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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Guernsey—Publication of Financial Sector Assessment Program
Documentation—Detailed Assessment of Observance on Basel Core
Principals**

Attached for the **information** of Executive Directors is the detailed assessment of observance on Basel core principles that was completed in connection with the Financial Sector Assessment Program assessment of Guernsey.

It is intended that this paper will be published on the Fund's external website, together with the update to the Financial System Stability Assessment, after Monday, December 27, 2010.

Questions may be referred to Mr. Schmieder, MCM (ext. 37947).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

GUERNSEY

BASEL CORE PRINCIPLES

DETAILED ASSESSMENT OF
OBSERVANCE

DECEMBER 2010

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BCP	Basel Core Principles for Effective Banking Supervision
CAR	Capital adequacy ratio
CIS	Collective Investment Scheme
DCS	Depositor Compensation Scheme
EU	European Union
FATF	Financial Action Task Force
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSC(G) L	Financial Services Commission (Bailiwick of Guernsey) Law
FSSA	Financial System Stability Assessment
GBP	Great Britain Pounds
GDP	Gross Domestic Product
GFSC	Guernsey Financial Services Commission
ICAEW	Institute of Chartered Accountants in England and Wales
IMF	International Monetary Fund
LOLR	Lender of last resort
MOU	Memorandum of Understanding
OFC	Offshore Financial Center
ROSC	Reports on Observance of Standards and Code
The States	The “States of Deliberation”—Guernsey’s Parliament
UK	United Kingdom

I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

A. Introduction

1. **This assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCPs) was undertaken as part of an IMF Financial Sector Assessment Program (FSAP) Update for Guernsey in 2010, and in particular was prepared during an IMF mission that visited Guernsey during March 2010.** It updates an earlier BCP assessment performed in the context of the 2002/2003 IMF Offshore Financial Center (OFC) assessment of Guernsey. The assessors were Peter Kruschel (BaFin) and Keith Bell (banking supervision consultant).

B. Information and Methodology Used for Assessment

2. **The assessment of compliance with the BCPs was made on the basis of a study of the legal and regulatory framework, a self-assessment prepared by the Guernsey Financial Services Commission (GFSC), and detailed discussions with relevant authorities and stakeholders.** Discussions were held with government representatives, the GFSC, the Association of Guernsey Banks (AGB), senior management of banks, and auditing firms.

3. **The assessment team enjoyed good cooperation from all stakeholders.** This included comprehensive provision of all documentation requested and extensive supplementary information and explanations delivered orally during meetings with members of the GFSC's Banking Division (BD). The mission team expresses its appreciation to the GFSC and the representatives of banks and other institutions for their cooperation.

4. **This assessment was conducted in accordance with the revised Core Principles Methodology issued by the Basel Committee on Banking Supervision (Basel Committee) in October 2006 and involved a qualitative assessment of compliance with each Core Principle (CP).** The methodology makes a distinction between "essential" and "additional" criteria. However, in accordance with the usual standards applied in the case of assessments that are conducted as part of an FSAP, the ratings take into account the essential criteria only.

5. **An assessment of compliance with the BCPs is not, and is not intended to be, an exact science.** Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are rapidly changing around the world; and theories, policies, and practices of supervision are evolving swiftly. Nevertheless, it is internationally acknowledged that the CPs are seen as minimum standards.

6. **The methodology provides that supervision of an individual principle is considered "*compliant*" when all essential criteria are generally met without any significant deficiencies.** A principle is considered "*largely compliant*" when only minor shortcomings are observed, which do not raise any concerns about the authority's ability

and intent to achieve full compliance with the principle within a prescribed period of time. A principle is considered “*materially noncompliant*” whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. A principle is considered “*noncompliant*” when no substantive progress toward compliance has been achieved. A principle is considered “*not applicable*” whenever, in the view of the assessors, the principle does not apply given the structural, legal, and institutional features of a country

C. Institutional and Macroeconomic Setting and Market Structure—Overview

7. **Guernsey is one the three British Crown Dependencies, the others being Jersey and the Isle of Man (IOM),¹ and as such it is not part of the United Kingdom (UK).** It has its own democratically elected parliament, the States of Deliberation (the States) with powers to raise taxes, determine expenditure, and pass legislation. Government functions are carried out by 10 departments, each led by a minister who, like the four ordinary members of the department, is elected by the States. The Policy Council (PC), a form of cabinet government, comprises the chief minister and the 10 ministers. The deputy chief minister is elected by the States from the ministers on the PC. Guernsey’s economy is highly oriented toward that of the UK and uses the pound Sterling as its currency, and Guernsey is in a customs union with the European Union (EU) for trade in goods.

8. **Economic growth is driven by financial services and is believed to have slowed in response to the global slowdown.** The principal sectors of the economy are financial services, which accounted for nearly 40 percent of GDP (2008) and a quarter of total employment, retail, and construction. The main financial services are banking, insurance (particularly captive insurance²), as well as trust and company services related to (mainly non-retail) collective investment schemes (CIS) (Table 1). Growth and inflation are correlated with those in Jersey and the UK. Guernsey’s real GDP growth has averaged 2 percent over the last decade, but is relatively volatile and was negative in 2003 and 2005. For 2008, GDP growth is provisionally estimated at 7.6 percent, driven by double digit growth of the finance services sector. Indications for 2009 are that there was a recovery in the second half of the year after significant weaknesses, including in financial services, in the early months—current estimates are a contraction in GDP of between 2 percent and 3 percent. Housing prices fell during the year and the number of unemployed rose (and has doubled since mid-2007), although the rate is still low, at 1.4 percent. Retail price inflation was 2.2 percent for 2009. The total number of financial

¹ The IOM and Jersey FSAP Update missions were conducted in September and November 2008 respectively.

² Defined by the International Association of Insurance Supervisors (IAIS) as “an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial, or financial entities, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties.”

institutions on the island has been rising steadily. However, the number of banks licensed has fallen—from a high of 54 in 2002 to 43 at 31 December 2009.

9. Guernsey has a low taxation regime, which was last comprehensively reviewed in 2007:

- (i) Under the 2007 review, a 20 percent rate for individual income tax was retained. Guernsey participates in the EU Savings Directive framework and currently withholds tax on payments of savings income to EU residents under a transitional option. It is now consulting on how and when to move to full exchange of information. However, depositors in EU countries other than the UK are few and many already opt for exchange of information.
- (ii) Corporate income tax was reduced from the start of 2008 to zero, except for profits derived from traditional banking (i.e., lending) activities (10 percent) and utilities and property companies (20 percent).
- (iii) There are no capital gains, wealth, inheritance or general sales taxes, but residents are subject to social security contributions.

10. The corporate tax regime is currently being reviewed, posing some threat to Guernsey's advantages in offering tax neutrality. The “zero/10” corporate tax regime is being reconsidered following representations from the U.K. government that it may now be regarded as noncompliant with the EU Code of Conduct on business taxation. A uniform 10 percent rate is contemplated. Fiscal neutrality is a key driver of the success of the island's services, and the government stated that an objective of any revised regime would be to safeguard tax neutrality applying to the broadest range of financial services products. However, Guernsey has other advantages, including its legal and regulatory system, time zone, and skilled workforce. Guernsey has been deemed by the Organization for Economic Cooperation and Development (OECD) to have implemented international standards on exchange of tax information. It has signed 15 Tax Information Exchange Agreements (TIEAs) and is negotiating more—the minimum is 12.

11. The GFSC is responsible for the regulation and supervision of all financial institutions and services. Most financial services, including trust and company services, are regulated, exceptions being consumer credit and pensions. The GFSC's statutory mandate requires it to take such steps as the GFSC considers necessary or expedient for the effective supervision of the finance business, and to counter financial crime and the financing of terrorism. It is funded by fees on the industry, and currently has over 100 staff.

12. The financial sector is diverse, with complementarities and interrelationships between different services. Unlike in Jersey and IOM, banking is not the largest sector. In addition to significant insurance operations, many regulated companies (including banks) provide administration, trustee, and custodial services to collective investment funds. (Fund management, stock broking and other investment services are more limited.) There are thousands of Guernsey-based or foreign trusts and companies serviced by

fiduciary and company service providers on the island. Banks support other sectors with deposits and lending services to funds and trusts and with letters of credit to captive insurance companies.

13. **Banking is one of two major sectors by asset size but U.K. banks are less dominant than in Jersey.** The major British banks and building societies have operations on the island, but tend to focus their offshore businesses in Jersey—so most banks represented in Guernsey are from outside the UK and EU. Total assets grew steadily from 2004 until 2008. In 2009, they fell by 40 percent (to September 2009), which is likely in part to reflect the financial crisis and its impact in Guernsey (see below). Banks' principal business is the collection of retail deposits from overseas, which are placed with parent banks (69 percent of banks' total assets are exposures to parents). There is limited commercial lending, mainly to domestic borrowers.

14. **There is an accelerating trend away from the retail business.** Guernsey is focusing more on private banking and other services to high net worth individuals, and to institutional fund and securities services (e.g., for private equity funds). With this has come greater complexity in Guernsey's financial services. Equally, there is limited treasury, trading or capital markets business on the island. The Guernsey-based Channel Islands Stock Exchange lists and trades mainly CISs.

15. **Aggregate banking sector data point to a high degree of financial strength.** Most banks have no significant exposure to structured finance and the retail nature of their deposit base ensured relative stability. Capital adequacy ratios (CAR) are high (on average 19 percent as of September 2009, up from 15 percent at the end of 2008), and almost all bank capital is in the form of Tier 1 instruments. However, the relatively low risk-weighting of banks' assets means that the aggregate capital to asset ratio (i.e. the inverse of the leverage ratio) has remained below 2 percent in recent years. Profitability has been comfortable, although this may in part reflect transfer pricing by parent institutions that prefer to book profits in a low-tax jurisdiction.

16. **The global crisis has, however, had a major impact on certain banks in Guernsey.** In 2007, the intervention in Northern Rock, a UK-based bank with a Guernsey subsidiary, created uncertainty over the position of Guernsey depositors until a U.K. blanket guarantee for Northern Rock was extended to Guernsey liabilities. The U.K. government subsequently took the bank into public ownership. In late 2008, the Guernsey subsidiary of the Icelandic group, Landsbanki was placed in administration when the bank was unable to draw down funds placed elsewhere in the group to meet escalating deposit withdrawals. An official enquiry has reported to the Guernsey government on the supervision of Landsbanki. Some 1,600 depositors had £120m on deposit and there was at the time no compensation scheme. To date, recoveries have amounted to around 70 percent. There have been other impacts from the problems of U.K. building societies with operations on the island.

17. **The authorities have responded to the crisis events with regulatory change and a new deposit insurance scheme.** The GFSC has strengthened its approach to banks' exposure to parents—disclosure requirements (to inform depositors on the

exposure to parents, exposure limits (set individually by bank) and contingency planning (for problems at the parent). Depositor compensation, which had long been provided for in law but not implemented, was introduced from November 2008.

D. Preconditions for Effective Banking Supervision

18. Guernsey's macroeconomic performance is generally satisfactory.

Unemployment is low, and the trend growth rate and inflation have been satisfactory.

19. The legal system, which is broadly based on common law with French and Norman elements, is highly developed. The courts are well versed in financial matters, and reportedly are able to act quickly if needed. The placing of a licensee in administration in 2007 is a case in point. A full range of high-quality accountancy, audit, legal, and ancillary financial services are available on the island.

20. Guernsey is not a member state of the EU or the wider European Economic Area. Consequently, Guernsey has not been obliged to implement European directives on the regulation of financial services. Instead, it has voluntarily followed a policy of adopting wider international standards such as those of the Basel Committee. Furthermore, Guernsey has introduced a system of information exchange and withholding tax on financial income in accordance with the EU Savings Directive.

21. The deposit insurance scheme covers deposits, mainly those from retail depositors, wherever located, up to £50,000 per person. It is not funded, although it has government guaranteed liquidity back-up, but aims to pay compensation within three months of a bank failure. The maximum total amount of compensation is capped at £100 million in any five year period.³ It will be paid for by the banks through annual charges and special charges in the event of a bank failure. The precise modalities of the funding mechanism remain under discussion.

E. Main Findings

22. The BCP assessment confirms the high standard of prudential regulation and supervision described in the 2003 assessment, and found that the issues identified at that time have largely been addressed. The GFSC now conducts a program of on-site supervision, supported by off-site analysis. The on-site program lays particular emphasis on inspection of licensees' risk management procedures for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and credit, although other "themes" are also addressed. On-site supervision visits are followed up with recommendations, where judged necessary, with close tracking of corrective action required. A framework of minimum prudential standards is provided by the Financial Services Commission (Bailiwick of Guernsey) Law 1987 (FSC(G) L, as amended, the Banking Supervision (Bailiwick of Guernsey) Law 1994, as amended, the Banking Supervision (Bailiwick of Guernsey) Regulations 1994, the Codes of Practice for Banks and applicable Guidelines and Guidance Notes issued by the GFSC.

³ This compares with GBP 1.2 billion in deposits covered by the scheme —i.e., amounts under GBP 50,000.

23. **The GFSC—as the integrated regulator—has as its main responsibility, the supervision of financial services provided on the island.** The GFSC is also responsible for (a) reducing the level of risks to the public due to financial unsoundness or mismanagement in a financial institution; (b) protecting and enhancing the island’s reputation; (c) pursuing activities and policies that promote the best economic interests of Guernsey; and (d) recognizing the need to counter financial crime.

24. **The GFSC enjoys considerable independence, and is subject to suitable accountability provisions.** The FSC (G) L, was amended in 2009 to remove “development of the financial services industry” as a function of the GFSC and to clarify the circumstances in which the PC may give instruction to the GFSC (i.e., in general terms and not in specific cases, without any instruction being made public). The GFSC’s chairman is appointed for a one-year term, an anachronism that appears to date from its initial establishment, when the chairman was a political appointee.

25. **The GFSC is broadly adequately resourced.** It is funded by fees on the industry, which it adjusts periodically to keep them in line with marginal costs plus a markup for fixed costs. The GFSC currently has over 100 staff. Close monitoring of salaries in the supervised sectors has enabled the GFSC to retain good staff. Representatives from the private sector generally felt that the GFSC carries out its duties with rigor and expertise; it consults with the industry but is viewed as not beholden to it.

26. **As the banking supervisor, the GFSC, has an array of disciplinary powers to address safety and soundness issues; there is evidence that it uses them when needed.** The GFSC can request information, issue directions, impose license conditions, appoint inspectors, revoke licenses, or even request that a court place a bank in administration. Fines cannot yet be imposed for administrative matters, such as late submissions of supervisory returns, but the necessary enabling powers are available in the law.

27. **In the recent past the authorities have faced two major challenges (see above) as the result of problems elsewhere being quickly transmitted to entities operating in the jurisdiction, ultimately leading to their failure.** Subsequent reviews of the GFSC’s performance under stress have been favorable.

28. **The GFSC cooperates with the home supervisors of institutions active on the island.** Numerous memorandums of understanding (MOU) with supervisors abroad have been signed to address both on-going supervision and information exchange. Information is in fact exchanged, and regular visits to and from the home supervisors are undertaken, including for the purpose of on-site supervision. However, as experience in the recent past has shown, the asymmetry in the relationship between the GFSC and certain “home” regulators severely limits the benefit that the GFSC can draw from cooperation with them.

29. **Several broad areas for further action have been identified.** Primarily, these require primary or secondary legislative changes and the latter’s consequent practical application. In these regards:

- (i) CP 4 “Transfer of significant ownership” requires that the GFSC be given power to review and, if necessary, rescind, transfers of controlling interests in licensed banks.
- (ii) A similar power for the GFSC is required by CP 5 “Major acquisitions.”
- (iii) For CP 9, the GFSC should have the explicit power to require that a bank increase its level of provisioning and, if necessary, its overall financial strength.
- (iv) Given the related party lending which characterizes the business model favored by several major participants in the Guernsey banking industry, large exposure limits (CP 10) should be applied on a consolidated basis and all transactions with banks’ related parties should receive prior board approval and be on market terms (CP 11).
- (v) Supervisory reporting (CP 21) to the GFSC would benefit from imposition of a requirement for senior level certification and capacity for the GFSC to impose administrative penalties for tardy reporting.
- (vi) The GFSC should consider amending its governing statute to increase the term of office of its chairman from the current one year period to a term consistent with international practice (CP 1(2)).

