ANGUILLA FINANCIAL SERVICES COMMISSION

ANNUAL REPORT 2013

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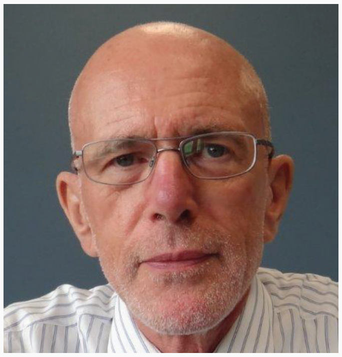
DIRECTOR'S REPORT



MR. KEITH BELL

Director

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At first glance, 2013 was not an entirely unsatisfactory year for those who have wealth and those who manage, or provide assistance in the management of, the wealth of others for a living: The Dow Jones Industrial Index rose 72.37 points to close at a new high of 16,576.66 – which translates to a gain of 26.5 per cent for 2013; the NASDAQ added 22.39 points to 4,176.59, an increase of 38 per cent for the year and, as well, reached its highest level in 13 years. The S&P 500 Index was up 7.29 points to 1,848.36 representing an improvement of 29 per cent for the year and recording its best year since 1997. In Europe, London's FTSE 100 advanced 14.4 per cent; Germany's DAX Index increased 25.5 per cent over the year (and hit record "highs"); France's CAC 40 rose 18 per cent and Spain's IBEX gained 21.4 per cent.

Away from the equity markets, U.S. home prices rose 13.6 per cent for the year (with particularly strong performance in the earlier months) showing the fastest pace of growth since February 2006 which, of course, predates the significant downturn in U.S. real estate markets.

Heartening though those statistics were, they did not appear to bring many encouraging ripples to Anguilla's shores. Tourism remained lacklustre, with the economy's bellwether sector again impacted by mediocre occupancy levels and by the layoffs associated with them. There was even a harbinger of the year's overall performance in the first few hours of 2013, when some festive celebrations were curtailed thanks to a lengthy power cut.

As the year unfolded, however, the event with the most impact for the island's financial services industry, and for economic activity and the island's reputation generally, occurred on 12 August 2013. On that day, the Eastern Caribbean Central Bank ("ECCB") announced its exercise of powers conferred on it by Part IIA, Article 5B of the ECCB Agreement 1993. The two ECCB Notices of Intervention appearing in the Official Gazette for 12 August 2013 (Vol. 40; No. 11) read, in part:

"AND WHEREAS the Central Bank is of the opinion that:

(a) The current situation at the bank has threatened the interest of depositors and creditors of the bank;

(b) The bank is likely to become unable to meet its obligations should the situation persist; and

(c) The financial system of Anguilla is in danger of disruption, substantial damage, injury or impairment as a result of the prevailing circumstances.

NOW THEREFORE with effect from 12 August 2013 and, in accordance with the powers granted to the Central Bank under the Agreement the Central Bank has assumed control of the bank."

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The two banks to which the Notices referred were, respectively, the National Bank of Anguilla Limited ("NBA") and the Caribbean Commercial Bank (Anguilla) Limited ("CCB"). In aggregate, those two banks accounted for approximately three quarters of the assets of the Territory's entire banking system in mid-2013. Significantly, a number of market participants in Anguilla's financial services industry had exposure to one or both of NBA and CCB at the time of the ECCB's intervention. Indeed, the Commission itself had exposure to one of the banks – since reduced - sufficient to cause the inclusion of an explanatory Note in the Certificate of Audit and Report of the Chief Auditor to its Financial Statements for the year ended 31 December 2012 and again for the year ended 31 December 2013.

The ECCB relieved each bank's Board of Directors and senior management team of their responsibilities and placed each bank under the full control (initially for a period of six months) of a Conservator recruited for the purpose by the International Monetary Fund/World Bank and with a mandate to ensure implementation of corrective measures to the satisfaction of the ECCB's Monetary Council and the Government of Anguilla. The length of the entire corrective process was declared by the ECCB to be contingent upon the financial, managerial, technical and other requirements for implementation of a successful resolution strategy.

Prior to its intervention, the ECCB had determined an urgent need to correct the structural deficiencies and rationalize the business models of both NBA and CCB and considered that the operations of the banks were not indicative of sound business practices or financial probity and posed significant threats to the institutions' depositors and creditors. Some of the identified threats to the banks included:

1. Weak corporate governance;
2. Poor and declining asset quality;
3. Poor earnings performance;
4. Deficient capital levels;
5. Excessive loan concentration;
6. Non-compliance with existing policies and procedures; and
7. Increasing reputational risks.

