. PRINCIPAL ACCOUNTING POLICIES

Basis of accounting

The financial statements are prepared in accordance with United Kingdom applicable accounting standards. The particular accounting policies adopted by the Commission are described below.

Accounting convention

The accounts are prepared under the historical cost convention.

Income

Annual Renewal Fees due under the Banking, Insurance and Financial Services Ordinances 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 %

Pension costs

The Financial Services Commission operates a money purchase pension scheme called the Financial Services Commission Retirement Benefit Scheme on behalf of its employees. 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.

Government contributions

Government contributions are recognised in the Income and Expenditure Account on a receipt basis.

Notes to the Financial Statements

Restatement of comparative figures

The Government of Gibraltar has now clarified that Government contributions paid to the Commission are not repayable and should be used to fund any operating deficits in future years. Consequently the amount previously shown as unutilised Government contributions which were reported as a liability in the Balance Sheet should be regarded as part of the General Fund of the Commission. As a result of this clarification, all Government contributions which were previously recognised as income only to the extent that they matched deficits in the operating expenses of the Commission have been fully recognised in the income statement in the year of receipt. Any surplus in the results for the year, to the extent that these arise from the Gibraltar government contribution, are transferred to a Special Reserve memorandum account forming part of the General Fund.

As a result of this clarification the comparatives have been restated and creditors, as previously stated, have been reduced by £356,832 with the General Fund increasing by a similar amount. The Gibraltar Government Contribution reported in the Income and Expenditure Account for 2005 has been restated by £128,765 from £21,235 to £150,000.

General Fund

The General Fund represents the retained earnings of the Commission and includes the Special Reserve set up to account for surpluses in Government contributions as further explained below.

Special Reserve

The Special Reserve is a memorandum account within the General Fund and reflects the accumulated unutilised portion of the Government contributions.

These funds are available to the Commission to fund deficits in operating income in future years and are not repayable to Government. The Special Reserve is therefore deemed to form part of the General Fund.

2. TAXATION

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

Notes to the Financial Statements

3. FEES RECEIVABLE

	2006 £	2005 £
Financial Services Ordinances	756,875	708,925
Banking Ordinance	124,000	109,000
Insurance Companies Ordinance	454,250	430,000
Others	53,932	37,865
	<hr/>	<hr/>
	£ 1,389,057	£ 1,285,790
	<hr/>	<hr/>

4. STAFF EXPENSES

	£	£
Salaries	818,113	705,155
Social security costs	27,706	21,673
Pension costs	55,065	41,837
Other staff costs	79,498	53,236
	<hr/>	<hr/>
	£ 980,382	£ 821,901
	<hr/>	<hr/>

Marcus Killick received total remuneration (including housing costs and pension provision) of £164,862 as Commissioner of the Financial Services Commission for the year ended 31 March 2006. (2005: £147,622)

The average number of employees for the year was 21 (2005: 18).

Regulatory	16	14
Administration	5	4
	<hr/>	<hr/>
Total staff employed	21	18
	<hr/>	<hr/>

Notes to the Financial Statements

5. COMMISSION MEMBERS' FEES

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

	2006 £	2005 £
Oonagh McDonald	12,000	10,000
Terry Mathews Deceased 27 November 2004	-	8,000
Mark Boleat	12,000	10,000
Brian Hilton	11,000	10,000
James Neish Retired 31 July 2006	12,000	10,000
Joseph Caruana	12,000	10,000
Franco Cassar	11,000	10,000
Alan Whiting Appointed 27 January 2005	11,000	-
	£ <u>81,000</u>	£ <u>68,000</u>

Subsequent to the year end Robert Vasquez was appointed as a Member of the Commission on 1 August 2006.

Notes to the Financial Statements

6. TANGIBLE ASSETS

	Office Furniture & Fittings £	Office Equipment £	Motor Vehicles £	Total £
Cost				
As at 1 April 2005	65,613	94,283	25,339	185,235
Additions	9,814	31,141	-	40,955
Disposals	-	-	-	-
<hr/>				
As at 31 March 2006	75,427	125,424	25,339	226,190
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Depreciation				
As at 1 April 2005	56,101	61,245	7,418	124,764
Charge for the year	4,326	23,372	5,068	32,766
Disposals	-	-	-	-
<hr/>				
As at 31 March 2006	60,427	84,617	12,486	157,530
<hr/>				
Net book value				
As at 31 March 2006	£ 15,000	£ 40,807	£ 12,853	£ 68,660
<hr/>				
As at 31 March 2005	£ 9,512	£ 33,038	£ 17,921	£ 60,471
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Notes to the Financial Statements

7. DEBTORS

		2006 £		2005 £
Other debtors and prepayments	£	63,272	£	44,013

8. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

		£		Restated £
Trade creditors		22,822		18,695
Accruals and deferred income		63,740		82,704
Taxation and social security		14,830		12,412
	£	101,392	£	113,811

Notes to the Financial Statements

9. GENERAL FUND

	Other Retained Earnings	Special Reserve	Total
At 1 April 2004 as previously stated	117,790	-	117,790
Prior year adjustment (Note 1)	-	228,067	228,067
At 1 April 2004 as restated	117,790	228,067	345,857
Result for the year	128,765	-	128,765
Transfer to Special Reserve	(128,765)	128,765	-
As at 31 March 2005	117,790	356,832	474,622
Result for the year	69,739	-	69,739
Transfer to Special Reserve	(69,739)	69,739	-
As at 31 March 2006	£ 117,790	426,571	544,361

10. LEASE COMMITMENTS

	£	£
The Commission leases a property for its own occupation. Annual rentals payable under this lease are as follows:		
Operating leases which expire:		
In the second to fifth year inclusive	58,390	49,642

11. RELATED PARTY TRANSACTIONS

James Neish is a Member of the Commission and also a partner of Triay Stagnetto Neish. During the year the Commission used Triay Stagnetto Neish to provide certain legal services. These were contracted on an arm's length basis, and are not considered to be significant in the context of the business of the parties.

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PO Box 940
Suite 943 Europort
Gibraltar

www.fsc.gi
info@fsc.gi

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