The Banking Supervision (Bailiwick of Guernsey) Regulations 2010, which came into operation on April 30, 2010 (i.e., following the conclusion of the mission’s on-site work) together with contemplated amendments to the GFSC’s Codes of Practice, have been designed to address the areas identified in (i) through (v) above.

30. Principle-by-principle compliance with the BCPs is summarized in Table 1.

Table 1. Summary of Compliance with the Basel Core Principles—Detailed Assessments

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation	C	
1.1 Responsibilities and objectives	C	
1.2 Independence, accountability and transparency	C	GFSC Chairman appointed annually by the States.
1.3 Legal framework	C	
1.4 Legal powers	C	
1.5 Legal protection	C	
1.6 Cooperation	C	
2. Permissible activities	C	
3. Licensing criteria	C	
4. Transfer of significant ownership	LC	Law does not provide GFSC power to review, object to and reject any proposal to transfer a “significant ownership” interest.
5. Major acquisitions	LC	Law requires the GFSC to be consulted prior to a major change in business focus. Regulations to define types and amounts (absolute and/or in relation to capital base) of acquisitions and investments needing prior supervisory approval (or <i>ex poste</i> notification) and to provide criteria to assess proposals have yet to be tested.
6. Capital adequacy	C	
7. Risk management process	C	
8. Credit risk	C	
9. Problem assets, provisions, and reserves	LC	No power to require banks to increase their levels of provisions.
10. Large exposure limits	LC	Large discretion to banks in applying exemption from large credit limit of 25 % on large exposures to parents.
11. Exposure to related parties	LC	No legal requirements that: (a) transactions with related parties subject to prior approval by the bank's board; and (b) that exposures to related parties explicitly may not be granted on more favourable terms.
12. Country and transfer risks	C	
13. Market risks	C	
14. Liquidity risk	C	
15. Operational risk	LC	The extent of outsourcing regarding the administered banks should be reduced and not cover essential functions as risk management. No guidance on the requirements of outsourcing and legal risk in place.
16. Interest rate risk in the banking book	C	

17. Internal control and audit	LC	Banks are not required to have internal audit function in place; the GFSC relies on the group audit systems. Banking legislation does not explicitly require banks to have a permanent compliance function.
18. Abuse of financial services	C	Main relevant rules are covered in the Handbook.
19. Supervisory approach	C	
20. Supervisory techniques	C	
21. Supervisory reporting	LC	Regulations permitting the imposition of administrative fines have not been issued. Prudential reports do not require “top management” certification.
22. Accounting and disclosure	C	
23. Corrective and remedial powers of supervisors	C	
24. Consolidated supervision	C	
25. Home-host relationships	C	
<i>Aggregate:</i> Compliant (C) – 23, Largely compliant (LC) – 8, Materially noncompliant (MNC) – 0, Noncompliant (NC) – 0, Not applicable (N/A) – 0		

II. RECOMMENDED ACTION PLAN AND AUTHORITIES’ RESPONSE TO THE ASSESSMENT

Recommended action plan

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles

CP1.2	Extend Chairman’s term of appointment to international norm.
CP 4	Amend law so GFSC has power to review, object to and reject any proposal to transfer a “significant ownership” interest.
CP 9	Commission should get authorisation to require banks to increase their levels of provisions.
CP 10	The Commission should continue to restrict large limits of banks to their parents in relation to their own capital approaching the 25 % limits to all banking exposures.
CP 11	Establish regulations that require transactions with related parties to be subject to prior approval by the bank’s board; legislation should be introduced that exposures to related parties explicitly may not be granted on more favourable terms.
CP15	The extent of outsourcing regarding the administered banks should not cover essential functions as risk management. The GFSC should stipulate detailed guidance on the requirements of outsourcing and continue its work on Guidance on legal risks.
CP 17	The banking legislation should require banks to have a permanent internal audit and compliance function in place.
CP21	Issue regs. to permit administrative fines. Require “top management” certification of prudential reports.

Authorities' response to the assessment

CP1.2	The Guernsey Financial Services Commission will request an amendment to the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 to be amended in order to address the IMF's recommendation
CP4	The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation
CP9	The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation
CP10	The Commission revised the Principle and Guidance to be followed by the locally incorporated banks regarding large exposures in order to satisfy the IMF's recommendation
CP11	The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation
CP15	The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation on the employment of sufficient individuals to cover essential functions. The Guernsey Financial Services Commission has also issued an outsourcing guidance paper which satisfies the IMF's recommendation on outsourcing. With reference to the IMF's recommendation on legal risk, the GFSC is, as recommended, continuing its work on legal risk.
CP17	The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation
CP21	The Financial Services Commission (Administrative Financial Penalties) (Bailiwick of Guernsey) Regulations, 2010 came into force on 1 September and satisfy the IMF's recommendation in relation to the imposition of administrative fines. The Banking Supervision (Bailiwick of Guernsey) Regulations, 2010 came into force on 30 April 2010 and satisfy the IMF's recommendation in relation to the prudential reports of banks being required to have "top management" certification

Table 3. Detailed Assessment of Compliance with the Basel Core Principles

Principle 1.	Objectives, autonomy, powers, and resources. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1).	Responsibilities and objectives. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	<p>Responsibilities of the Guernsey Financial Services Commission (the “Commission” or “GFSC”) are established in the <u>Financial Services Commission (Bailiwick of Guernsey) Law 1987</u> (the “FSC(G)L”) and related statutes (as amended), including the <u>Banking Supervision (Bailiwick of Guernsey) Law, 1994</u> (the “BSL”).</p> <p>The FSC(G)L sets out the GFSC’s general functions. <i>Inter alia</i>, these require the GFSC:</p> <ol style="list-style-type: none"> 1. to take such steps as it considers necessary or expedient for effective supervision of finance business in the Bailiwick; and 2. to counter financial crime (as defined) and of the financing of terrorism; <p>A framework of minimum prudential standards is provided by the BSL, attendant Guidance Notes, Codes and Regulations, including;</p> <ul style="list-style-type: none"> • The Banking Supervision (Bailiwick of Guernsey) Regulations 1994 as amended; • Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing; • Code of Practice for Banks 2003; • Principle 1/1994/24 on large exposures; • Guidance on verification of prudential returns; • Guidance on trilateral discussions (March 1997); • Guidance issued under s1(a) and s1(b)(ii) of the Accounts Rules; • Guidance on prudential and statistical returns; • Code of Conduct on deposit advertisements; • Principles of conduct of finance business; • Principles of conduct of derivatives business; • Guidance on corporate governance; • Guidance on Basel II implementation; and • Principles for the Management of Credit Risk. • The Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 as amended • The Transfer of Funds (Guernsey/Alderney/Sark) Ordinance, 2007 • Guidance on Liquidity Risk Management 2009

	<ul style="list-style-type: none"> • Implementation Paper on Upstreaming 2009 <p>The BSL (1994) has been amended several times, most recently in 2008. Notably, the minimum criteria for licensing of banks (originally set out in Schedule 3 to the BSL) were amended and came into force on 23 January 2008.</p> <p>Regulated entities must produce audited accounts that are publicly available. The Director of Banking produces some figures and commentary in the GFSC's Annual Report, including on capitalization. Statistics on the banking sector's size are publicized at least quarterly, reported in the local press, and reported to and published in various formats by the Bank for International Settlements (BIS), the IMF CPIS survey and the Bank of England. However, detailed, quantitative information on the financial strength and performance of the industry is not regularly published.</p>
Assessment	Compliant
Comments	In November 2009 the GFSC published an implementation paper requiring Guernsey-incorporated banks to make clear to their depositor clients that "upstreaming" takes place and to advise clients to satisfy themselves of the parent's ability to enable repayment of deposits. The paper's provisions came into force in January 2010.
Principle 1(2).	Independence, accountability and transparency. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Description	<p>The GFSC, a body corporate established by statute, has between five (5) and seven (7) members ("Commissioners"), elected by the States from persons nominated by the Policy Council and appearing to the latter to be persons "having knowledge, qualification or experience appropriate to the supervision of finance business in the Bailiwick"(FSC(G)L; Schedule 1; Sec. 1).</p> <p>The GFSC's Chairman, nominated by the Policy Council, is elected annually (and on the arising of a casual vacancy) by the States. The current incumbent has served as Chairman since January 2006. (The annual election appears to be an anachronism related to the formative years of the GFSC when the Chairman was the President of the Advisory and Finance Committee, a political office holder.)</p> <p>Commissioners are appointed for a period not exceeding three years and are eligible for re-appointment (Commissioners generally serve for two periods). All Commissioners must retire on reaching the age of 72. A Commissioner may resign his office at any time. (FSC(G)L Schedule 1; Secs. 3.4).</p> <p>The GFSC's Chairman may declare the office of a Commissioner vacant – and notify that fact as he sees fit - if it appears to him/her that the Commissioner:</p> <ul style="list-style-type: none"> • has been absent from three (3) consecutive meetings without the Commission's consent; • has become declared insolvent; • is incapacitated by physical or mental illness; or • is otherwise unable or unfit to discharge the functions of a Commissioner. <p>If it appears to the States on the recommendation of the Policy Council that any member</p>

	<p>of the GFSC (including the Chairman):</p> <ul style="list-style-type: none"> • has been absent from three (3) consecutive meetings without the Commission's consent; • has become declared insolvent; • is incapacitated by physical or mental illness; or • is otherwise unable or unfit to discharge the functions of a Commissioner; <p>the States may, on the recommendation of the Policy Council, declare the member's office vacant and where such member is the Chairman, public notice "shall be given for the reasons for the dismissal" ((FSC(G)L Schedule 1; Sec. 4).</p> <p>The most senior executive officer of the GFSC (FSC(G)L; s11) is its Director-General (D-G), who holds office for a minimum term determined by the Commission. (The present incumbent, a former Attorney-General, has a term of office extending from 30 June 2009 through 31 December 2012.) The D-G may be dismissed from office by the Commission, but only where he/she:</p> <ul style="list-style-type: none"> • has been absent from three (3) consecutive meetings without the Commission's consent; • has become declared insolvent; • is incapacitated by physical or mental illness; or • is otherwise unable or unfit to discharge the functions of D-G. <p>The FSC(G)L (ss. 4(1)) provides that: "The Commission is not a committee of the States, or a servant or agent of the States, and, except to the extent that this Law or any other enactment otherwise provides –</p> <ul style="list-style-type: none"> (a) is not subject to any rule of law relating to committees of the States; (b) does not have any right or privilege vested in committees of the States. <p>Notwithstanding ss. 4(1), the FSC(G)L further provides (ss. 7(1)(2)(2A)) that:</p> <p>"The Policy Council may, after consulting the Commission, give the Commission –</p> <ul style="list-style-type: none"> (a) written guidance of a general character; and (b) written directions of a general character, concerning the policies to be followed by the Commission in relation to the development and supervision of finance business in the Bailiwick and the manner in which any function of the Commission is to be carried out. <p>(2) It is the duty of the Commission, in carrying out any of its functions –</p> <ul style="list-style-type: none"> (a) to take into account any guidance given under para. (a) of ss(1); and
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	<p>(b) to act in accordance with any directions given under para. (b) of ss(1).</p> <p>(2A) Any guidance or direction given under this section –</p> <ul style="list-style-type: none"> (a) may be given only in the public interest, and not to influence particular cases (b) must not prejudice the operational independence of the Commission by prescribing the specific manner in which the Commission shall carry out its supervisory functions, and (c) must be published – provided that the guidance or direction may come into effect as soon as it is given." <p>The Policy Council has never given the GFSC written guidance or directions contemplated by ss. 7(1)(2)(2A) of the FSC(G)L.</p> <p>The assessors did not detect any obvious influence or control exercised by the industry over the GFSC. The relationship between the industry and the GFSC appears, in general, to be one of mutual regard, albeit coloured by tensions normal between a regulator and the regulatees. Both participants have a common (and clearly expressed) interest in the success of the jurisdiction as a financial centre.</p> <p>The GFSC's objectives are laid down in the FSC(G)L (see CP 1(1), above). At the operational level, the GFSC's executives are answerable to its non-executive members (the Commissioners) who meet regularly and who each have a particular expertise in financial services. The GFSC's Annual Report is laid before the States each year and is available free of charge from (or can be read on) the GFSC's website. The Report details financial information and, as well, the GFSC's approach to topical issues and the results of its activities.</p> <p>The GFSC is audited annually by external auditors and undergoes internal audit by a separate external audit firm.</p> <p>The BD has a budgetary staff allocation of 12 people (increased to 13 in 2010). These include the Director, the Deputy Director, two Assistant Directors, four Senior Analysts, two Analysts and two administration staff. Of the twelve current staff, four have been GFSC employees for more than five years, eight are graduates, and one has a professional qualification. In addition, periodic vacancies are filled through secondment of staff from professional accountancy firms or appropriate independent consultants until permanent staff are found.</p> <p>Both the Director and the Deputy Director have extensive experience at senior levels in banking supervision in offshore jurisdictions and, as well, in related international organizations.</p> <p>Industry representatives indicated that the GFSC-BD and its staff have credibility based on their professionalism and integrity</p> <p>The GFSC is funded by fees paid by the finance sector. Banks are required to pay such fees (set by the GFSC) under a provision in secondary legislation (the Financial Services Commission (Fees) Regulations). The recent increase in fees was imposed</p>
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	<p>over opposition from some sectors of the industry.</p> <p>Management considers the budget allocated to the BD (approx. £1mn in 2009) is adequate for the current complement, which management judges adequate for delivery of its assigned program. The Commission is currently consulting on its preference to make all divisions self-sufficient. This means that banking fees would have to increase by some 70%. (The current fee structure for banks covers only divisional costs and excludes central costs; management believes that this needs to be rectified.)</p> <p>Salary levels are competitive with those in the finance sector. An external consultancy firm within industry is used to provide a benchmark for pay rate assessments annually. In the event that the BD identifies exceptional budgetary needs, the GFSC will supply these subject to an acceptable business case.</p> <p>The Commission may appoint inspectors (BSL:s27) who must be “competent persons to investigate and report to the Commission.” It has done so on various occasions (e.g. at one licensee on the scale and impact of the trading book in 2002 and at another regarding the quality of its customer base in 2003).</p> <p>The Commission can require a bank to submit a third party report to both the bank and itself (BSL: s25). (The assessors noted engagement of a major accounting firm to report on a licensee regarding perceived Corporate Governance and AML/CFT weaknesses.)</p> <p>The BD has an annual staff training program which is reviewed twice yearly.</p> <p>The BD does not have a separate IT budget but draws on the GFSC’s central IT resource. The GFSC’s budget for IT costs is adequate with four IT staff employed in the Operations Division. The Commission subscribes to several databases (such as World-Check, Lexis-Nexis Companies House and the SIS) to enable it to carry out adequate monitoring and intelligence gathering. A major project is currently underway to upgrade the Commission’s software facilities, including additional electronic archiving, cross divisional licensee referencing and electronic invoicing.</p> <p>The BD has a travel budget that allows it to react to external demands as necessary. Most work outside Guernsey involves visits to parental companies and home regulators (the only licensed entities of banks incorporated in Guernsey are in Jersey). The BD attends the twice yearly meetings of the Offshore Group for Banking Supervisors (OGBS) and the biennial International Conference of Banking Supervisors and the Basel Cross Border Banking Resolution Group. Further the GFSC meets regularly with the FSA and other regulators and attends conferences and training seminars. The object of these visits is to enable the GFSC to ensure that overseas regulators have sufficient information to carry out their consolidated supervision (and to garner intelligence on banking groups represented in both jurisdictions).</p>
Assessment	Compliant
Comments	<p>The assessors believe that the current practice whereby three of the six non-executive Commissioners are sourced “off-Island” is useful in bolstering the GFSC’s independence. However, the requirement for annual renewal of the Chairman’s mandate by the legislature is at variance with international standards and merits careful review, notwithstanding the four consecutive renewals accorded the current Chairman and several Commissioners’ observations that failure to renew the Chairman’s mandate would have the effect of having them seriously consider their own continuance in post.</p>
Principle 1(3).	Legal framework. A suitable legal framework for banking supervision is also necessary.

