

# 2021

## FINANCIAL RESILIENCE REVIEW



Jersey Financial  
Services Commission

# Reviewing our financial resilience

As outlined in our business plan for 2021, the strengthening of our financial resilience has been a key strategic priority for us over the past year.



Historically our policy was to maintain an accounting reserve equal to six months' operational costs plus a reserve for litigation costs. However, in light of a number of factors including our capital investment requirements, the expansion of our regulatory remit and the increasing complexity of our regulatory landscape, we need to change the focus to a liquidity reserve.

"Going forward, we now want to ensure that we maintain sufficient funds to cover anticipated costs, both capital and revenue-based, while providing greater clarity to Industry about how that is to be achieved."

To do so, we undertook a detailed review of our financial position – past, present and future. We were also aware of questions by Industry about the management of our costs, the levels of regulatory fees relative to other jurisdictions, our staff numbers, and the self-funding of different Industry segments. Our review covered these questions, in part because of our commitment to Industry to be as transparent as possible, but also because they provided a useful checkpoint in our evaluation.

The aim of our review was to propose a framework within which we would be able to better secure our financial position and provide a sound rationale for the level of regulatory fees and any increases thereof. This approach should also allow us to mitigate the risk of abrupt changes in fee levels.

# What our review looked at

The review looked across a number of the key aspects of our financial management, including:

- Our financial performance over the past decade
- How we have managed our costs
- A cost comparison with similar jurisdictions
- Our required expenditure for operational, capital, and litigation matters
- The future liquidity reserves we need to ensure that we can operate



# Our past financial performance

To provide the context for our plans, we analysed our historic performance. In particular, we looked at the trend and relationship between our revenue and our most significant areas of expenditure.



Over the past 12 years, the regulated community has experienced a varying approach to setting fee levels, during a period when the breadth and required standard of regulation has increased.

In the five years following the financial crisis of 2007/8, we adopted a particularly conservative approach to setting fees in order to reduce the cost impact on Industry. This constrained both investment in our operations and our ability to achieve the accounting reserves target. The position that arose was unsustainable and led to the need for greater fee increases in subsequent years. This scenario was not ideal for us nor the businesses we regulate.

Nevertheless, these fee increases have allowed us to cover our operational costs and the latest cycle of capital investments. Going forward, we now want to ensure that we maintain sufficient funds to cover anticipated costs, both capital and revenue-based, while providing greater clarity to Industry about how that is to be achieved.

# How we have managed our costs



Our historic financial performance demonstrates our commitment to controlling costs in light of increasing regulatory and supervisory requirements. Our investment in IT systems has been a major contributor to this as our regulatory and registry mandates become more operationally demanding.

"We shall continue managing costs by streamlining how we work and reaping the benefits of our investment in technology".

Given the nature of our operations and the vital need for skilled and experienced staff, it is unsurprising that the largest element of our costs relate to our people. Staff costs represent two-thirds of our operational expenditure so managing these costs effectively is key. Setting staff costs at too high a level would place a cost burden on Industry, whereas failing to develop and retain talent would put our operations and, by extension, Jersey's reputation as a competitive and successful International Financial Centre at risk.

Despite the ongoing challenges of increased regulation and supervision, we have carefully controlled our headcount with average growth in staff numbers of 3.8% per annum over the past five years. This has been possible because we have been able to adjust the mix of staff levels with an average increase in cost per employee of 0.9% per annum. Over this five-year period, inflation has ranged between 0.5% and 4.5% with an average of 2.6%, indicating that inflationary pressures have been largely mitigated. We shall continue managing costs by streamlining how we work and reaping the benefits of our investment in technology.

In addition, we have restructured internally so that teams share oversight for cross-sector activities. For example, our Supervision teams look after pooled portfolios of entities and we established a shared financial crime examination unit. This approach has enabled us to use our resources more efficiently, particularly when regulatory requirements have flexed between sectors year-on-year.

The need to apply focus on preventing money-laundering and terrorist financing means that we need to be able to dynamically allocate our resources and we do this through our risk model and our risk-based approach. This has minimised increases in our operational costs by targeting our finite resources on the areas of greatest risk.

The use of pooled resources and the agile deployment of key teams across sectors (for example, Policy and Enforcement) does generate a barrier to being able to determine a cost of supervision by regulatory sector and apply fee levels accordingly. However, we carefully monitor the change in supervisory effort to ensure that fee level changes for each sector are in line with the change in demands and can be explained to Industry.

# How we compare to other jurisdictions

Part of our review looked at fee levels in other relevant, and broadly similar, jurisdictions to see how the cost of regulation in Jersey compares.



We assessed our current initial application and annual fees for the Island's three largest regulatory sectors - banking, trusts and funds – against four other jurisdictions.

As there are a number of differences between the jurisdictions and their regulators, in both structure and funding, our fees are not always directly comparable. Despite this, our analysis indicates that the cost of being regulated in Jersey is not out of line with those jurisdictions. Looking at fees across the three sectors, ours were neither the lowest nor the highest and we feel that they are appropriate for a well regulated International Finance Centre.

# The outcome of our review

## A new retained liquid asset policy

As a result of the review, we have concluded that we need to change from a policy based on accounting reserves to one based on retained liquid assets. This will allow us to continue investing in capital initiatives that drive efficiencies, while still managing our operating costs effectively.

It also ensures that if a significant adverse event were to occur, we would retain the financial ability to continue with business-critical projects, in addition to our normal regulatory and registry operations.

