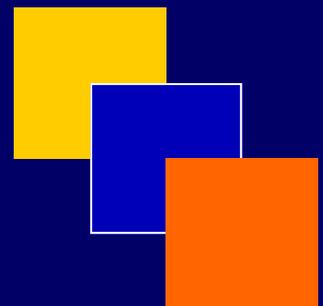




Financial Services Commission
Gibraltar

Annual Report
2007



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 2007

Introduction from the Chairman

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

This is my last report as Chairman and Commissioner. Under the new Financial Services Commission Act 2007, the role of the Commissioner is replaced with that of a Chief Executive and the role of Chairman separated. This is in line with best practice in corporate governance and marks the culmination of the Commission's move to best practice. We had achieved much already but this legislative change has been necessary to complete this task.

As these changes took effect after the year end, reference to our statutory duties below reflect the previous Act.

I am delighted that my last report should end on a high note. The Commission, like the Gibraltar finance sector, has never been stronger. The published IMF report provides further independent evidence of our adherence to international standards. This adherence is however achieved by working with our stakeholders, by culturally being part of the finance sector, not isolated from it.

There remains work to be done and no regulator can afford to be less than totally vigilant.

Our success could not have been achieved 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

During the year, the work of the Commission was 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 match 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 UK and Gibraltar 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.

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. It also undertakes any additional tasks including preparation of Anti Money Laundering Guidance Notes as required under the Criminal Justice Act.

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 Offshore 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 invite the Attorney General 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 relate to alleged miss-selling of investment products. The Commission's remit does not extend to adjudicating on levels of

compensation. 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 2006-2007

2006/07 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 continued growth of the Experienced Investor Fund regime has also seen a welcome growth in the fund industry here.

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

The Commissioner has also been given the role as Competent Authority under the Market Abuse and Prospectus Acts.

During the year to the end of March the following financial services related EU directives were introduced in Gibraltar :

- 2003/41/EC - Supervision of institutions for occupational retirement provision.
- 2006/49/EC and 2006/48/EC - Capital Requirements Directive (Recast Directive)
- 2004/39/EC - Markets in Financial Instruments Directive

Like every regulator 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 risk assessment programme of firms 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 Nicholas

Azopardi, Stephanie Goodridge, Susan Harland, Bibiana Peralta, Krisanne Tonna and Shianne Walker as new members of staff. This took our complement of staff to 25 by the end of March. Further recruitment will take place in 2007/08. James Neish, one of longest serving an outstanding Commission Members stood down and was replaced by Robert Vasquez, a senior local lawyer and former bar council chairman. Other staff departures were Mark Dellipiani and Nicholas Macias. We thank them for their work and wish them well.

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 the plans to introduce a Stock Exchange here are well advanced. The introduction of legislation to promote the growth of Shari'a financial services is also likely

Other sectors including, banking, funds, insurance and investment services continue to progress.

The Commission will also be shortly assuming responsibility for the licensing and supervision of bureau de change and money transmission services.

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 3rd Money Laundering Directive and the Markets in Financial Instruments Directive (MiFID).

Internally we will also continue to build the strength of an already, internationally recognised regulatory team at the Commission through our participation in the pilot "Investors in People" programme and our continued commitment to ISO 90001:2000.

Statement of the Commission's responsibilities

The Commission was 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

24 May 2007



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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 2007 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 2007 and 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 accounts, whether the Commission's Balance Sheet and Income and Expenditure Account dealt with by this report are in agreement with the books of accounts, 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 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,