	including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	<p>The BSL specifies that the GFSC is responsible for granting and withdrawing (revoking) banking licences (BSL:s6; s8). If a person is aggrieved by the GFSC's decision he may appeal (BSL:s18) to the Royal Court (of Guernsey).</p> <p>The BD regularly issues policy and guidance and there are provisions in the BSL for introducing codes of practice, guidance, principles and rules (by the GFSC; ss36A(1)) and regulations or ordinances (made by the States and / or its Policy Council s1; s4; ss 24(11)) without the need to change the primary Law.</p> <p>It is a GFSC policy that proposed rules, regulations and codes of practice (and changes to them) are subject to public consultation via documentation and formal and informal contact with industry representatives and licensed banks. The GFSC must publish "any regulations, rules, codes of conduct and guidance notes made by the Commission in pursuit of its functions"(FSC(G)L:s11A(a)).</p> <p>There has been continuing consultation with industry in implementation of Basel II. This included a number of guidance papers issued in collaboration with the Isle of Man and Jersey regulators, a number of Guernsey-specific guidance papers being issued with formal and informal discussions being undertaken with industry bodies. Consultation also took place with the industry regarding the structure and content of the new Basel II returns (BSL/2) which banks have been submitting since Q1 2008. Further detail of the GFSC's approach to Basel II is outlined under CP 6. Other recent examples of consultation are the "Guidance on Liquidity Risk Management" and the "Implementation Paper on Upstreaming" (both 2009).</p> <p>As regards both banks and banking groups, the BSL(s25) contains provisions for the GFSC to obtain information and documents and enter premises to obtain that information and documents. In practice, banks make all information available to the GFSC and provide copies of documents when requested..</p> <p>All banks have a condition imposed on their licence requiring them to provide the GFSC with monthly and quarterly prudential and statistical returns and to inform the GFSC of material adverse developments.</p> <p>In practice, the GFSC has periodically required banks to provide additional information and this can be pertaining to the parent where counterparty risk is significant. For example, during the 2007-9 crisis, several banks were required to report liquidity daily or weekly. In two cases this was made a licence condition.</p>
Assessment	Compliant
Comments	
Principle 1(4).	Legal powers. A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Description	<p>The BSL (Sched 3) sets out "Minimum Criteria for Licensing" for a bank. The criteria are to be observed continuously following initial licensing. Section 6 prescribes that "Business (is to) be conducted in a prudent manner" and specifies, <i>inter alia</i>, that the bank's capital base "is an amount which the Commission considers appropriate"; that the bank "maintains adequate liquidity" and "makes adequate provision for depreciation or diminution in the value of its assets". The BSL (s8; s9; s12) provides the GFSC</p>

	<p>capacity to assess, using qualitative judgement, whether a bank complies with Sched. 3's safety and soundness requirements and to act accordingly.</p> <p>In pursuit of its mandate, the GFSC (BSL:s25, 26) has unfettered and routine access to all banks' files and carries out file reviews during on-site visits to banks. This includes verification that banks meet internal rules and limits as well as external laws and regulations. The GFSC also has full and regular access to the board and senior management of banks.</p> <p>The Commission may take (or require banks to take) a wide range of remedial actions where necessary. These include imposing conditions on a licence (BSL:s.9) (there is no constraint on the nature of the condition which may be imposed); giving institutions directions (BSL:s12); appointing inspectors (BSL:27); and revoking licenses (BSL:s8).</p> <p>The assessors were shown examples of substantive remedial action taken on three licensees (besides action taken on the Landsbanki and Northern Rock Guernsey files).</p>
Assessment	Compliant
Comments	
Principle 1(5).	Legal protection. A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p>The FSC(G)L (s22) provides that no member, officer or servant of the GFSC is personally liable in any civil proceedings in respect of anything done or omitted to be done in the discharge or purported discharge of any function (statutory or general) of the GFSC thereunder unless the thing is done or omitted to be done in bad faith.</p> <p>GFSC staff who have carried out their duties in good faith and against whom a lawsuit is taken will have their costs defending such a lawsuit met by the GFSC. Management believes that the GFSC has adequate financial resources to cover the costs of defending its actions and, under the FSC(G)L (s15) it may borrow from the government (States General Revenue Account) to assist it to carry out its functions. The GFSC may also borrow from any person provided that it may not borrow monies at any time to the extent that the aggregate amount outstanding by way of principle in respect of monies so borrowed would exceed one third of the GFSC's fee income for the preceding calendar year.</p>
Assessment	Compliant
Comments	
Principle 1(6).	Cooperation. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>The GFSC is Guernsey's sole prudential regulator for the financial system.</p> <p>In carrying out its duties the GFSC shares information with government committees where appropriate and with police, customs and excise and the Financial Intelligence Service (FIS).</p> <p>Regular meetings are held between the GFSC, police, customs and excise, the FIS and the office of the Attorney General in "The Bailiwick AML/CFT Advisory Committee". Financial Crime Group meetings are also held regularly between individuals from each of these agencies at an operational level. The Financial Crime Group reports to the Bailiwick Financial Crime Committee. There is also a Guernsey Terrorist Finance Team, which includes representatives of the GFSC, customs and excise, police Special Branch and the Attorney General's office. Finally, senior representatives of the three Crown Dependencies' (i.e. Jersey, Guernsey and the Isle of Man) police, customs and excise,</p>

	<p>FIUs, Attorneys General and their respective Financial Services Commissions meet regularly.</p> <p>Co-operation and information sharing by the BD can and does frequently take place under both the BSL and the FSC(G)L. While the BSL Part III sets out Restrictions on disclosure of information (s 43 – see below), including that received from “relevant foreign authorities”, the BSL (s44) provides for the disclosure of information by the GFSC of bank information in specified circumstances. The FSC(G)L (s21) provides for disclosure of information to foreign countries, also in specified circumstances.</p> <p>Regular meetings are held (at least annually) with the Financial Services Authority (FSA) in the UK and communication with the UK regulators is frequent. Meetings are held with Swiss regulators (FINMA) annually. Other offshore regulators (e.g. Jersey, Isle of Man, Bermuda, Bahamas, Barbados, Cayman Islands and Mauritius) are met at the OGBS’ annual meeting and a formal bilateral meeting with Bermuda is arranged around the OGBS meetings. Every two years the BD meets other international banking supervisors (including that of Cyprus) at the International Conference of Banking Supervisors (ICBS). Close contact is maintained with the Isle of Man Financial Supervision Commission and the Jersey Financial Services Commission.</p> <p>GFSC executives visit other home supervisors as conditions require (e.g. Iceland (July 2008); Cyprus, Greece, and Ireland (2009)). These visits involved seeing both the supervisor, the parent bank and, in all but one case, the central bank to discuss the local economy.</p> <p>Letters are exchanged each year with other home regulators of banks licensed in Guernsey to confirm the licensees’ good standing in their home jurisdiction. The letters were updated in 2009 to include a specific reference to matters affecting the safety and soundness of the Guernsey licensee.</p> <p>As evidenced by recent examples, the GFSC seeks as close a link as possible with the home supervisor, especially when a bank is considered at-risk. The GFSC tries to ensure that key facts and issues are agreed in writing for the home supervisor, and will travel to meet the latter as found necessary.</p> <p>The GFSC has signed MOUs with 17 other regulatory bodies. The BD has found in practice finds that it is able to establish good relations with other regulators irrespective of whether or not the GFSC has a formal MOU. Nevertheless, the BD has found MOUs useful in the formal transmission of data, particularly relating to third parties, between regulators.</p> <p>The GFSC has signed two EC Multi-lateral Cooperation and Coordination Agreements (MCCs) as a condition to attend college meetings for two banks headquartered in the EU and intends to sign other MCCs as required.</p> <p>As noted above, the BSL (s44) and the FSC(G)L (s21) provide for disclosure of information by the GFSC of bank information in its possession in specified circumstances. However, it may only share information in its possession if satisfied that the information is requested only for proper exercise of supervisory functions and will be treated with appropriate confidentiality.</p>
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	<p>Whenever information is disclosed to another regulator it is the BD's policy to include the following wording:</p> <p>"This information is confidential. It is provided in accordance with the provisions of s.21 of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987. It should not be disseminated further without the written consent of the Commission and should only be used for supervisory purposes."</p> <p>The FSC(G)L (s21) states that information provided to the GFSC is confidential and therefore it can deny any demand for confidential information in its possession. This information may be disclosed if the GFSC is satisfied that it falls within specific, defined areas.</p> <p>The BSL (s43) states:</p> <p><u>"Restrictions on disclosure of information"</u></p> <p>43. (1) Subject to the provisions of Section 44 –</p> <p>(a) no person who under or for the purposes of this Law receives information relating to the business or other affairs of any person;</p> <p>(b) no person who obtains any such information directly or indirectly from a person who has so received it;</p> <p>shall disclose the information without the consent of the person to whom it relates and (if different) the person from whom it was so obtained.</p> <p>(2) A person who discloses information in contravention of this section is guilty of an offence."</p> <p>This also means that the GFSC may deny any demand for information that is confidential (although there are circumstances (in s44) where it may disclose information).</p>
Assessment	Compliant
Comments	Despite progress outlined in the Description, above, the GFSC considers that, due to an asymmetry of information, contact and information flow between a home and host authority are not as good as they should be. The Commission has committed resources in both the OGBS and in the Basel Cross-Border Banking Resolution Group to address this problem through international consensus. Current thinking on this issue is set out in the recent paper from the Cross-border Banking Resolution group. The Commission has written to the FSA CEO with suggestions as to how Commission-FSA communications might be developed.
Principle 2.	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word "bank" in names should be controlled as far as possible.
Description	<p>The term "bank" is not clearly defined in the BSL, the FSC(G)L or any regulations thereto. Instead, the activity of concern which brings an entity within the scope of the BSL (and, in effect, acts as a substitute for the definition of a bank) is "deposit-taking business".</p> <p>(The BSL (s1) provides that: "no person shall in the Bailiwick accept a deposit in the course of carrying on a deposit-taking business except under the authority of and in</p>

	<p>accordance with the conditions of a licence granted by the Commission under s6 (a “banking licence”).”)</p> <p>“ “deposit” has the meaning given in (BSL) s2,” (The meaning given is fairly generic, denoting “a sum of money paid on terms ...under which it will be repaid, with or without interest..”)</p> <p>“ “deposit-taking business” has the meaning given in (BSL) s3,” (The meaning is as under:</p> <p>“3(1)...a business is a deposit-taking business...if-</p> <ul style="list-style-type: none"> (a) in the course of the business money received by way of deposit is lent to others, or (b) any other activity of the business is financed to any material extent out of the capital of or the interest on money received by way of deposit. <p>3(2) A business is not a deposit-taking business...if in the normal course of business-</p> <ul style="list-style-type: none"> (a) a person carrying on the business does not hold himself out as accepting deposits on a day to day basis, and (b) any deposits which are accepted are accepted only on particular occasions, whether or not involving the issue of debentures or securities.”) <p>From the definition given above, the specific permissible activities of “licenced institutions” (a defined term in the BSL:s56 for an institution which holds a banking license) subject to supervision as banks are: (i) taking deposits and (ii) lending monies raised thereby. The GFSC’s banking licences do not specify which particular activities are permissible for each bank, a practice followed in other common law jurisdictions (such as the UK).</p> <p>The BSL (s37) states (<i>inter alia</i>):</p> <p>“37. (1)No person carrying on any business in the Bailiwick, other than a licensed institution, a person specified in paragraph 2, 3, 4 or 5 of Schedule 1 or a person who has first obtained the permission of the Commission in that behalf under Section 38 and who is acting in accordance with the conditions of that permission, shall so describe himself or so hold himself out, as to indicate or reasonably be understood to indicate (whether in English or any other language) that he is a bank or banker or is carrying on a banking business.</p> <p>(2) No person carrying on any business in the Bailiwick, other than a licensed institution, a person specified in paragraph 2, or 3 of Schedule 1 or a person who has first obtained the permission of the Commission in that behalf under Section 38 and who is acting in accordance with the conditions of that permission, shall use any name which indicates or may reasonably be understood to indicate (whether in English or any other language) that he is a bank or banker or is carrying on a banking business.”</p> <p>Any use of ‘bank’ or a similar term in a name would be referred to the BD for permission under the BSL.</p>
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	<p>As noted above, the BSL (ss1(1)) prohibits persons from taking deposits in the course of carrying on a deposit-taking business except under the authority of a banking licence.</p> <p>In regard to the listing of licensed institutions, the BSL (s13) states:</p> <p>“(1) The Commission shall, in January each year, cause to be published in <i>La Gazette Officielle</i> a list of all institutions holding banking licences.</p> <p>(2) The Commission shall make available to any person, on request and on payment of such charge (if any) as the Commission may reasonably demand to cover the cost of preparation, a list of all institutions holding banking licences.</p> <p>(3) The Commission shall publish the fact that an institution has ceased to hold a banking licence, whether by virtue of the revocation, surrender or expiry of the licence or otherwise.</p> <p>(4) The Commission may also publish the fact that a particular person has been granted or refused a banking licence or that a particular person does not hold or has not held a banking licence.</p> <p>(5) Any list or publication under this section may contain such information (if any) in respect of all or any of the persons named therein as the Commission may think desirable or expedient.”</p> <p>A current list of licensed banks is maintained on the GFSC’s web site.</p>
Assessment	Compliant
Comments	
Principle 3.	<p>Licensing criteria. The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>The GFSC is responsible for both licensing and supervising banks.</p> <p>The BSL (Sched. 3) sets out minimum criteria for licensing those carrying on deposit taking business. Notably, the minimum criteria for licensing of banks (originally set out in Schedule 3 to the BSL) were amended and came into force on 23 January 2008. (No new licenses have been granted since that date.)</p> <p>The criteria (1. Integrity and skill in the conduct of the business; 1A. Continuous observance of the provisions of the GFSC’s “Principles of Conduct of Finance Business” and all rules, codes and guidance issued under the BSL; 3. Fit and Proper Board and Management; 4. Business to be directed by at least two individuals of appropriate standing and experience; 5. Board composition; 6. Prudent conduct of the business, particularly as regards adequacy of capital, liquidity, valuations, accounting and control systems) used for both licensing banks and ongoing supervision are consistent as the</p>