Under our new liquid assets policy, we have set initial levels of:

- A target of £8.5m
- A minimum of £5.7m

These figures are based on retaining sufficient funds to cover a period of operating costs; a reserve for investigation and litigation costs; and funds to cover essential capital investments. The target level represents the funding that we would seek to achieve and maintain to provide resilience. However, we anticipate that at certain points in our investment and cost cycles, levels may temporarily drop, but not below the minimum level to ensure that we can always meet our immediate demands between fee run cycles.

In determining these target and minimum levels, we have assessed a range of possible future events which would require access to such funding. For each scenario, we have considered mitigating factors and the likely reactive measures we would take together with the associated time frames. We have then considered what overall retained liquid asset position would be suitable to provide for potential combinations of scenarios based on a set of worked examples.

Through this sensitivity analysis, we believe that these levels are appropriate. We will review these levels as part of our annual financial budget and business plan process to ensure that they remain fit for purpose.

Achieving and remaining broadly at this target level will require careful management of our costs and funding requirements. In future, we anticipate having some years in which we make an operating cash surplus which will replenish these funds; other years we will consciously incur greater costs than revenue as we invest for the future.

How we propose to reach our liquidity target will be outlined to stakeholders each year in our annual business plan. In the event that we foresee a risk of liquid assets falling below our defined minimum level in any budget period, we will take action to ensure this level is sustained. This action would start internally with viable cost-saving measures, but may also involve fee increases that will be explained and notified in good time to Industry.

We believe this change will not only strengthen our operational resilience, but will help smooth the impact of adverse events and reduce the risk of short-term and reactive fee changes. Instead, in as far as we can, we will use the strength of our balance sheet to cover these impacts and look to replenish liquid assets over time.

## Five year planning

As part of our annual planning process we will model our projected financial performance over a five year period to assess:

- Our anticipated future needs
- Any impact on our retained liquid assets position
- Any change to funding levels to achieve our target position in the medium-term, while placing the least financial burden on Industry.

As detailed above, we anticipate that this will result in cycles of building up retained liquid assets in time for the next cycle of investment, as illustrated below.

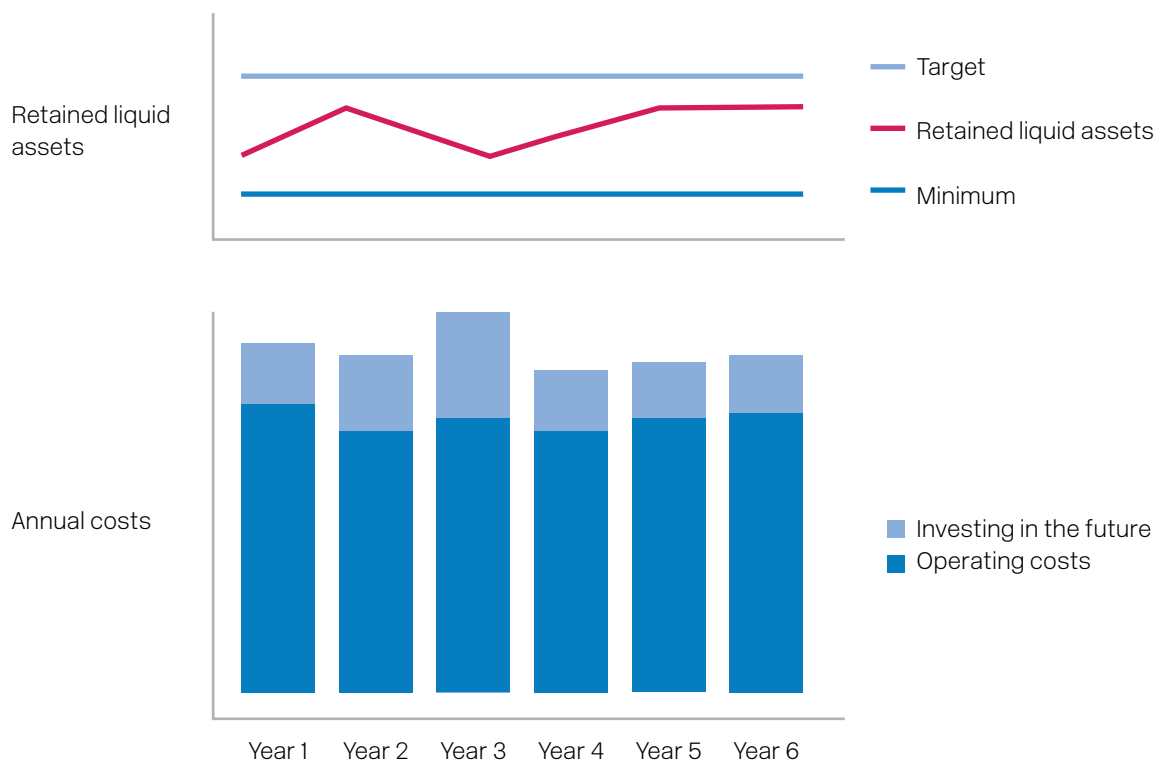


Chart 1: Illustration of our expected performance through an investment cycle



# Conclusion



Our review has confirmed that, whilst we have been successful in managing costs, our requirement to invest in the future needs a change in approach to ensure financial resilience.

The new policy of establishing both a minimum and target retained liquid assets position should enable us to ensure that we remain financially resilient, while providing a suitable mechanism for reducing the risk of more material and/or sudden changes in fee levels for Industry.



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