24 May 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 2007

| | Notes | 2007 £ | 2006 £ |
|-----------------------------------|-------|-----------|-----------|
| INCOME | | | |
| Fees receivable | 3 | 1,502,730 | 1,389,057 |
| Interest receivable | | 35,520 | 31,794 |
| | | <hr/> | <hr/> |
| TOTAL INCOME | | 1,538,250 | 1,420,851 |
| | | <hr/> | <hr/> |
| EXPENDITURE | | | |
| Staff expenses | 4 | 1,169,939 | 980,382 |
| Establishment costs | | 127,648 | 130,266 |
| Other operating expenses | | 96,828 | 108,652 |
| Commission members fees | 5 | 79,542 | 81,000 |
| Legal and professional fees | | 102,975 | 170,796 |
| Auditors remuneration | | 6,500 | 2,400 |
| Depreciation | 6 | 38,568 | 32,766 |
| Other professional charges | | 14,455 | 14,850 |
| | | <hr/> | <hr/> |
| TOTAL EXPENDITURE | | 1,636,455 | 1,521,112 |
| | | <hr/> | <hr/> |
| OPERATING LOSS | | (98,205) | (100,261) |
| Gibraltar Government Contribution | | 170,000 | 170,000 |
| | | <hr/> | <hr/> |
| RESULT FOR THE YEAR | £ | 71,795 | £ 69,739 |
| | | <hr/> | <hr/> |

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 16 form part of these financial statements.

Balance Sheet

As at 31 March 2007

| | Notes | 2007 £ | 2006 £ |
|---|-------|-----------|-----------|
| FIXED ASSETS | | | |
| Tangible assets | 6 | 97,207 | 68,660 |
| CURRENT ASSETS | | | |
| Debtors and prepayments | 7 | 46,160 | 63,272 |
| Fixed term deposits | | 414,879 | 419,561 |
| Cash at bank and in hand | | 104,371 | 94,260 |
| | | 565,410 | 577,093 |
| CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR | 8 | 46,461 | 101,392 |
| NET CURRENT ASSETS | | 518,949 | 475,701 |
| NET ASSETS | | £ 616,156 | £ 544,361 |
| FINANCED BY: | | | |
| GENERAL FUND | 9 | £ 616,156 | £ 544,361 |

The financial statements on pages 10 to 16 were approved by the Commission on 24 May 2007 and signed on its behalf by:

Marcus Killick
Financial Services Commissioner

The notes on pages 12 to 16 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 Gibraltar Accounting Standards. The particular accounting policies adopted by the Commission are described below.

Accounting convention

The accounts are prepared under the historical cost convention.

Cash Flow Statement

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

Income

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

Interest receivable is accounted for on an accruals basis.

Depreciation

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

| | | |
|-------------------------------|-----------|--------------------|
| Motor Vehicles | | 20% |
| Office Furniture and Fittings | | 20% |
| Office Equipment: | General | 20% |
| | Computers | 33 $\frac{1}{3}$ % |

Leasehold Improvements

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

Pension costs

The Financial Services Commission operated a money purchase pension scheme called the Financial Services Commission Retirement Benefit Scheme on behalf of its employees. During the year this scheme was replaced by the Gibraltar Provident Trust (No. 3) Pension Scheme. Costs are accounted for on an accruals basis and are

Notes to the Financial Statements

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.

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 Act, the income of the Commission is exempt from income tax.

3. FEES RECEIVABLE

| | 2007 £ | 2006 £ |
|-------------------------|-------------|-------------|
| Financial Services Acts | 756,055 | 756,875 |
| Banking Act | 158,000 | 124,000 |
| Insurance Companies Act | 506,000 | 454,250 |
| Others | 82,675 | 53,932 |
| | <hr/> | <hr/> |
| | £ 1,502,730 | £ 1,389,057 |
| | <hr/> | <hr/> |

Notes to the Financial Statements

4. STAFF EXPENSES

| | 2007 £ | 2006 £ |
|-----------------------|-------------|-----------|
| Salaries | 948,131 | 818,113 |
| Social security costs | 31,137 | 27,706 |
| Pension costs | 76,043 | 55,065 |
| Other staff costs | 114,628 | 79,498 |
| | <hr/> | <hr/> |
| | £ 1,169,939 | £ 980,382 |
| | <hr/> | <hr/> |