	<p>same principles are applied to both, although additional requirements, such as reporting obligations, are required as part of ongoing supervision. The same staff of GFSC carry out both activities.</p> <p>The BSL (s6(2)) provides:</p> <p>“The (GFSC) shall not grant an application for a banking license unless satisfied that, in relation to the applicant and in relation to any person who is or is to be a director, controller or manager of the applicant, the criteria specified in Sched. 3 are fulfilled. Further, the BSL (para. 8(1)(d)) provides for revocation of a banking license in any case where the GFSC has been provided false, misleading, deceptive or inaccurate information by or on behalf of the institution or, in connection with an application for a banking license.</p> <p>The BSL (s8) provides that in considering whether to revoke a banking license, failure to meet the minimum criteria of the BSL (Sched. 3) may be valid reason for revocation. If a bank no longer fulfilled the required criteria, GFSC’s strategy is to take action to bring it into compliance or revoke its license.</p> <p>In determining whether a license should be granted, the GFSC considers both the applicant’s structure and that of the wider group. For this purpose, the GFSC requires that the application form for a banking licence include:</p> <ul style="list-style-type: none"> -a group structure diagram, including details of any company or partnership in which the applicant or its holding company has an equity shareholding or is a partner (the whole to include all related companies connected by common ownership, trading name, partnership or special trading arrangement. The place of incorporation, principal activities and registered office off all companies shown must be disclosed. -a short resume of the parent organisation including its position regarding regulations and supervision and its recent financial performance. -names and addresses of the beneficial owners of the applicant’s share capital, showing the percentage interest of each beneficial owner (GFSC does not require such information in respect of holdings of less than 5% of the applicant’s share capital or where the shares in the applicant or its ultimate parent are traded on a Recognised Stock Exchange). -all of the applicant’s current or proposed senior officers and directors (the latter to be identified as executive or non-executive) director. -all current or proposed Guernsey resident managers of the applicant, specifying their area of responsibility. <p>GFSC BD staff review this information in deciding on the licence application and ensure that the home supervisor is aware of the proposal to establish an operation in Guernsey and indicates no objection to it.</p> <p>The BSL (s36B) stipulates a minimum capital requirement at L1million “or such other sum as the Commission may by regulation prescribe”. No such regulation has been made.</p> <p>The BSL (Sched.3; para.3) states that:</p>
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	<p>“(1) Every person who is, or is to be, a director, controller or manager of the institution is a fit and proper person to hold that position.</p> <p>(2) In determining whether a person is a fit and proper person to hold a particular position, regard shall be had to –</p> <p>(a) his probity, competence, experience and soundness of judgment for fulfilling the responsibilities of that position;</p> <p>(b) the diligence with which he is fulfilling or likely to fulfil those responsibilities;</p> <p>(c) whether the interests of depositors or potential depositors of the institution are, or are likely to be, in any way threatened by his holding that position;</p> <p>(d) his educational and professional qualifications, his membership of professional or other relevant bodies and any evidence of his continuing professional education or development;</p> <p>(e) his knowledge and understanding of the legal and professional obligations to be assumed or undertaken;</p> <p>(f) his policies, procedures and controls for the vetting of clients and customers and his record of compliance with any provision contained in or made under -</p> <p style="padding-left: 40px;">(i) the Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991,</p> <p style="padding-left: 40px;">(ii) the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999,</p> <p style="padding-left: 40px;">(iii) the Drug Trafficking (Bailiwick of Guernsey) Law, 2000,</p> <p style="padding-left: 40px;">(iv) the Terrorism and Crime (Bailiwick of Guernsey) Law, 2002,</p> <p style="padding-left: 40px;">(v) the Disclosure (Bailiwick of Guernsey) Law, 2007,</p> <p style="padding-left: 40px;">(vi) the Transfer of Funds (Guernsey) Ordinance, 2007, the Transfer of Funds (Alderney) Ordinance, 2007 and the Transfer of Funds (Sark) Ordinance, 2007,</p> <p style="padding-left: 40px;">(vii) any legislation implementing European Community or United Nations sanctions and applicable in the Bailiwick, or</p> <p style="padding-left: 40px;">(viii) any other enactment prescribed for the purposes hereof by regulation of the Commission, and</p> <p>(g) his policies, procedures and controls to comply with any rules, codes, guidance, principles and instructions referenced under paragraph 1A.</p> <p>(3) Without prejudice to the generality of the foregoing provisions, regard may be had to the previous conduct and activities in business or financial matters of the person in question and, in particular, to any evidence that he has-</p>
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	<p>(a) committed any offence, and in particular any offence involving fraud or other dishonesty or involving violence,</p> <p>(b) contravened any provision contained in or made under -</p> <ul style="list-style-type: none"> (i) this Law, (ii) the Ordinance of 1971, (iii) the regulatory Laws, (iv) any enactment relating to money laundering or terrorist financing (including, for the avoidance of doubt, rules, instructions and guidance issued by the Commission in relation thereto), or (v) any other enactment appearing to the Commission to be designed for protecting members of the public against financial loss due to – <ul style="list-style-type: none"> (A) dishonesty, incompetence or malpractice by persons concerned in the provision of regulated activities (within the meaning of the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000), banking, insurance, investment or other financial services, or (B) the conduct of discharged or undischarged bankrupts or persons who are otherwise insolvent (including persons who have been declared in a state of "désastre"), <p>(c) engaged in any business practices (whether unlawful or not) -</p> <ul style="list-style-type: none"> (i) appearing to the Commission to be deceitful or oppressive or otherwise improper, or (ii) which otherwise reflect discredit on his method of conducting business or his suitability to carry on deposit-taking business, or <p>(d) engaged in or been associated with any other business practices or otherwise conducted himself in such a way as to cast doubt on his competence and soundness of judgement.</p> <p>(4) For the purposes of subparagraph (3) and for the avoidance of doubt,</p> <ul style="list-style-type: none"> (a) "conduct and activities" includes any conduct, activity or omission in any jurisdiction, (b) "offence" includes an offence under the law of another jurisdiction which would be an offence in the Bailiwick if the conduct, activity or omission constituting the offence occurred in the Bailiwick, and (c) "enactment" includes any primary or secondary legislation of any jurisdiction
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	<p>in the British Islands or elsewhere.”</p> <p>All managers, directors, money laundering reporting officers and company secretaries of banks are required to complete a detailed personal questionnaire (form PQ) including questions on personal details, relationship with the bank (and with former employees and other third parties), experience, qualifications, other business interests and good reputation and character. They have to sign the following declaration:</p> <p>“DECLARATION</p> <p>I confirm that the information supplied is complete and correct to the best of my knowledge and belief at the time of submission and that there are no other facts of which the Guernsey Financial Services Commission should be aware.</p> <p>I am aware it is an offence, under the legislation in respect of which the Commission exercises its functions, to knowingly or recklessly provide the Commission with information, which is false or misleading in a material manner.</p> <p>I undertake to inform the Commission, without delay, of any material changes to the information supplied in this form.”</p> <p>Thus they are required to update information provided to the Commission in a form PQ (or PD).</p> <p>The Commission uses the information declared in forms PQ and consequential checks on the information (and the individual) to assess whether the Sched.3, requirements are met prior to that person carrying on his or her duties. PQ forms are renewable every five years.</p> <p>A detailed business plan and application form must be submitted to and approved by the GFSC prior to licensing of a bank. These are examined to ascertain, <i>inter alia</i>, that corporate governance will be effective and appropriate and that the plans are acceptable and achievable. The application form requires banks to provide a full account of how the applicant will satisfy itself that any possibility of money laundering or financing terrorism will be avoided. Procedures for assessing applications require an assessment of the system of corporate governance to be in place.</p> <p>Review of the submitted plan and early meetings with representatives of the shareholder / head office seek to ensure that operational policies / procedures, internal control and oversight are adequate and reflect the scope and degree of sophistication of the proposed activities of the bank. This is explicitly stated in Banking Division procedures. The application form requires a business plan to include “outline of the nature and scale of the proposed business, plans for the future development of that business and particulars of the arrangements for the management of that business. The operational structure outlined in the business plan should include, <i>inter alia</i>, adequate operational policies and procedures, internal control procedures and appropriate oversight of the Applicant’s activities including management of the Applicant’s risk. The operational structure should reflect the scope and degree of sophistication of the proposed activities of the Applicant” (q. 14 of form BP/2).</p> <p>The licence application is submitted to a inter-divisional assessment committee</p>
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	<p>consisting of the divisional directors. The latter go through a formal process to determine the suitability of the application. Divisional directors are required to unanimously agree and to sign off the decision of the committee.</p> <p>The application requires latest audited accounts of the parent bank (shareholder) and (if different) of the ultimate parent organisation. It requires a three-year pro-forma financial statements projection. It also asks for details of external funding. All of this is reviewed and analysed by GFSC staff.</p> <p>As a matter of course and policy, the GFSC requires the home country supervisor's prior consent before granting a banking licence to an applicant.</p> <p>In the letter to the home supervisor requiring prior consent it is stated:</p> <p>I should be obliged if you would furnish me with the following assurances:-</p> <p>“(c) that, in supervising the bank, you will be taking into account their transactions in Guernsey and satisfying yourselves as to the overall prudential soundness of the group on a consolidated basis.”</p> <p>As a matter of principle the GFSC does not permit a bank to pursue a financial activity in an area of business where it considers that none of the directors has a sound knowledge. In addition the BSL requires banks to review each financial year whether any activity has been entered into in the course of the bank's business in respect of which no director of the bank has sound knowledge.</p> <p>“36C. (1) Without prejudice to any other requirement of or under this Law, a licensed institution shall review, in connection with business carried on in or from within the Bailiwick by the institution or by any subsidiary thereof, not less than once in every financial year –</p> <p>(d) whether any activity has been entered into in the course of the institution's business in respect of which no director of the institution has a sound knowledge”</p> <p>Any shortcomings or deficiencies in this area must be reported to the GFSC immediately along with steps proposed to remedy the deficiency(ies).</p>
Assessment	Compliant
Comments	
Principle 4.	Transfer of significant ownership. The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	<p>“Significant shareholder” is defined (BSL: ss23(2)) as:</p> <p>“For the purposes of this Law, a “significant shareholder”, in relation to an institution, means a person who, alone or with associates, is entitled to exercise, or control the exercise of, 5 per cent or more but less than 15 per cent of the voting power in (a) general meeting of that institution or of any other institution incorporated in the Bailiwick of which that institution is a subsidiary.”</p> <p>“Shareholder controller” is defined (BSL: s56) as:</p>

	<p>“Shareholder controller”, in relation to an institution, means a person who, alone or with associates, is entitled to exercise, or control the exercise of, 15 per cent or more of the voting power in general meeting of that institution or of any other institution of which that institution is a subsidiary.”</p> <p>The BSL (ss14(1)) stipulates that the GFSC’s <u>prior</u> approval be obtained where a person proposes to become a “shareholder controller” or an “indirect controller” (the latter means either (a) a person upon whose directions/instructions any director of an institution or parent of that institution is accustomed to act, or (b) a person upon whose directions/instructions any controller is accustomed to act.)</p> <p>“No person shall become a shareholder controller or an indirect controller of a licensed institution incorporated in the Bailiwick unless he has notified the Commission in writing of his intention to become such a controller and the Commission has notified him in writing that there is no objection to his becoming such a controller.”</p> <p>In contrast, the BSL (s23) permits after-the-fact notification of a person’s acquisition of ‘significant shareholder’ status (failure to provide the required notice is an offence):</p> <p>“A person who becomes a significant shareholder in relation to a licensed institution incorporated in the Bailiwick shall, within a period of 14 days immediately following the day of that event, give notice in writing of the event to the Commission.”</p> <p>Given the quotations above, the GFSC does <u>not</u> have power to object to (and reject) a proposal for acquisition of “significant shareholder” status, but does have power to object to (and reject) a proposal to obtain “shareholder-controller” status (see Comments section). In that latter regard, the BSL (ss14(3)) states:</p> <p>“The Commission may serve notice of objection under this section if it is not satisfied-</p> <ul style="list-style-type: none"> (a) that the person concerned is a fit and proper person to become a controller of the description (i.e. shareholder controller or indirect controller) in question of the licensed institution; (b) that the interests of depositors and potential depositors of the licensed institution would not in any other manner be threatened by that person becoming a controller of that description; or (c) without prejudice to paragraphs (a) and (b), that, having regard to that person’s likely influence on the licensed institution as a controller of the description in question, the criteria of Schedule 3 would continue to be fulfilled in relation to that institution or, if any of those criteria is not so fulfilled, that that person is likely to undertake remedial action.” <p>Shareholders of Guernsey-incorporated banks are identified in their annual audited accounts and are discussed at BD’s prudential meetings with senior management. All Guernsey-incorporated banks are subsidiaries of existing overseas banking groups. For those groups headed by an entity whose shares are publicly traded, a change in a “significant shareholder” (or “shareholder controller”) is transparent as it will be a matter of public record in that entity’s “home” jurisdiction, as well as being notified to the GFSC.</p>
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	<p>The BSL (s16 and s17) provides the GFSC powers to take action where a change of control occurs without its approval:</p> <p>“16. Contraventions by controllers</p> <p>A person who-</p> <ul style="list-style-type: none"> (a) becomes a shareholder controller or an indirect controller in contravention of Section 14(1); or (b) becomes or continues to be such a controller after a notice of objection has been served on him under Section 14 or 15; <p>is guilty of an offence unless in the case of an offence under paragraph (a) he shows that he was not aware of the acts or circumstances by virtue of which he became a controller of the description in question; but in such a case he shall be guilty of the offence if he fails to give the Commission notice in writing of the fact that he has become a controller of the description in question within a period of 14 days immediately following the day on which he becomes so aware.</p> <p>17. Restrictions on sale of shares.</p> <p>(1)The powers conferred by this section are exercisable where a person has become a shareholder controller in contravention of Section 14(1) or has become or continued to be such a controller after a notice of objection has been served on him under Section 14 or 15.</p> <p>(2) The Commission may, by notice in writing served on the person concerned, direct that any specified shares to which this section applies shall, until further notice, be subject to all or any of the following restrictions-</p> <ul style="list-style-type: none"> (a) any transfer of, or agreement to transfer, those shares or, in the case of unissued shares, any transfer of, or agreement to transfer, the right to be issued with them, shall be void; (b) no voting right shall be exercisable in respect of those shares; (c) no further shares shall be issued in right of them or in pursuance of any offer made to their holder; (d) except in a liquidation, no payment shall be made of any sum due on the shares from the licensed institution, whether in respect of capital or otherwise. <p>(3) The Court, on the application of the Commission, may order the sale of any specified shares to which this section applies and, if the shares are subject to restrictions under subsection (2), that they shall cease to be subject thereto.</p> <p>(4) No order shall be made under subsection (3) in a case where a notice of objection has been served under Section 14 or 15</p> <ul style="list-style-type: none"> (a) until the end of the period within which an appeal can be brought against the notice of objection;
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	<p>(b) if such an appeal is brought, until the appeal is determined or withdrawn.</p> <p>(5) Where an order is made under subsection (3) the Court may, on the application of the Commission, make such further order relating to the sale or transfer of the shares as it thinks fit.</p> <p>(6) Where shares are sold pursuant to an order under subsection (3), the proceeds of sale, less the costs of the sale, shall be paid to Her Majesty's Sheriff for the benefit of the persons beneficially interested in them; and any such person may apply to the Court for an order for the whole or part of the proceeds to be paid to him.</p> <p>(7) This section applies –</p> <p>(a) to all shares in the licensed institution of which the person in question is a controller of the relevant description which are held by him or any associate of his and which were not so held immediately before he became such a controller of that institution; and</p> <p>(b) in cases where the person in question became a controller of the relevant description of a licensed institution as a result of the acquisition by him or any associate of his of shares in another body corporate, to all shares in that body corporate which are held by him or any associate of his and which were not so held before he became such a controller of that licensed institution.</p> <p>(8) A copy of the notice served on the person concerned under subsection (2) shall be served on the licensed institution or body corporate to whose shares the notice relates and, if the notice relates to shares held by an associate of that person, on that associate."</p>
Assessment	Largely Compliant
Comments	<p>This Principle requires that the supervisor has the power to review, object to and reject any proposals to transfer (i) significant ownership or (ii) controlling interests. At the time of the mission's on-site work, the GFSC had the required power in the latter case but not in the former. Section 6B(c) of the Banking Supervision (Bailliwick of Guernsey) Regulations 2010, which came into operation on 30 April 2010, provided the GFSC the required powers. (The mission did not discuss with GFSC officials the proposals which resulted in the legislative changes effected 30 April 2010. The new provisions remain to be tested.)</p>
Principle 5.	Major acquisitions. The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p>The GFSC imposes the condition on every license that the bank:</p> <p>"should not establish a branch outside the Bailiwick or invest in any company, which after such investment would be a subsidiary, associate or joint venture without the prior consent in writing of the Commission."</p> <p>The terms "subsidiary" and "associate" (but not "joint venture") are defined in the BSL (s 56). The BD undertakes periodic surveys requiring banks to disclose the name and activities of subsidiaries as a means to verify that the license condition is being observed (the last survey in 2008 revealed only one non-reported subsidiary). Information relating to subsidiaries, associates and joint-ventures is also sought from the</p>