Some of the threats mentioned by the ECCB had been fairly easily discernible to readers of the two banks' audited accounts. For NBA, for example, the accounts for the year ended 31 March 2010 bore an audit opinion dated 12 September 2012 (i.e. the audited accounts were released fourteen months after the date prescribed by the bank's governing statute) while those for the year ended 31 March 2011 bore an audit opinion dated 23 July 2013 (i.e. the audited accounts were almost twenty-four months overdue). For both years, the external auditors saw fit to include "Emphasis of Matters" paragraphs in their Opinion and a Note to the accounts "which indicates the existence of material uncertainty that may cast significant doubt about the Group's ability to continue as a going concern." (NBA's audited accounts for the years ended 31 March 2012 and 31 March 2013 remained unavailable as this Report was written.) In the case of CCB, audited accounts for the years ended 31 October 2011 and 2012 both bore an expressly Qualified Opinion and an "Emphasis of Matters" paragraph from the auditors. (CCB's audited accounts for the year ended 31 October 2013 were also unavailable as this report was written.) At the writing of this Report, the banks' future remained under active discussion among the ECCB, the Government of Anguilla, the United Kingdom Foreign and Commonwealth Office, the International Monetary Fund and the World Bank and the Conservatorship arrangement, first imposed in August 2013, had been extended upon its initial expiry in February 2014.

Licences

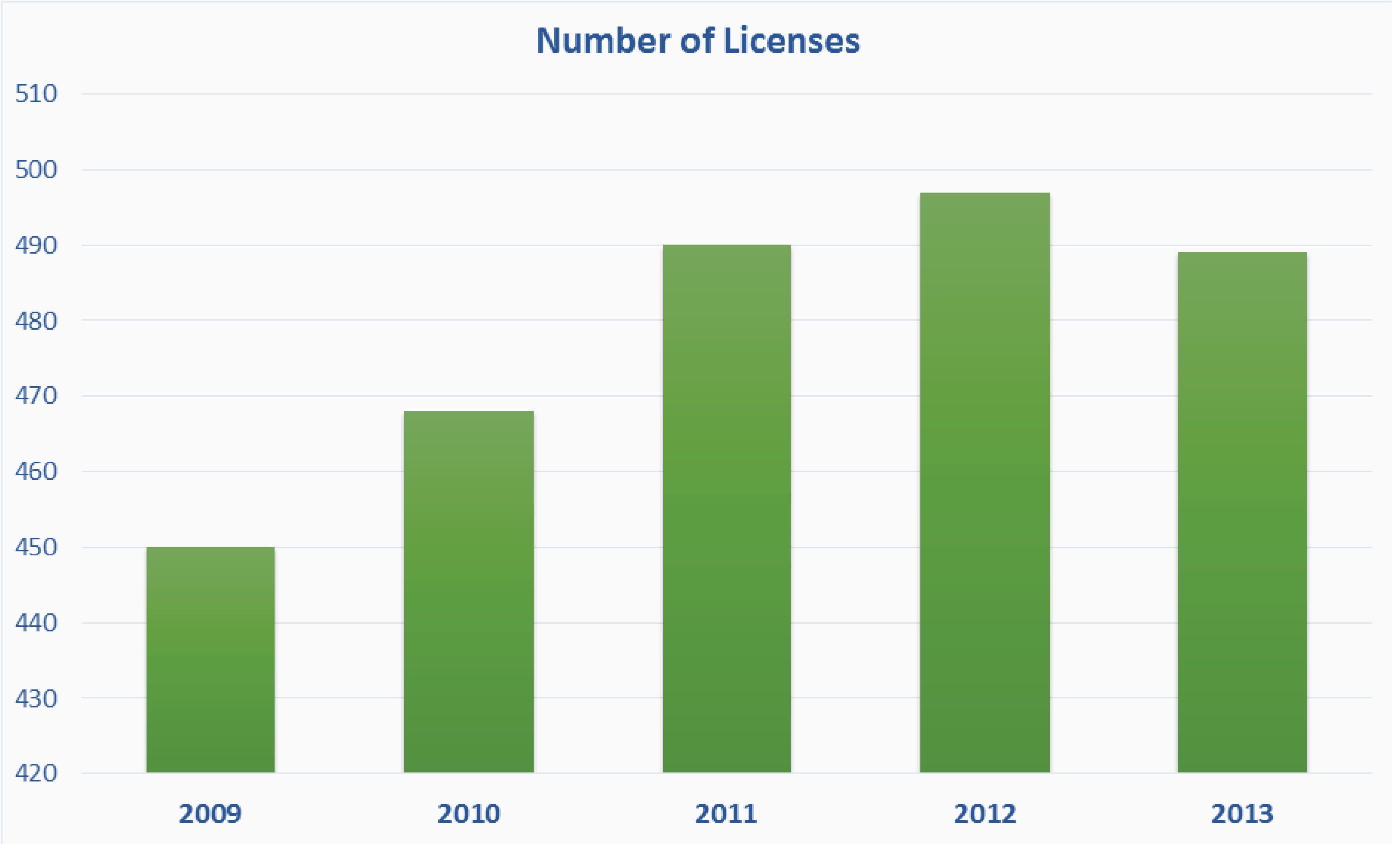
During 2013, licensees in all categories continued to assess carefully the economic viability of their businesses, with a number of requests for license surrender or revocation being the subsequent outcome (in some cases, licensees simply failed to pay the prescribed annual fee for license renewal, an action which required the Commission to revoke a license). In aggregate, 64 licenses were either revoked or surrendered, with the bulk (numbering 41) being in the offshore captive insurance sector. The total number of licensees in all categories stood at 489 at 31 December 2013, down from 496 reported at year end 2012. The only categories to show increases were those of Insurance Intermediaries and Offshore Insurance, each of which added a net 3 licensees.