Marcus Killick received total remuneration (including housing costs and pension provision) of £193,672 as Commissioner of the Financial Services Commission for the year ended 31 March 2007. (2006: £164,862)

The average number of employees for the year was 23 (2006: 21).

| | | |
|----------------------|-------|-------|
| Regulatory | 18 | 16 |
| Administration | 5 | 5 |
| | <hr/> | <hr/> |
| Total staff employed | 23 | 21 |
| | <hr/> | <hr/> |

5. COMMISSION MEMBERS' FEES

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

| | £ | £ |
|---|----------|----------|
| Oonagh McDonald | 11,500 | 12,000 |
| Mark Boleat | 11,500 | 12,000 |
| Brian Hilton | 11,500 | 11,000 |
| James Neish Retired 31 July 2006 | 2,875 | 12,000 |
| Joseph Caruana | 11,500 | 12,000 |
| Franco Cassar | 11,500 | 11,000 |
| Alan Whiting | 11,500 | 11,000 |
| Robert Vasquez Appointed 1 August 2006 | 7,667 | - |
| | <hr/> | <hr/> |
| | £ 79,542 | £ 81,000 |
| | <hr/> | <hr/> |

Notes to the Financial Statements

6. TANGIBLE ASSETS

| | Office Furniture & Fittings £ | Office Equipment £ | Motor Vehicles £ | Total £ |
|-----------------------|--|--------------------------|------------------------|------------|
| Cost | | | | |
| As at 1 April 2006 | 75,427 | 125,424 | 25,339 | 226,190 |
| Additions | 30,190 | 37,665 | - | 67,855 |
| Disposals | (31,021) | (21,722) | - | (52,743) |
| <hr/> | | | | |
| As at 31 March 2007 | 74,596 | 141,367 | 25,339 | 241,302 |
| <hr/> | | | | |
| Depreciation | | | | |
| As at 1 April 2006 | 60,427 | 84,617 | 12,486 | 157,530 |
| Charge for the year | 8,294 | 25,206 | 5,068 | 38,568 |
| Disposals | (30,303) | (21,700) | - | (52,003) |
| <hr/> | | | | |
| As at 31 March 2007 | 38,418 | 88,123 | 17,554 | 144,095 |
| <hr/> | | | | |
| Net book value | | | | |
| As at 31 March 2007 | £ 36,178 | £ 53,244 | £ 7,785 | £ 97,207 |
| <hr/> | | | | |
| As at 31 March 2006 | £ 15,000 | £ 40,807 | £ 12,853 | £ 68,660 |
| <hr/> | | | | |

7. DEBTORS

| | | 2007 £ | | 2006 £ |
|-------------------------------|---|-----------|---|-----------|
| Other debtors and prepayments | £ | 46,160 | £ | 63,272 |
| | | <hr/> | | <hr/> |

Notes to the Financial Statements

8. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | 2007 £ | 2006 £ |
|------------------------------|-----------|-----------|
| Trade creditors | 8,967 | 22,822 |
| Accruals and deferred income | 37,494 | 63,740 |
| Taxation and social security | - | 14,830 |
| | <hr/> | <hr/> |
| | £ 46,461 | £ 101,392 |
| | <hr/> | <hr/> |

9. GENERAL FUND

| | Other Retained Earnings | Special Reserve | Total |
|-----------------------------|-------------------------------|--------------------|---------|
| At 1 April 2006 | 117,790 | 426,571 | 544,361 |
| Result for the year | 71,795 | - | 71,795 |
| Transfer to Special Reserve | (71,795) | 71,795 | - |
| As at 31 March 2007 | £ 117,790 | 498,366 | 616,156 |

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 | 60,112 | 58,390 |
| | <hr/> | <hr/> |

11. RELATED PARTY TRANSACTIONS

Robert Vasquez is a Member of the Commission and also a partner of Triay & Triay. During the year the Commission used Triay & Triay 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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