	<p>notes to banks' audited accounts.</p> <p>Beyond subsidiary, associate and joint-venture companies (see above), neither laws nor regulations precisely define what types and amounts (absolute and/or in relation to a bank's capital) of proprietary acquisitions and investments need prior supervisory approval. (If the term "exposure" is interpreted to mean <u>all</u> claims and transactions, whether proprietary or resulting from a debtor-creditor relationship (the latter being more usually considered in the context of the treatment of CP 10; EC 2), then a bank may not incur an exposure to an individual counterparty which exceeds 25 per cent of the bank's capital base without prior reference to the GFSC. See below.)</p> <p>Moreover, neither laws nor regulations provide precise criteria by which to judge individual proprietary acquisitions and investments proposals.</p> <p>A condition imposed on every licence is that:</p> <p>"there shall be no significant change in the nature of the business conducted without prior consultation with the Commission;"</p> <p>The GFSC clearly relies on its relationship with the licensed institutions and its view that there is a shared perspective such that any proprietary acquisition or investment could signal a change in the licensee's business pattern and possibly be an event to trigger prior consultation between the GFSC and the licensed institution concerned to determine whether the institution would continue to meet the minimum criteria for licensing (BSL; Sched.3) or whether formal license conditions would be warranted, or indeed, whether the proposed acquisition/investment should proceed at all. (The latter would be the case if the GFSC had concerns that the proposals exposed the licensee to undue risk or could hinder effective supervision.)</p> <p>As noted above, the GFSC could refuse its required written consent to a licensee's acquisition of a subsidiary or establishment of a branch in a secrecy jurisdiction (or a jurisdiction with other regulations prohibiting information flows deemed necessary for adequate consolidated supervision) if it considered that the bank making such an investment would be put in breach of the minimum criteria for licensing. (The GFSC has in the recent past objected to the acquisition by a licensee of a general partner stake in a specialist investment fund on the grounds that the bank was not the appropriate body to be making the investment as it could introduce additional risks to the bank.)</p> <p>When prior consultation does occur (as GFSC management states it invariably does) then the licensee's proposal to establish an acquisition/investment is put forward to BD's Assessment Committee. The procedure for the Proposal for Consideration to the BD Assessment Committee states that presented to the Committee should be:</p> <p>"a summary of analysis of the effect of the proposal on the bank (or banks in the case of amalgamation), detailing the pre- and post-event position of the bank, including a summary of changes to ownership, capital, management and business plan."</p> <p>Exposures (see above) over 25 per cent of the capital base of a bank must be notified to the GFSC in advance. However, para 10 of Principle 1/1994/24 states:</p> <p>"If an exposure which exceeds 25% of capital base has been entered into without prior notification to the Commission notification must be made within two working days of</p>
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	<p>entering such an exposure. A bank would not be expected to enter such exposures without notification unless the nature of the business is such that prior notification would be commercially disadvantageous but it would be expected that such possible circumstances are discussed with the Commission and outlined in the bank's large exposures policy."</p> <p>Large credit exposures of more than 10 per cent and less than 25 per cent of a bank's capital base are reported quarterly in arrears on form BSL/1 for subsidiaries and BSL/2 for branches.</p> <p>As a unitary regulator the GFSC also licences a series of other non-bank financial activities, often undertaken as sister activities, within a holding company structure to the bank. Material adverse findings, from any Division, are circulated for information and consideration via the Heads of Divisions (HODs) meetings. Action taken against a firm within a group is communicated to other relevant Divisions.</p>
Assessment	Largely Compliant
Comments	<p>According to the 2006 BCP methodology, Principle 5 requires that: <i>"The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria,..."</i>, the emphasis in the latter being on the existence of prescribed criteria against which the supervisor assesses an action, rather than the supervisor having the authority to establish such criteria. The first Essential Criterion is that: <i>"Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) need prior supervisory approval"</i> (emphasis added).</p> <p>Principle 5 will find its fullest application in those jurisdictions where supervised institutions actively engage in, for example, acquisitions of part (or all) of the business of another supervised institution, portfolio or "strategic" investment in equities or investment in income producing real estate. The assessors understand that, in Guernsey, such direct exposure of the banking sector to asset price risk is minimal, since most licensees do not hold shares or rated securities and do not have direct exposure to asset prices. Moreover, most licensees are themselves parts of larger groups and therefore they typically do not themselves have major subsidiaries, nor do they engage in non-financial business. Decisions on acquisitions are normally taken at a group level and subject to review by the home supervisor. Hence, the application of Principle 5 to Guernsey is limited. However, the Essential Criteria for this Principle are fairly precise and (particularly for ECs 1.,2., and 5) usually met by provisions in a jurisdiction's banking statute or regulations thereto or in a "Rulebook" or "Banking Codes". Section 6B(a) and (b) of the Banking Supervision (Bailliwick of Guernsey) Regulations 2010, which came into operation on 30 April 2010, should enable the Criteria to be met in full. (The mission did not discuss with GFSC officials the proposals which resulted in the legislative changes effected 30 April 2010.) The new provisions remain to be tested.</p>
Principle 6.	Capital adequacy. Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.
Description	Each incorporated bank's licence imposes a requirement to complete specified quarterly returns, including that setting out computation of the bank's actual risk asset ratio (RAR) against its prescribed minimum. Components of capital are defined in the applicable GFSC quarterly prudential return (BSL/1) and the accompanying Guidance to Prudential

	<p>and Statistical Returns.</p> <p>The definition of capital is in line with international requirements. In practice, almost all bank capital in Guernsey is "Tier 1", being either equity or reserves. There is some "Tier 2" subordinated debt. The method of calculation of capital follows that laid down by the Basel Committee. For Basel I, the GFSC applies prescribed RARs between 10% and 16%.</p> <p>The GFSC has power to impose a specific capital charge and/or limits on all material risk exposures. The BSL (Sched.3 ss6(2)) states:</p> <p>"(2) An institution shall not be regarded as conducting its business in a prudent manner unless it maintains or, as the case may be, will maintain a capital base-</p> <ul style="list-style-type: none"> (a) of an amount commensurate with the nature and scale of the institution's operations; and (b) of an amount and nature sufficient to safeguard the interests of the institution's depositors and potential depositors, having regard to the particular factors mentioned in sub-paragraph (3) and any other factors appearing to the Commission to be relevant. <p>(3) The particular factors mentioned in sub-paragraph (2)(b) are-</p> <ul style="list-style-type: none"> (a) the nature and scale of the institution's operations; and (b) the risks inherent in those operations and in the operations of any other institution in the same group so far as capable of affecting the institution." <p>Through Basel II, specific capital charges are now being made for bank specific risks identified through the Supervisory Review and Evaluation Process (SREP).</p> <p>Under Basel I, the GFSC set RARs based on its overall perception of a bank's risk profile deduced over time through prudential and other meetings with management, examination of regulatory returns, meetings with the home regulator and assessment of overall group strength. These GFSC views were then internally challenged and summarised through the risk rating methodology.</p> <p>Off balance sheet exposures are captured through regulatory returns and are factored into the RAR.</p> <p>Under Basel II, a RAR is set for each bank with reference to its current Basel I absolute level of capital and Basel 1 RAR, together with a more detailed break-out of bank specific Pillar 2 risks.</p> <p>For off balance sheet exposures, Basel I has applied a charge for committed undrawn facilities in Pillar 1 and the GFSC has now also applied an automatic Pillar 2 charge for undrawn uncommitted facilities.</p>
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	<p>For both Basel I and Basel II, peer group analysis is also applied to ensure consistency.</p> <p>In light of the potential for off-balance sheet exposure, litigation and operational risk in many Guernsey banks (as a consequence of private banking operations) all banks have a RAR above the Basel minimum.</p> <p>A bank falling below its prescribed minimum RAR will call into question its ability to meet in full the minimum criteria for licensing, which include a requirement (see above; BSL: Sched.3, para. 6) that a bank has sufficient capital commensurate with the nature and scale of its operations. The GFSC has a range of corrective measures available (e.g. issuance of direction(s) to a bank (BSL:s12); imposition of license conditions (s9; BSL); appointing reporting accountants or inspectors) but ultimately it may revoke a licence if, <i>inter alia</i>, any of the criteria of BSL Sched.3 are not-or have not-been fulfilled. Breaching a condition imposed on a licence is an offence (BSL:ss9(5)). No bank has ever breached its RAR.</p> <p>As well, under the FSC(G)L, the GFSC has powers to enforce discretionary financial penalties and issue public statements:-</p> <p>“11D. (1) Where the Commission is satisfied that a licensee, former licensee or relevant officer -</p> <p style="padding-left: 40px;">(a) has contravened in a material particular a provision of, or made under, the prescribed Laws, or</p> <p style="padding-left: 40px;">(b) does not fulfil any of the minimum criteria for licensing specified in the regulatory Laws and applicable to him,</p> <p>it may, subject to the provisions of Section 11E, impose on him a penalty in respect of the contravention or non-fulfilment of such amount not exceeding £200,000 as it considers appropriate.”</p> <p>(The GFSC demanded in 2008 that distressed assets be transferred from the balance sheet of a Guernsey-incorporated bank to that of its parent in order that the subsidiary's capital position be preserved. The demand was met within a month of being made.)</p> <p>All Guernsey-incorporated banks are using the standardised approaches. While the GFSC stands ready to address the use of models insofar as any bank may wish to use them, the absence of a credit default history for many common types of lending category, the limited size of the various books and the difficulty of running either a credit or operational model on the basis of the limited critical mass, suggests that the use of such models will be very limited.</p>
Assessment	Compliant
Comments	
Principle 7.	Risk management process. Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.
Description	The Code of Practice for Banks issued under section 36A of the BSL states at

	<p>paragraph 7 that banks should have in place comprehensive risk management processes to identify, measure, monitor and control material risks. These processes must be adequate for the size and nature of the activities of the bank and must be periodically adjusted in light of the changing risk profile of the bank and external market developments and include appropriate board and senior management oversight.</p> <p>Section 36C of the BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. As a condition of their licence, banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to rectify the position. The Commission requires sight of annual reviews and requires them to have been signed off by the board of directors or senior management of a branch.</p> <p>In addition, Schedule 3 paragraph 6 of the BSL states that a bank shall not be regarded as conducting its business in a prudent manner unless it maintains adequate systems of control of its business and records.</p> <p>Local banks benefit significantly through adoption of group wide risk management policies and processes.</p> <p>The Commission undertakes on-site visits at which risk management policies and processes are assessed in detail. The SREP also involves a detailed examination of a firm's ICAAP.</p> <p>Section 36C of the BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. As a condition of their licences, banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to rectify the position. The Commission requires sight of these annual reviews and requires them to have been signed off by the board of directors or senior management of a branch.</p> <p>ICAAP submissions must be agreed by the Board.</p> <p>Conditions placed on banking licences oblige banks to report exceptions in prudential limits immediately to the Commission. Where material the Commission investigate to determine whether the exception is systematic of a failure to implement high level policies. This includes liquidity, capital, and large exposures.</p> <p>In addition section 36C of the BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. Samples of controls, checks and procedures may be requested by the Commission. Internal audit reports, which are often part of the annual review submissions, include assessments of banks' procedures and processes.</p> <p>On-site visits include assessing the effectiveness of board policies, the way in which exceptions are dealt with by the board and how remedial actions are resolved.</p> <p>The Commission probes the understanding of key risk issues by the senior executive members of the bank at prudential meetings. It also periodically asks to see key board data. This enables the Commission to determine the extent to which senior</p>
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	<p>management understands the key management information.</p> <p>Section 36C of the BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment . As a condition of their licence, banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to remedy the position. The Commission requires sight of these annual reviews and requires them to have been signed off by the board of directors or senior management of a branch (S36C). The requirement for senior management to carry out this exercise annually compels them to review and understand the implications and limitations of the management information they receive.</p> <p>On-site reviews test the extent to which senior management regularly reviews and understands the implications and limitations of the risk management information that it receives.</p> <p>The SREP process has required subsidiaries to identify Pillar 2 risks; whilst the Commission has required subsidiaries to maintain regulatory capital levels above 8%.</p> <p>The Commission reviews quarterly prudential returns produced by banks. These calculate a bank's risk asset ratio. Capital issues are discussed at prudential meetings with subsidiaries, including the likelihood of breach of the minimum prescribed risk asset ratio. Banks in Guernsey are generally non-complex, adopting a more qualitative approach to capital planning. This includes the application of internal capital buffers and the retention of significant amounts of excess capital as a response to customer perception and taxation.</p> <p>The SREP process has led to banks in general allocating the required Pillar 2 risks in order to reach minimum regulatory capital levels. Some banks have used a quantitative approach to determine certain Pillar 2 risks. An example would be the additional funding cost that might arise in the event of a two notch downgrade of the external rating, of the parent and/or the group. However, generally banks have allocated capital without model usage. No bank is using either the advanced regulatory approaches or economic capital models to help determine regulatory capital requirements.</p> <p>At present no model is being used in Guernsey; the Commission does not expect models to be used but of course is willing to engage with banks wishing to use models.</p> <p>Models to measure components of risk will be permitted under Basel II where the Commission is able to work closely with the home supervisor on the model approval process. In determining whether or not to permit a bank to utilise the advanced approaches the Commission would take into account, inter alia, the following:</p> <ul style="list-style-type: none"> · the willingness of the home supervisor to share with the Commission the details of its model approval process in so far as it applies to the risks present in the Guernsey subsidiary; · the supervisory resources of the home supervisor; · the appropriateness of the models being used in light of the risks being faced by the Guernsey subsidiary bank; · how much data has been collated, for how long and how relevant it is to the Guernsey subsidiary's risks; · the resources available in Guernsey with which the bank intends to implement
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	<p>the advanced approach;</p> <ul style="list-style-type: none"> the resource implications for the Commission. <p>Section 36C of the BSL requires banks to carry out an annual review of (inter alia) the bank's individual loans, asset classification and loss provisioning (including on and off balance sheet exposures) and whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. As a condition of their licence banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to resolve the position. The Commission requires sight of these annual reviews and requires them to have been signed off by the board of directors or senior management of a branch.</p> <p>The quality and assurance arrangements for information systems are considered during on-site visits. This includes consideration of the use of IT and end user computer risk, as well as the assurance over information flows.</p> <p>The SREP process has focussed on corporate governance and board oversight of risk. The Commission as a consequence identified several banks with weaknesses and has required those banks to improve corporate governance.</p> <p>As part of the ICAAP process the Commission investigates the process by which new products and major risk management initiatives are approved internally and by the board. In addition, as a condition of the license, the Commission requires to be informed of significant changes to the business plans of a bank, including discussion of new products and major risk management initiatives. During this discussion and as part of on-site reviews, the Commission seeks assurance around the internal challenge process.</p> <p>The Commission requires business risk assessments to be reviewed and signed off by the board.</p> <p>Section 36C of the BSL requires banks to carry out an annual review of whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. As a condition of their licence, banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to rectify the position. The Commission requires sight of these annual reviews and requires them to have been signed off by the board of directors or senior management of a branch.</p> <p>Through the Commission's work on engagement with banks on the SREP process the Commission has had an opportunity to study and understand each firm's perception of risks and the controls in place to mitigate those risks, documented in their ICAAPs. Further, as part of the dialogue during the SREP the Commission engages in face to face challenges with the senior risk management executives involved in evaluating monitoring and controlling the banks risk exposure.</p> <p>The Commission has issued a number of papers covering matters raised by the above issues, especially as part of its Basel II implementation. This is summarized in the table below:</p>
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	<table><tr><th>Title</th><th>Date of issue</th></tr><tr><td>Basel II – External Credit Assessment Institutions’ Ratings and Mapping of Ratings to Risk-Weights</td><td>October 2006 (Revised November 2006)</td></tr><tr><td>National Discretions for the Standardised Approaches to Credit and Operational Risk under the Basel II Capital Framework</td><td>August 2006 (Revised November 2006)</td></tr><tr><td>Considerations on Pillar 2 for Subsidiary Banks</td><td>November 2006</td></tr><tr><td>Basel II – Operational Risk</td><td>May 2007</td></tr><tr><td>High level principles on Pillar 2 and revision of supervisory returns.</td><td>June 2007</td></tr><tr><td>The Internal Capital Adequacy Assessment Process (“ICAAP”) and the supervisory review.</td><td>October 2007</td></tr><tr><td>Basel II – Credit Risk</td><td>November 2007</td></tr><tr><td>Reporting Market, Interest Rate and Settlement Risks under Basel II</td><td>November 2007</td></tr><tr><td>Implementation of Basel II in Guernsey</td><td>December 2007</td></tr><tr><td>Our Pillar 2 assessment: the SREP framework</td><td>June 2008</td></tr><tr><td>Guidance on Liquidity Risk Management</td><td>July 2009</td></tr></table>	Title	Date of issue	Basel II – External Credit Assessment Institutions’ Ratings and Mapping of Ratings to Risk-Weights	October 2006 (Revised November 2006)	National Discretions for the Standardised Approaches to Credit and Operational Risk under the Basel II Capital Framework	August 2006 (Revised November 2006)	Considerations on Pillar 2 for Subsidiary Banks	November 2006	Basel II – Operational Risk	May 2007	High level principles on Pillar 2 and revision of supervisory returns.	June 2007	The Internal Capital Adequacy Assessment Process (“ICAAP”) and the supervisory review.	October 2007	Basel II – Credit Risk	November 2007	Reporting Market, Interest Rate and Settlement Risks under Basel II	November 2007	Implementation of Basel II in Guernsey	December 2007	Our Pillar 2 assessment: the SREP framework	June 2008	Guidance on Liquidity Risk Management	July 2009
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Principle 8.	Credit risk. Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.																								
Description	<p>An internal evaluation of banks’ credit policies, practices and procedures is a requirement of the Code of Practice for Banks. During prudential meetings the make up of the bank’s credit committee and reporting lines, the overall condition of the loan book and credit granting process are generally discussed as are, where appropriate, the individual credit limits of management, local credit committees, large exposures and staff discretionary limits.</p> <p>The BSL also requires banks to review annually their loans, asset classification and loss provisioning (including on and off balance sheet exposures) (section 36C) and report any shortcomings or deficiencies to the Commission immediately along with proposed</p>																								