The license of Fidelity Insurance Company Limited ("Fidelity") was made subject to a Directive on 1 August 2013. The Directive prohibited Fidelity from writing new business due to its failure to meet "margin of solvency" requirements as disclosed by its ultimate beneficial shareholder. The Directive remained in effect at year end and subsequently, on 20 January 2014, Fidelity's license issued under the Insurance Act, R.S.A. c. I16 was surrendered.

The Commission used the powers provided by the Financial Services Commission Act, R.S.A. c. F28 ("FSC Act") both to issue a Notice of Suspension or a Directive on a number of occasions in the course of the year, primarily for the purpose of having a licensee achieve capital adequacy requirements or deliver to the Commission its audited accounts, both as required by the licensee's governing statute.

A graphic representation of the number of licensees at year end can be found below.

Bar Chart Showing Years 2009-2013 Licensees



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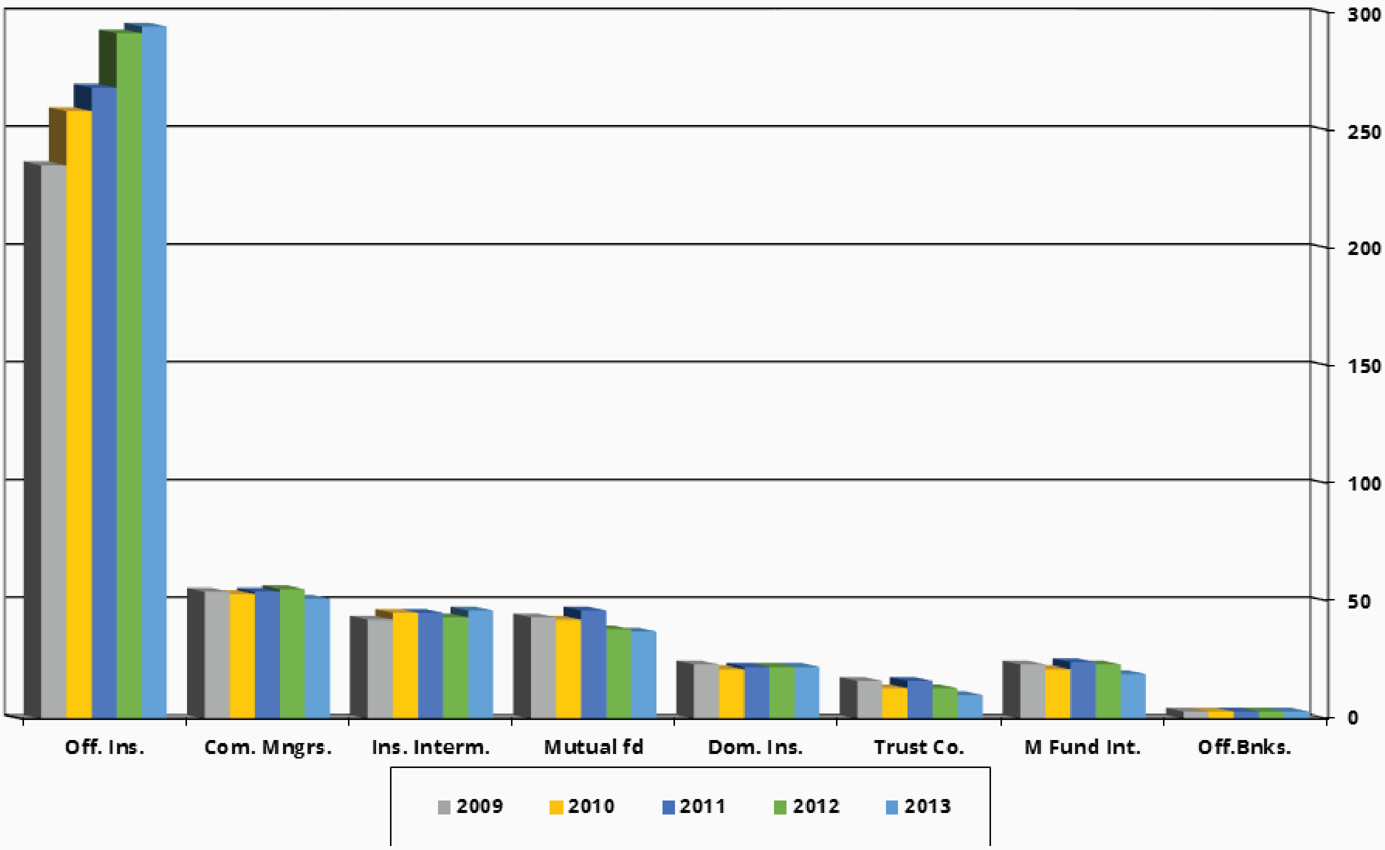
The following chart provides an industry sector breakdown of licensees, excluding a small number of foreign insurance companies and, as well, the two money services businesses which came within the purview of the Commission by virtue of the Money Services Business Act, 2009. The dominance of the offshore captive insurance sector remains clear and demonstrates Anguilla's position as the world's fifth largest jurisdiction (by number of companies licensed) in the captive insurance market.

Sectorial Distribution of Licensees



Regulatory Capacity

In my report for the year ended 31 December 2012, I remarked: "A start has been made .... by the Commission taking an inventory of the capabilities of its own human resources and then taking the opportunity to access capacity made available by the international organizations themselves, or by closely related affiliates." Given that the insurance sector remains the most significant of the Commission's activities where technical regulatory knowledge is required, it was entirely appropriate that, in 2013, the Commission's senior management engaged with the Caribbean Regional Technical Assistance Centre ("CARTAC") for the latter's provision of hands-on technical advice and training, using specially contracted CARTAC consultants, to enable the Commission's Regulators to conduct on-site inspections of insurance companies. By year end, the conduct of one such inspection had been completed (and the report of findings provided to the licensee's Board and senior management) and all preparations made for the conduct of a second inspection – entirely by the Commission's own staff – in the first two weeks of the New Year.