	<p>remedies.</p> <p>In addition, the Banking Division carries out on-site credit reviews. The on-site process includes verifying that credit granting is approved by the management and the board. Banks are required to submit a separate credit risk reporting module in the prudential return BSL/2 each quarter. The new reporting incorporates the new weightings and credit risks mitigation techniques brought in under Basel II.</p> <p>The Code of Practice requires banks to ensure that the credit risk environment is controlled. Credit policy is challenged at prudential meetings. Large loans are more formally monitored by the Commission and verification of the credit process completed by the bank is often obtained by the Commission.</p> <p>Credit risk is assessed periodically during on-site credit reviews of banks. The Commission obtains in particular documents to review before on-site visits on the bank's policy on large exposures, credit procedures manual as well as the latest reports by internal auditors of the bank relating to credit arrangements.</p> <p>Banks are required under section 36C of the BSL to review annually their loans, asset classification and loss provisioning (including on and off balance sheet exposures), control environments and risk management controls as part of the annual review and report any shortcomings or deficiencies to the Commission immediately along with proposed remedies.</p> <p>Banks are required to have to detail their large exposures, loans by risk weight, specific loan provisions, non-performing assets and loans and classifications of loans and advances in their quarterly prudential returns. Banks are required to have policies and procedures in place to measure and report this information accurately.</p> <p>Banks are required to ensure that credit decisions are made free of conflicting interests, on an arm's length basis and free from inappropriate pressure from outside parties under the Code of Practice for Banks. This is stated in the Commission's policy document on large exposures. Accordingly, exposures to connected persons require special care to ensure a proper objective credit assessment is undertaken. Such exposures may be justified only when undertaken for the clear commercial advantage of the lending bank, and when they are negotiated and agreed on an arm's length basis.</p> <p>The formal verification by the Commission of decisions being made at arm's length takes place during on-site credit reviews.</p> <p>Banks provide the Commission with free access to this information during on-site visits. At least the ten largest exposures / non-bank investments are reported to the Commission (along with the ten largest money market placements) in quarterly prudential returns. For subsidiaries all non-bank exposures over 10% of the capital base must be notified to the Commission. The Commission challenges lending officers during prudential meetings and on-site visits. They are questioned on their roles and the implementation of procedures by Commission staff. Credit and investment portfolios are reviewed during on-site credit reviews and at annual prudential meetings with bank senior management.</p>
Assessment	Compliant
Comments	
Principle 9.	Problem assets, provisions and reserves. Supervisors must be satisfied that banks

	establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Description	<p>According to schedule 3 of the BSL an institution has to make adequate provision for depreciation or diminution in the value of its asset (including provision for bad or doubtful debts), for liabilities which will or may fall to be discharged by it and for losses which it will or may incur.</p> <p>If a bank does not conduct its business in a prudent manner it fails to meet the essential criteria for licensing under BSL. The BSL requires banks to review, at least annually, their individual loans, asset classification and loss provisioning (including on and off balance sheet exposures). If this review identifies any shortcomings in this respect then the bank is required to immediately report the shortcomings or deficiencies to the Commission together with details of the steps it proposes to take to remedy the position.</p> <p>In their quarterly prudential returns to the Commission banks have to detail their specific loan provisions and non-performing assets and loans and classifications of loans and advances. Banks therefore need to have policies and procedures in place to measure and report this information accurately.</p> <p>The adequacy of classification and provisioning policies is reviewed by external audit during the annual audit process. Provisioning is reported on quarterly returns and is also discussed with the bank during annual prudential meetings. It is also discussed during credit reviews and the reasonableness of the loan classifications given to individual credits is reviewed and would be challenged if felt to be inappropriate. The quarterly figures reported by banks include loan provisioning and loan classifications, if there appears to be inconsistency between these reported positions this is raised with the bank. Banks therefore need to have policies and procedures in place to measure and report this information accurately.</p> <p>Loan classification is reported to the Commission by all banks on a quarterly basis. This includes on and off balance sheet exposures.</p> <p>The appropriateness of policies and processes to ensure that provisions and write-offs reflect realistic repayments and recovery expectations is discussed at prudential meetings and is reviewed during on-site credit reviews of banks. Provisions are analysed off-site as part of a bank's risk assessment. Banks are required, by a condition on their licence, to report to the Commission promptly, any loan loss provisions or write offs.</p> <p>In their quarterly prudential returns to the Commission banks have to detail their specific loan provisions and non-performing assets and loans and classifications of loans and advances. Banks therefore need to have policies and procedures in place to ensure that provisions and write offs are realistic.</p> <p>Further, the policies regarding the recognition of provisions and impairments have to be included in each bank's audited financial statements. The banks are required to file audited financial statements with the Commission on an annual basis.</p> <p>The appropriateness of policies and processes and organisational resources for the early identification of deteriorating assets is reviewed and determined during on-site credit reviews.</p>

	<p>Information on the classification of credits or assets including provisioning is obtained from quarterly returns. This issue is also discussed with banks during annual prudential meetings. Banks are required, by a condition on their licence, to report to the Commission promptly, any loan loss provisions or write offs.</p> <p>According to section 24 of the BSL the value of that capital base at any time shall be determined by the Commission. The Commission requires banks to have taken account the standing of the counterparty, the nature of the bank's relationship with the counterparty, the nature and extent of security taken against the exposure, the maturity of the exposure, and the bank's expertise in the particular type of transaction.</p> <p>Collateral and guarantees taken over loans are discussed and challenged at prudential meetings and banks are expected to pay close regard to loan-to-value ratios in their lending policies. During periods of volatile markets this is particularly closely monitored by the Commission.</p> <p>The Commission does not explicitly have the power to require a bank to increase its level of provisions and reserves.</p> <p>If, after dialogue with a bank which is deemed to have inadequate provisions, the bank failed to carry out suitable remedial action and as such it failed to meet the minimum criteria for licensing, the Commission would take steps to revoke its licence.</p> <p>The Code of Practice for Banks requires banks to ensure that mechanisms are in place to frequently assess strength of guarantees and appraising the worth of collateral in support of credit facilities and valuation of loan or guarantee collateral reflects net realisable value.</p> <p>Impaired loans are defined in the Guidance to completing the quarterly return. Banks are also required to report impaired loan values and write-offs in quarterly returns to the Commission and in maturity analyses they are required to report overdue assets and liabilities.</p> <p>There is no specific regulation on information flow to the Board on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning and major problem assets, but the Commission requires management in prudential meetings to have information on these matters to hand and to be fully informed.</p> <p>The ten largest exposures are reported on the quarterly returns on an individual item basis. Valuation, classification and provisioning of large exposures are a requirement of the Code of Practice for Banks and discussed with banks at annual prudential meetings.</p>
Assessment	Largely compliant
Comments	<p>Although in practice the Commission does have impact on the level of provisions of the banks, the Commission should receive the explicit power to require banks to increase their levels of provisions and reserves and/or overall financial strength. The Commission should require that the Board receives timely and appropriate information on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning and major problem assets.</p> <p>According to information of the GFSC, regulation amending Schedule 3, 6B(d) of the BSL will introduce an explicit requirement for banks to increase capital base and provisions. In addition, regulation 5 amending Schedule 3 6(B)(e) BSL will explicitly</p>

	<p>require the Board to provide information to the Commission regarding information which could have material effect on problem assets, the level of provisions, capital base and overall strengths.</p> <p>These rules have to get approved in practice.</p>
Principle 10.	<p>Large exposure limits. Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.</p>
Description	<p>Principle 1/1994/24 on Large Exposures defines a closely related counterparty when one of them has, directly, or indirectly, control over the other or others. In addition a group of connected counterparties is defined, when individual counterparties are connected in such a way that the financial soundness of any of them may affect the financial soundness of the other or others or the same factors may affect the financial soundness of both or all of them.</p> <p>In such cases the exposure to these individual counterparties should be aggregated and considered as a single exposure to a group of closely related counterparties.</p> <p>The requirement refers to the Commission in this definition allows the Commission to exercise discretion in determining this on a case-by-case basis.</p> <p>The Law sets prudential limits as does Principle 1/1994/24, for large exposures. This applies to all transactions (both on and off-balance sheet) and covers single and closely related borrowers. According to paragraph 6 of this Principle, a bank may not incur exposures which exceed 10 percent of capital base to individual counterparties or groups of closely related counterparties which in aggregate exceed 800 percent of the bank's capital base without prior agreement of the Commission. According to paragraph 9 of the Principle for large exposures, a bank may not grant a loan to an individual counterparty which exceeds 25 per cent of the bank's capital without the Commission's approval. No stricter limits are defined regarding exposure to bank's connected counterparties than for those for other single borrowers.</p> <p>Banks are required, by submitting the information in their quarterly prudential returns, to report large exposures to the Commission before entering into any exposure over 25 per cent of capital. The exposure has to be reported to the Commission. The Commission challenges bank management about recognition of risks and mitigates prior to acknowledgement and management are required to provide detailed information on their monitoring of such limits during annual prudential meetings and on-site credit reviews.</p> <p>The Commission does extensively exercise discretion to banks in applying exemption from the large credit limits of 25 % to almost the whole banking sector regarding their large exposure to their parent credit institutions. The Commission does restrict or lift those exemptions only in certain economics and prudential circumstances.</p> <p>According to section 24 (3) of the BSL, the Commission may direct a licensed institution which has not licensed subsidiaries to report large credits as the transactions and capital base of the subsidiaries were included in those of the institution. But the Commission does not confirm that those large credit limits are not exceeded on a consolidated basis.</p> <p>The Commission requires, in its quarterly prudential returns, all banks to report on bank exposures over 10% of capital base. The requirement to submit a return is a condition</p>

	<p>on banks' licences. The ten largest interbank exposures must also be reported quarterly.</p> <p>In addition, large exposures are discussed at annual prudential meeting with the bank and during on-site credit reviews to focus the banks awareness of their obligations. The Principles and Guidance for Large Exposures issued under section 24(9) of the BSL currently require the Board of banks to adopt a policy statement on large exposures and supply a copy of the policy statement to the Commission. This is reviewed by the Commission and, if necessary, the bank will be required to reconsider the appropriateness of the policy statement. The Principles and Guidance also currently require that the necessary control systems to give effect to a bank's policy on large exposures must be clearly specified and monitored by the Board of the bank, including monitoring the size of the capital base to ensure that the limits set in the principle and their policies are not exceeded. In addition, section 36C BSL requires banks to review the institution's control environment on an annual basis and compliance with particular controls is tested by the Commission.</p> <p>According to The Code of Practice for Banks major credit or investments have to be agreed and approved at a senior management level. In addition, the banks are obliged to ensure that management information systems provide senior management with sufficient information to carry out their duties in a prudent manner and that the systems provide essential details on the condition of loan and / or investment portfolios.</p> <p>During on-site credit reviews the bank's risk management policies and processes regarding the concentration risks are considered. Credit managers are challenged by the Commission where the Commission wishes to understand a specific exposure in greater depth.</p> <p>In addition, the BSL requires banks to carry out an annual review of whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment and a review of the bank's individual loans, asset classification and loss provisioning. Banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to remedy the position. The Commission requires sight of these annual reviews and requires them to have been signed off by the board or senior management.</p> <p>According to The Code of Practice for Banks, banks are required to ensure that policies and procedures give due regard to the identification, monitoring and control of country risk and transfer risk. Exposures should be monitored under such procedures on an individual country, end-borrower and end-counterparty basis. In addition, banks have to implement policies and procedures to monitor and evaluate developments in country risk, sectoral risk and transfer risk and to apply appropriate countermeasures including (where appropriate) stress testing the loan portfolio or particular concentrations of the portfolio.</p> <p>Geographical and currency statistics for all assets and liabilities are provided to the Commission quarterly. The Principles for Large Exposures issued under S.24(9) of the BSL requires the Board of Banks to adopt a large exposure policy statement and provide a copy to the Commission. This must set out a bank's policy on large exposures and including exposures to individual customers, countries, economic sectors and the group. The Commission reviews the document and ensures that the policy statement takes into account sectoral exposures, on a bank by bank basis. The Principles and</p>
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	<p>Guidance state that a breach of agreed levels would invoke consideration of whether statutory minimum criteria for authorisation continue to be met.</p> <p>The minimum criteria for licensing under schedule 3 to the BSL includes a criterion that banks must conduct business in a prudent manner and it states that a bank will not be acting in a prudent manner if it does not maintain sufficient capital to take account of the risks inherent in its operations. If the Commission considers that a bank has concentrations that appear to present significant risk and the bank has insufficient capital then the Commission could, in the extreme, move to revoke a bank's licence. The Commission also has powers to impose conditions on a licence which could prohibit a bank from carrying out a certain type or amount of business.</p> <p>Where concentrations appear to present significant risks section 24(6) of the BSL permits the Commission to require the bank to make arrangements for the protection of the bank's capital base.</p>
Assessment	Largely compliant
Comments	<p>The financial crisis showed that large exposures including those to parent banks can cause immense insolvency risks. This is recognised by the Commission, which has already limited exposures of banks to their parents in certain cases. The Commission should continue to restrict large limits of banks to their parents in relation to their own capital approaching the 25 % limits to all banking exposures</p> <p>The Commission should require the banks to comply with credit limits regime on consolidated basis.</p> <p>The Commission is issuing revised Principles & Guidance to be followed by banks regarding large exposures that will define limits for exposure to connected parties. The revised Principles and Guidance to be followed by banks regarding large exposures will explicitly require banks to ensure that the limits are not exceeded on a consolidated basis.</p>
Principle 11.	<p>Exposures to related parties. In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.</p>
Description	<p>BSL defines a related company at section 25(6) in relation to an institution, as any body corporate in which that institution holds for a significant period a qualifying capital interest for the purpose of securing a contribution to that institution's own activities by the exercise of any control or influence arising from that interest.</p> <p>In addition, Principle 1/1994/24 stipulates connected counterparty to associated companies, directors, controllers and their associates as well as non-group companies with which the reporting bank's directors and controllers are associated.</p> <p>Paragraph 17 of Annex 1 to this Principle affords the Commission discretion in making judgements about the existence of connections between the banks and other parties.</p> <p>According to paragraph of Principle 1/1994/24, exposures to companies or persons connected with the lending bank, its managers, directors or controllers require special care to ensure a proper objective credit assessment is undertaken. Such exposures may be justified only when undertaken for the clear commercial advantage of the lending bank, and when they are negotiated and agreed on an arm's length basis.</p>

	<p>The Commission examines particularly exposures to companies or persons connected to a lending bank and deducts them from the bank's capital base if they are of the nature of a capital investment or are made on particularly concessionary terms.</p> <p>Loans to connected parties must be identified as such in the bank's quarterly prudential reporting. In addition, this matter is reviewed during on-site credit reviews.</p> <p>There is no legislation in place, according exposures to related parties explicitly may not be granted on more favourable terms.</p> <p>According to section 162 of the Companies (Guernsey) Law, a director of a company must disclose to the board of directors after becoming aware of the fact that he is interested in a transaction with the company.</p> <p>There is no legislation in place, according to the Commission requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's board and that Board members with conflicts of interest are excluded from approval process.</p> <p>But the Commission sent a copy of the Basel Committee on Banking Supervision's paper entitled "Principles for the Management of Credit Risk." to all banks. in this document is stipulated that material transactions with related parties should be subject to the approval of the board of directors (excluding board members with conflicts of interest), and in certain circumstances (e.g. a large loan to a major shareholder) reported to the banking supervisory authorities.</p> <p>The extent to which banks have taken account of those principles is reviewed when the Commission carries out on-site credit reviews but there will be specific briefing ahead of such visits setting out the particular objectives of the visit.</p> <p>Credit approval limits and personal authorities of staff and directors are also discussed at prudential meetings and at on-site credit reviews.</p> <p>According to Section 5 of the Code of Practice for Banks, banks have to ensure that credit and other decisions are made free of conflicting interests, on an arm's length basis and free from inappropriate pressure from outside parties.</p> <p>Segregation of duties in granting credit facilities are also a subject evaluated at on-site credit reviews.</p> <p>According to section 8 of Principle 1/1994/24, exposures to companies or person connected with the lending bank, its managers, directors or controllers require special care to ensure a proper objective credit assessment is undertaken. Such exposures may be justified only when undertaken for the clear commercial advantage of the lending bank, and when they are negotiated and agreed on an arm's length basis.</p> <p>The Commission examines the exposures to companies or persons connected to a lending bank and can deduct them from the bank's capital base if they are of the nature of a capital investment or are made on particularly concessionary terms.</p> <p>According to section 36c of the BSL banks have to review every financial year whether</p>
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	<p>there has been effective control by the institution's board of directors over every aspect of risk management.</p> <p>Pursuant to Principle 1/1994/24, relevant factors which the Commission will expect a bank to have taken into account when setting its policy and considering the acceptability of particular exposures include the bank's relationship with the counterparty. Exposures to counterparties connected with the bank will continue to be particularly closely examined.</p> <p>Banks are required to aggregate and report connected party loans and advances to the Commission on a quarterly basis. Bank management are challenged during on-site visits, prudential meetings and a case by case basis with regard to related party exposures as part of continuing risk based supervision.</p> <p>Banks are required to aggregate and report connected party loans and advances to the Commission on a quarterly basis. This information is reviewed during on-site credit reviews.</p> <p>Other than money market exposures (such as upstreaming of deposits to parent organisations) exposures to related parties are subject to the same limits and controls as those to non-related parties.</p>
Assessment	Largely compliant
Comments	<p>A regulation should be included into the banking regulations according to the Commission requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's board. Legislation should be introduced, according to exposures to related parties explicitly may not be granted on more favourable terms.</p> <p>According to the GFSC, regulation amending Schedule 3 – (6B(g)) BSL will require that all transactions with related entities must receive the prior approval of the bank's board of directors and must not be on more favourable terms than transactions with unrelated companies or persons who are not associates. Those rules have to get approved in practice.</p>
Principle 12.	Country and transfer risks. Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.
Description	<p>According to point 5 of the Code of Practice for Banks, banks have to implement policies and procedures to monitor and evaluate developments in country risk, sectoral risk and transfer risk and apply appropriate countermeasures including (where appropriate) stress testing the loan portfolio or particular concentrations of the portfolio.</p> <p>As stated in the Principle 1/1994/24 on large exposures, the Commission does not believe that a common limit should be applied to the aggregate of banks' exposures to counterparties in the same country; nor does it consider it appropriate to publish guideline percentages for the acceptable level of exposure to counterparties in particular countries. There may be circumstances where the Commission will insist on a limitation on a bank's country exposure. Banks likewise will be expected to set limits for country exposures on the basis of their own risk assessments which should be set out in their policy. The nature of the exposure (for example, whether it is trade finance or longer term balance of payments finance) will be relevant in considering an acceptable level of exposure.</p>

	<p>Certain banks in Guernsey have had limits placed on their exposure to certain countries. In certain circumstances, the Commission requires banks not to book any deposits or transact any other business of certain countries.</p> <p>This risk area is also addressed during on-site credit reviews and bank management are challenged on a case-by-case basis as part of continuing risk based supervision.</p> <p>Transfer risk is identified in focussed on-site credit reviews and reviewed in annual prudential meetings as part of the Banking Division's discussions on the analysis of the locational statistics.</p> <p>It seems acceptable that the Commission does not publish guideline percentage for the level of exposure in particular countries but only in certain circumstances.</p> <p>The bank's information systems, risk management systems and internal control systems are addressed during annual prudential meetings with bank management and are assessed during on-site credit reviews.</p> <p>Country exposures are reported to the Commission quarterly on LOC/1 returns.</p> <p>It is a requirement of the Code of Practice for Banks that banks have due regard to country risk and transfer risk and set percentages or guidelines or decide for each individual loan. The Commission requires this during prudential meetings and on-site credit reviews. Provisioning has to be subject to statutory audit and provisions are reported to the Commission quarterly.</p> <p>A breakdown of the geographical source of all assets and liabilities is reported by all banks to the Commission in form LOC/1 (which provides locational statistics collected by the Commission and reported on to the Bank for International Settlements). This information is reviewed and salient points addressed during prudential meetings.</p> <p>During the 2008-9 financial crises, commentators raised questions as to whether several countries had the ability to support their banks. The Commission was also attuned to this concern and conducted additional sovereign risk analyses on certain countries, chosen due to the mix of banks in Guernsey. In the event concerns over a country, the Commission requires a bank to put in place a closure contingency plan.</p>
Assessment	Compliant
Comments	
Principle 13.	Market risk. Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Description	<p>It is a requirement of the Code of Practice for Banks that banks have control systems of market risks where they have a trading book. In addition, schedule 3 to the BSL states that an institution shall not be regarded as conducting its business in a prudent manner unless it maintains adequate accounting and other records of its business and adequate systems of control of its business and records. External auditors of banks are required to communicate to the Commission if they have reasonable cause to believe that any of the criteria specified in Schedule 3 of the law may not have been fulfilled.</p> <p>Where banks are seen to have a material trading book, external accountants are used</p>

	<p>to verify the adequacy of banks' policies and procedures. In terms of size, there is little trading activity in Guernsey banks.</p> <p>With reference to market risk the Commission carries out an annual survey of the size of banks' trading books and requires banks to inform the Commission if they intend to carry out material trading on their own account. From this information the Commission determines whether any Guernsey bank has a material trading book. Certain market risks on the banking book would result in an additional capital charge. The Commission issued a paper which includes guidance and reporting forms for market risk capital charges in November 2007. This paper also deals with settlement risk and offers a possible methodology for reporting interest rate risk on the banking book.</p> <p>It is a requirement of paragraph six of the Code of Practice for Banks that banks ensure they have suitable policies and procedures related to the identification, measuring, monitoring and control of market risk. In addition the requirement of paragraph 8 of the Code is for the board of directors to ensure that the bank has in place internal controls that are adequate for the nature and scale of the bank's business. Foreign exchange exposures are also reported quarterly to the Commission and are discussed, where appropriate, at annual prudential meetings.</p> <p>It is a requirement of the Code of Practice for Banks that banks have such internal control procedures. These systems are a matter of routine discussion and challenge during annual prudential meetings and on-site visits where treasury and market limits are discussed with senior management.</p> <p>Trading books, treasury positions and illiquid assets (where present) are discussed and challenged in general and specific terms at annual prudential meetings with bank management. Where markets are volatile ad hoc discussions take place. Banks would be required to make adjustments to their holdings in such assets, if necessary by imposing a condition on the bank's licence.</p> <p>The Commission does not require banks to perform stress testing and contingency planning and periodic validation of the system used to measure market risk. But market risks are included in the bank's ICAAP models, which are assessed by the Commission.</p>
Assessment	Compliant
Comments	The team recognises that there is a relatively low impact of market risks to the Guernsey banking sector. But the Commission should require banks to perform stress testing and contingency planning and periodic validation of the system used to measure market risk.
Principle 14.	Liquidity risk. Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Description	<p>The guidance on completion of the quarterly return states in connection with the maturity analysis the Commission's view on control of liquidity risks by banks. Accordingly, the Commission would not normally expect a maturity negative mismatch at one month of more than 20%.</p> <p>Where banks exceed or are near this -20% mismatch at one month the Commission undertakes a desk top analysis to consider whether the inclusion of the relevant bond portfolio corrects the mismatch to below -20%. In particular cases discussion with banks will take place.</p>

	<p>The Commission also states that deposits must be reported according to their earliest repayment date. Loans should be reported according to final maturities. Generally all assets and liabilities should be reported at their true residual maturities.</p> <p>Undrawn commitments and other off balance sheet liabilities are included in the quarterly liquidity report to the Commission.</p> <p>In response to new guidance from Basel the Commission revised its liquidity policy and, by end - September 2009 banks were required to have submitted new internal liquidity policies and by end-Q1 2010 the Commission aims to have transitioned most banks onto the new liquidity regime.</p> <p>The new approach divides banks into two. The first set (the branches) will apply the mismatch of -20%. In practice, the mismatch of -20% acts here as a proxy number for behavioural adjustment. The second set (the subsidiaries) apply a more bespoke approach to include individual behavioural adjustments. In addition the second set need to undertake mandatory stress testing.</p> <p>Schedule 3 to the BSL states that an institution shall not be regarded as conducting its business in a prudent manner unless it maintains adequate liquidity, having regard to the relationship between its liquid assets and its actual and contingent liabilities.</p> <p>Where a bank fails to meet the minimum criteria for licensing the Commission can remove its licence.</p> <p>The paper for liquidity specifically requires Board sign off on Liquidity Management Programmes.</p> <p>Apart of the Guidance on completion of the quarterly return which states in connection with the maturity analysis that bank management has to monitor and measure their liquidity positions and to at least have defined the -20% mismatch as a position to monitor, banks also have in practice their own group liquidity monitoring policies and procedures and this is a routine matter for discussion and challenge at annual prudential meetings.</p> <p>Liquidity positions and policies are discussed and challenged with senior management during annual prudential meetings with senior management. In addition, the Commission sets conditions on some banks related to liquidity.</p> <p>The BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. Banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to remedy the position (Section 36C).</p> <p>Information to identify institutions carrying out significant foreign currency liquidity transformation is provided in quarterly prudential returns and location statistics submitted to the Commission by all banks which show net short open positions in currency holdings and currency exposures as at the time of the return. This attracts a capital charge.</p>
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	<p>Guernsey banks deal almost exclusively with four major international currencies (Sterling, US-Dollar, Euro and Swiss Franc) and foreign currency liquidity transformation is therefore not considered to be problematic. Exposures in minor currencies are discussed during annual prudential annual meetings with banks.</p> <p>There are no material short currency positions in Guernsey banks as they are able to fund in a variety of currencies and typically only invest in foreign currency assets where they are funded in those currencies.</p> <p>External auditors are required under section 1 (a) of the Banking Supervision (Accounts) Rules 1994 to produce in Guernsey banks' audited accounts a statement on currency exposures (on and off balance sheet) showing the net position for the current and previous years in major currencies. The Commission issued guidance to explain how the rules are satisfied.</p> <p>Where banks have a negative mismatch of more than 20 per cent in their maturity analysis and the relevant bond portfolios do not reduce the mismatch to 20 per cent or less, the Commission will discuss what access the bank has to liquidity, either from other group members, from standby facilities with other banks or from sale of liquid assets with long contractual maturities.</p> <p>The Commission has been proactive in taking regulatory action to maintain local liquidity in circumstances where it felt that the parent bank may be exposed to a run.</p> <p>In addition, in certain cases, the Commission has gone beyond the Guernsey banks to study liquidity at the parent with both the home regulator and the parent bank.</p>
Assessment	Compliant
Comments	
Principle 15.	Operational risk. Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.
Description	<p>The Code of Practice for Banks requires at section 7 among others that banks should have a robust and independent internal audit function, have procedures in place to counter external fraud and other financial crime, establish adequate system security and data protection procedures as well as have procedures in place to address internal fraud and negligence including the taking out of adequate and appropriate professional indemnity insurance cover.</p> <p>In addition, schedule 3 to the BSL states that a bank shall not be regarded as conducting its business in a prudent manner unless it maintains adequate systems of control of its business and records. It also requires banks to carry out an annual review whether there has been effective control by the institution's board of directors with over every aspect of risk management and of the bank's control environment. Banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to remedy the position.</p> <p>In addition, the Commission discusses and challenges risk management regarding operational risks with banks during annual prudential meetings with banks. Reporting lines for risk management are also discussed as part of the questionnaire for on-site visits to banks.</p>