Immediately prior to year end, a group of the Commission's Regulators enrolled in the professional education program for the captive insurance industry delivered by the International Center for Captive Insurance Education ("ICCIE"). ICCIE's "Associate in Captive Insurance" ("ACI") is the professional designation of the captive insurance industry and Anguilla has a cohort of 20 students who have taken up the challenge to achieve it (8 of the 20 are employees of the Commission). The Commission is cooperating with the Anguilla Financial Services Association ("AFSC") and Anguilla Finance Limited ("AFL") in facilitating group study and mentoring for the cohort; all of the Commission's Regulators enrolled in the program successfully completed the first course early in 2014.

The Commission concluded negotiations with the Commonwealth Secretariat for the latter's provision in 2014 of an insurance advisor to provide capacity building in, inter alia, legislative development and both on-site and off-site supervision of insurance companies.

Anti-Money Laundering and Combating the Financing of Terrorism ("AML/CFT")

Several AML/CFT training sessions were conducted throughout the year. In March 2013, following a request from the management of the licensee, the Commission's Chairman, Mrs. Helen Hatton, held a training session for the management and staff of NBA. In January and June 2013, the AML/CFT Unit, in collaboration with AFSA and the Society of Trust and Estates Practitioners ("STEP") conducted two foundation events geared towards compliance, with the June event focusing on company managers and trust companies. In December 2013, the AML/CFT Unit combined with the Financial Intelligence Unit to conduct a seminar at the Teachers' Resource Centre in The Valley. The seminar was well attended by the target group, namely independent legal professionals, accountants, real estate agents and financial institutions numbered among those subject to the Externally and Non-Regulated Service Providers ("ENRSP") Regulations, 2013.

The Proceeds of Crime (Amendment) Act, 2013, which came into force 25 September 2013, expanded the scope of the supervision and enforcement regime to include ENRSPs. A companion piece of AML/CFT legislation enacted in September 2013 was the AML/CFT (Amendment) Regulations, 2013. In accordance with section 159 of the Proceeds of Crime Act, R.S.A. c. P98, the Commission consulted with the Governor concerning amendments to the AML/CFT Code and the revised version of the Code was subsequently published in The Gazette in December 2013.

The AML/CFT Unit conducted 24 site inspections and 12 follow up site inspections, covering corporate governance and related issues, across the financial services sector between February and November 2013. As in previous years, the purpose of each examination was to evaluate the service provider's compliance with the AML/CFT legislation. The main conclusions of the themed inspections were published on the Commission's website. While recognizing progress made, those conducting the inspections noted a number of areas where service providers exhibited a low level of compliance with the AML/CFT legislation, particularly in training and awareness, policy and systems and controls. Where necessary, service providers have been informed that regulatory sanctions will be considered when inadequate performance of compliance responsibilities is encountered.

Legislation and Guidance Update

The FSC Act's Administrative Penalties Regulations, 2013 ("APR") and the Financial Services Commission (Amendment) Act, 2013 received the Governor's assent on 25 September 2013. The APR, providing for administrative imposition of monetary penalties for defined infractions of statutes, is secondary legislation frequently found in a regime governing participants in a financial services industry. The Financial Services Commission (Amendment) Act, 2013, while primarily "housekeeping" in nature (including better coordinating the FSC Act with

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legislation governing Anguilla's AML/CFT regime) now enables the Commission to require a licensee to appoint – at the licensee's cost – "a person with relevant professional skill" to advise the licensee on the proper conduct of its business or to investigate and report to the Commission on any aspect of the licensee's business and affairs. While as yet unused, these are important and powerful provisions commonplace elsewhere that the Commission had, until the third quarter of 2013, singularly lacked.

In common with comparable legislation elsewhere in the world, the FSC Act permits the Commission to issue Guidelines regarding procedures to be followed by, and the conduct expected of, licensees in the operation of licensed businesses. This is a useful regulatory technique as it helps avoid unproductive use of time and, as well, misunderstandings between the regulator and licensees. In the course of 2013, the Commission issued two Guidelines for Captive Insurers regarding, firstly, Audit Exemption Applications and, secondly, the Use of Letters of Credit on such Insurers' Initial Capitalization.

Regulatory Capacity

Members of the Commission's staff were heavily involved in the preparation of the follow up report on improvements made to Anguilla's AML/CFT regulatory framework which was presented in November 2013 by officials of the Attorney General's Chambers at the CFATF Plenary Meeting XXXVIII held in Freeport, Grand Bahama Island. Further contributions from Commission staff will be provided when Anguilla again makes its report to the CFATF Plenary Meeting XXXIX in May 2014.

Looking Ahead

This is my second Report as Director of the Commission and it will also be my last, as I will return to retirement in Canada before this Report is published. (I confess that it will be something of a relief to have to deal with only one currency on visits to the supermarket – rather than two – and once more to drive a left-hand-drive car on the "right" side of the highway in getting there.)

In my Report for 2012, I remarked that the pressure from the OECD and other international bodies on jurisdictions such as Anguilla was likely to be unremitting. Entirely unsurprisingly, this has proved to be an accurate assessment. I also remarked in the same Report on the resilience that abounds in this Territory; it has needed every ounce of it as the aftershocks of what I believe is now called the "GFC", or "Global Financial Crisis", continue to make their unwelcome presence felt. Having served as the Commission's Director for two years, however, I'm of the view that there's enough inventiveness, energy and dedication among the island's human resources – both among those born and raised here and those professionals from elsewhere who have been granted permits to work here – to give Anguilla a fair shot at success as an international financial centre conducting substantive business at internationally recognized standard and with regulatory practices to match.

To all those working in the financial services industry, whether at a market participant or the regulator, I extend my Best Wishes for your future success.

Keith Bell