	<p>The Banking Division takes note of the need to undertake due diligence over how banks manage operational risk, not least as this is set out in principle 9 (of the BIS paper on Sound Practices for the Management and Supervision of Operational Risk). In this context the Banking Division considered the appropriateness of operational risk frameworks through the off-site 36C process, whereby banks sign off on their operational risk framework. The Commission intensified its oversight of operational risk through the ICAAP process and also through on-site visits around Business Continuity Planning and Outsourcing in 2008.</p> <p>The Banking Division reviews as part of their SREP the general framework each bank has in place to identify, assess, monitor, and control/mitigate material operational risks and how this fits in with the bank's overall approach to risk management. It also reviews as part of its SREP process the allocation of capital to operational risk and challenges each bank as to the allocation and whether any add-ons are required under Pillar 2 to take into account both the methodology used and the controls currently in place.</p> <p>Under Basel II subsidiaries in Guernsey can receive a Pillar 2 capital charge for operational risk. In addition, the Commission has engaged banks about Pillar 2 add-ons for operational risk. It generally applies an add-on in Pillar 2, for operational risk where deemed necessary. This will be based on the creation of an add-on rather than a gearing of Pillar 1. The reason for this is that the Banking Division wishes banks to estimate their residual operational risk without reference to their credit exposure, not least as the amount of the latter is often small. The Banking Division also sees this as a way of subsidiaries addressing operational risk in detail and on an individual basis as part of the ICAAP process.</p> <p>The BSL requires banks to carry out an annual review whether there has been effective control by the institution's board of directors over every aspect of risk management and of the bank's control environment. Banks are required to immediately report any shortcomings or deficiencies to the Commission together with the steps they propose to take to remedy the position.</p> <p>The 'Guidance on Corporate Governance in the Finance Sector in Guernsey' issued by the Commission, states that the Board of Directors is responsible for the corporate governance of the organisation. Members of the Board should be proactive in recognising and understanding the risks the organisation faces in achieving its business objectives and should demonstrate effective and prudent management of those risks. The Board should ensure that the organisation's operations are conducted reasonably and within the framework of any applicable laws, regulations, rules, guidelines and codes as well as established policies and procedures.</p> <p>In addition the Board and management should according to the Guidance analyse existing and prospective business, products and services to identify and measure the types and significance of the current and potential risks to be managed and controlled, both individually and in the aggregate. The Board and management should develop and implement appropriate and prudent risk management policies and procedures and monitor their effectiveness through timely, accurate and complete information systems.</p> <p>In addition, the Guidance requires the Board to assess and document whether its approach to corporate governance achieves its objectives and, consequently, whether the Board itself is fulfilling its own responsibilities. The Board should also review the</p>
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	<p>effectiveness of its overall approach to governance and make changes where that effectiveness needs to be enhanced. In carrying out this review the Board should assess whether the organisation's control environment is appropriate and effective, taking into account the nature and scale of the business, its approach to governance, management and style of communication, organisation structure, resource availability, procedures and controls.</p> <p>During thematic studies, the Commission checked on Board sign off on, for example, Business Continuity Planning strategies.</p> <p>Through discussions at annual prudential meetings, on-site visits and the annual review process (under Section 36C of the BSL) the Commission assesses the effectiveness of management's implementation of strategies and policies. Where implementation appears to be less than effective the Commission challenges management and seeks changes in management style and behaviour (and occasionally changes in personnel). In addition, as part of a thematic review, the Commission requires a remedial action plan for material exceptions.</p> <p>The Code of Practice for banks states that sound business resumption plans should be in place.</p> <p>In 2008 the Commission undertook a thematic review on Business Continuity Planning within the Guernsey banking industry. The aim of the review was to confirm whether banks have locally relevant, up-to-date, and regularly tested business continuity and disaster recovery plans. Further it allowed the Commission an opportunity to assess, on a sample basis, whether there were significant gaps or deviations from best practice that could set operational risk levels at a level that was unacceptable for the Commission. The Commission issued the results of its findings to industry in September 2008.</p> <p>IT developments are a routine matter for discussion with banks during the annual prudential meetings held with the management of banks.</p> <p>In addition, schedule 3 to the BSL states that an institution shall not be regarded as conducting its business in a prudent manner unless it maintains adequate accounting and other records of its business and adequate systems of control of its business and records.</p> <p>External auditors of banks are required to communicate to the Commission if they have reasonable cause to believe that any of the criteria specified in Schedule 3 of the law may not have been fulfilled.</p> <p>The Code of Practice for banks states that adequate system security and data protection procedures should be established, sound business resumption plans should be in place, procedures should be in place covering major system modifications and in preparation for strategic changes in the business environment.</p> <p>As regards to oversight of IT, this is currently done through the section 36C process.</p> <p>The BSL states at section 36C among others that a licensed institution shall review, in connection with business carried on in or from Guernsey by the institution or by any subsidiary, the institution's individual loans, asset classification and loss provisioning (including on and off balance sheet exposures), whether the institutions has in place</p>
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	<p>control systems which are effective to ensure that all returns and other documents required under this Law to be submitted to the Commission are duly submitted and that any inaccuracies in any such returns and other documents are identified, corrected and reported to the Commission expeditiously.</p> <p>Banks also are required to submit monthly and quarterly data to the Commission and annual prudential meetings are held with senior management of the bank.</p> <p>The Code of Practice for Banks states that banks should deal openly and honestly and co-operate with the Commission and any other regulatory authorities to whose consolidated supervision they are subject.</p> <p>As a matter of practice, banks in Guernsey keep the Commission apprised of operational risk developments.</p> <p>The Commission issued a paper entitled "Legal Risk Guidance Note for Banks" on 11 January 2010. This recognises legal risk as a subset of operational risk and requires banks to establish responsibility for the management of legal risk, with appropriate reporting to the Board of Directors of the bank or Executive Committee of a branch. Banks are also asked to establish policies and procedures relating to the management of legal risk and consider the use of stress testing exercises to assess the adequacy of such policies and procedures.</p> <p>On reviewing banks' annual reviews the Commission ensures that all relevant risks (including legal risks) are addressed in the review process. The Commission includes legal risk in its oversight of operational risk, as it adopts the Basel definition of operational risk.</p> <p>In 2008 the Commission undertook a thematic review on outsourced activities with the Guernsey banking industry. The aim of the review was to confirm where banks have outsourced activities, that those functions outsourced are suitable for outsourcing and have followed a process which stands up to scrutiny when compared to international and local Commission guidance. Further it allowed the Commission an opportunity to assess, on a sample basis, whether there were significant gaps or deviations from best practice that could set operational risk levels at a level that was unacceptable for the Commission. The Commission issued the results of its findings to industry in October 2008.</p> <p>There is no guidance on the policies and processes to assess, manage and monitor outsourced activities as well as on the content of outsourcing agreements in place.</p> <p>The Commission does accept the establishment of "Administered Banks". Under the administered bank concept existing banks are permitted to administer other banks, seconding staff and leasing areas of office space.</p> <p>Many of the administered banks do not have any staff in Guernsey at all. In addition is to be pointed out, that one service provider bank in Guernsey manages 8 administered banks.</p> <p>This concept of outsourcing even essential parts of banking business is not compatible</p>
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	with international standards regarding outsourcing.
Assessment	Largely compliant
Comments	<p>The extent of outsourcing regarding the administered banks should be reduced and not cover essential functions as risk management. A minimum number of persons should be required to be locally employed by the administered banks providing the essential functions.</p> <p>According to the GFSC, regulation amending Schedule 3 – 6C BSL will require banks to employ a sufficient number of individuals employed in Guernsey to cover essential functions including risk management.</p> <p>In addition, the Commission should stipulate detailed guidance on the requirements of outsourcing, in addition to the results to the review on outsourced activities which were already sent to the banks.</p> <p>The Commission is issuing an Outsourcing Guidance. This will require banks to ensure that banks conduct due diligence checks on outsourcing service providers, structure outsourcing to ensure that the arrangements do not impair the bank's conduct of business, senior management control, conduct oversight and control by internal governance bodies such as the Board of Directors, or committees of the boards and not compromise the Commission's ability to supervise the bank. Outsourcing contingency arrangements and exit strategies must be established. The Outsourcing Guidance will explicitly require banks to consider the effects of and conduct risk assessment before outsourcing.</p> <p>Those regulations and guidance have to get approved in practice.</p>
Principle 16.	Interest rate risk in the banking book. Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk..
Description	<p>Point 7 of the Code of Practice states that there should be good management information and stress testing of interest rates and the associated interest rate risk.</p> <p>Under the quarterly reporting requirements of Basel II and during the SREP process, the Commission considers how Interest Rate Risk on the Banking Book is considered by each entity, where applicable. A module has been created by the Commission and circulated to all banks that can use this to report their Interest Rate Risk on the Banking Book each quarter. Guidance was issued by the Commission in 2007 on interest rate risk. As part of a bank's ICAAP, they are required to consider and document their interest rate risk and how the bank manages this (either through controls, capital allocation or a mixture of both).</p> <p>The Commission believes that the SREP reviews confirm that this risk is not material to the industry as a whole in Guernsey. The Commission monitors each bank separately through their prudential reporting and each entity's SREP review, and applies Pillar 2 add-ons for this risk where it is considered material.</p> <p>The Commission determines that banks have in place appropriate interest rate risk measurement systems during prudential meetings. In addition, under the Banking</p>

	<p>Supervision (Accounts) Rules, 1994, audited accounts of Guernsey incorporated banks have to be submitted in to the Commission and are reviewed by Banking Division staff. They include a detailed review of the bank's risk profile including statements on credit, liquidity, interest rate and foreign currency risk. There are also tables in the accounts providing interest rate sensitivity gap analysis, foreign exchange and interest rate contracts and currency exposure.</p> <p>The Commission reviews this as part of the SREP process and continually thereafter.</p> <p>Appropriate stress testing to measure the bank's vulnerability to loss under adverse interest rate movements is currently required from each bank on an annual basis as part of the SREP process. Also a number of banks complete the Commission's own Interest Rate Risk on the Banking Book module which allows the Commission to review a bank's risk on a quarterly basis. This does not suggest a vulnerability to interest rate risk.</p> <p>The Commission has the power to subject a bank to more intensive scrutiny should it feel it is warranted.</p>
Assessment	Compliant
Comments	
Principle 17.	<p>Internal control and audit. Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p>The Commission has issued Guidance on Corporate Governance in the Finance Sector in Guernsey, which lays out the responsibilities of the board of regulated financial services businesses. More specific regulations on corporate governance include the amended Guidance on Corporate Governance in the Finance Sector, which is now under consultation.</p> <p>In addition the Code of Practice for banks states at Paragraph 8 that the board of directors of banks is responsible for banks having in place internal controls that are adequate for the nature and scale of the bank's business.</p> <p>English legal principles would be adopted by Guernsey law when determining the general nature of a director's duties and liabilities to a company. Accordingly, directors will be regarded as fiduciaries and subject to the obligations to act honestly and in good faith, to act bona fide in the interests of the company, to act for a proper purpose, not to place themselves in a position where there is a conflict between their duties to the company and their personal interest or duties to others, not to use corporate property, opportunity or information to make unauthorised or secret profit and to exercise reasonable care and skill.</p> <p>Section 49 of the BSL states that where an offence under this Law is committed by an institution and is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, chief executive, controller, manager, secretary or other similar officer of the institution or any person purporting to act in any such capacity, he as well as the institution is guilty of the offence and may be proceeded against and punished accordingly.</p>

	<p>In addition section 36C of the BSL requires banks to review, at least annually, the responsibilities and conduct of the bank's board of directors with respect to corporate governance principles. If this review identifies any shortcomings in this respect then the bank is required to immediately report the shortcomings or deficiencies to the Commission together with details of the steps it proposes to take to remedy the position.</p> <p>The Commission looks at a bank's risk framework as part of SREP process. It has emphasised operational risk (including corporate governance) as part of this process. The Commission is recommending that at least one non executive member of a corporate board should be drawn from outside the group.</p> <p>With reference to <i>checks and balances</i>, schedule 3 to the BSL includes the minimum criterion for licensing that at least two individuals resident in Guernsey of appropriate standing and experience and sufficiently independent of each other, shall effectively direct the business of the institution.</p> <p>With reference to <i>accounting procedures</i>, schedule 3 to the BSL includes the criterion for licensing that the institution conducts or, in the case of an institution which is not yet carrying on deposit-taking business, will conduct in a prudent manner.</p> <p>To ensure compliance with these requirements annual prudential meetings held with the management of the bank review such matters as those listed in this essential criterion.</p> <p>With reference to <i>all internal controls</i>, the Code of Practice for Banks requires that the board of directors of banks are responsible for banks having in place internal controls that are adequate for the nature and scale of the bank's business.</p> <p>With reference to <i>organisational structure</i>, on-site visits (including on-site credit reviews) to banks and prudential meeting examine reporting lines for key responsibilities (such as compliance and risk management). Reporting lines and organisational structure are also discussed in detail at prudential meetings held annually with banks.</p> <p>The Guidance on Corporate Governance in the Finance Sector in Guernsey states that the board should establish internal control procedures that are, in the Board's opinion, necessary and sufficient for the purposes of managing operational risks and conducting the organisation's business having regard to its size, nature and complexity.</p> <p>Additional measures to strengthen corporate governance are under consultation.</p> <p>The Commission conducts regular and annual meetings with the management of banks. Due to the small population of banks and their close physical proximity to the Commission the quality and nature of the banks' management is well understood.</p> <p>The BSL requires banks to review, at least annually, the bank's control environment. This includes reviewing (Section 36C) whether any activity has been entered into in the course of the institution's business in respect of which no director of the institution has a sound knowledge, the responsibilities and conduct of the institution's board of directors with respect to corporate governance principles and whether there has been effective control by the institution's board of directors over every aspect of risk management.</p> <p>If this review identifies any shortcomings in this respect then the bank is required to immediately report the shortcomings or deficiencies to the Commission together with</p>
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	<p>details of the steps it proposes to take to remedy the position. For example, the Commission requests clarification on risks it had identified in a risk assessment but were not included in the quarterly operational risk report to the board.</p> <p>Section 17A of the BSL gives the Commission the powers to issue a prohibition order against a person considered not to be fit and proper prohibiting that individual from performing any function, any specified function or any specified description of function.</p> <p>Permission in writing from the Commission is required under section 22A of the BSL before a director or manager may be appointed.</p> <p>In addition, the BSL requires in section 22 that institution shall give notice in writing to the Commission of the fact that any person has become or has ceased to be a director, controller or manager of the institution. Such notices are required to be given within a period of 14 days immediately following the day on which the institution becomes aware of the relevant fact. An institution which fails to give notice in accordance with this section is guilty of an offence.</p> <p>All directors, branch managers, company secretaries, money laundering reporting officers, members of branch management committees and managers reporting directly to directors are required to complete a very detailed personal questionnaire (form PQ).</p> <p>If the Commission does not approve of a board member or manager or other person in a position of responsibility being appointed (as they are not “fit and proper”) then the Commission can threaten to remove a licence or impose a condition on a licence or fine or issue a public statement on the grounds that one of the minimum criteria for licensing (Schedule 3 to the BSL) have not been met. For example the bank could not be said to be conducting its business “in a prudent manner” (section 6(1) of Schedule 3 to the BSL).</p> <p>The criterion to have an appropriate balance in the skills and resources of the back office and control functions relative to the front office is dealt with by a mixture of on-site reviews, annual (and other) prudential meetings, personal questionnaires and the minimum criteria for licensing laid out in schedule 3 to the BSL. These ensure that there is an appropriate balance in the skills and resources of the back office and control functions relative to the front office/business origination. In addition, banks are required to submit a copy of any management letter produced by their auditors (following an annual audit) to the Commission. Matters such as this are included in management letters if deficiencies were found to be in place.</p> <p>The banking legislation does not explicitly determine that banks have a permanent compliance function within the banks, but the Commission derives this obligation from the general rules for the internal control systems for banks.</p> <p>The Commission requires that all Guernsey banks have regular reviews by sufficiently robust internal audit. The Commission periodically meets internal auditors and has reviewed routine and specific internal audit reports. These are often submitted to the Commission as part of the annual review submission made to the Commission by banks under Section 36C of the BSL. Not all Guernsey banks have a local internal audit function and this function would be performed by group internal audit.</p> <p>The Code of Practice for Banks (point 9) stipulates that the internal audit function should</p>
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	<p>report direct to a parent undertaking with a demonstrable level of independence from local senior management or to an audit committee which can provide the requisite independence and experience. The Commission will consider the nature, complexity, and risk of a bank's activities in assessing the efficacy of the internal audit function.</p> <p>As Guernsey banks are all subsidiaries of major international banks they are subject to independent internal audits on a regular basis from Head Office. The Commission addresses matters of internal audit during annual prudential meetings, in assessing annual review submissions under Section 36C of the BSL and on-site visits. All external audit reports are copied to the Commission and cover all the functions required by this criterion.</p>
Assessment	Largely compliant
Comments	<p>The banks are not required to have an independent, permanent and effective internal audit function in place charged with ensuring that policies and processes are complied with and reviewing whether the existing policies, processes and controls remain sufficient and appropriate for the bank's business. However, it should be stressed that as all Guernsey banks are part of major banking groups, internal audit is provided in practice by group function. The Commission regularly requires the banks to forward those internal audit reports, assesses them and challenges the major findings with banks in prudential meetings.</p> <p>The banking legislation does not explicitly require banks to have a permanent compliance function that assists senior management in managing effectively the compliance risks faced by the bank.</p> <p>Supervisory regulations should require the banks to establish inter audit and compliance and the Commission should stipulate the criteria on the processing. If the Commission accepts outsourcing of those functions into bank's group entities in certain circumstances, the guidelines should be nevertheless met.</p> <p>According to the GFSC, new regulations will require banks to have an internal audit function, or an audit function that is compliant with the Commission's Outsourcing Risk Guidance Note for Banks. The Guidance will explicitly require banks to consider the effects and conduct risk analysis before outsourcing.</p>
Principle 18.	Abuse of financial services. Supervisors must be satisfied that banks have adequate policies and processes in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Description	<p>The FSC Law states that one of the functions of the Commission is the countering of financial crime and of the financing of terrorism which includes any offence involving fraud or dishonesty, misconduct in, or misuse of information relating to, a financial market, or handling the proceeds of crime and offence includes an act or omission which would be an offence if it had taken place in Guernsey.</p> <p>The Guernsey authorities are committed to ensuring that money launderers, terrorists, those financing terrorism and other criminals, cannot launder the proceeds of crime through Guernsey, or otherwise use Guernsey's finance sector. The Policy Council and the Commission endorses the Financial Action Task Force on Money Laundering's Forty Recommendations on Money Laundering and the IX Special Recommendations on Terrorist Financing. The Handbook issued is a statement of the standards required by the Commission of all financial services businesses in Guernsey to ensure Guernsey's compliance with the FATF's standards.</p> <p>Schedule 3 of the BSL requires the business of the bank to be carried on with prudence</p>

	<p>and integrity, with professional skill appropriate to the nature and scale of activities and in a manner which will not tend to bring Guernsey into disrepute as a finance centre.</p> <p>Schedule 3 also requires directors of banks to be fit and proper persons and for policies, procedures and controls to comply with rules, codes, guidance and instructions issued by the Commission including The principles of conduct of Financial Business, rules, codes and guidance issued under the Banking Supervision Law including the Code of Practice for banks and all applicable legislation relating to AML/CFT requirements of the Handbook.</p> <p>Guernsey's anti-money laundering and countering the financing of terrorism legislation (and by extension the Handbook) applies to all financial services conducting business in Guernsey and this includes Guernsey based branches of banks incorporated outside Guernsey conducting banking activities in Guernsey.</p> <p>The Handbook contains additional rules (i.e. breaches that attract sanctions) and requires banks to comply with the requirements of the relevant legislation concerning money laundering, terrorist financing and related offences to prevent banks in Guernsey from being used in the laundering of money of the financing of terrorism.</p> <p>Regulation 15 of this Handbook requires that financial services business must establish policies, procedures and controls as may be appropriate and effective for the purposes of forestalling, preventing and detecting money laundering and terrorist financing, establish and maintain an effective policy, for which responsibility must be taken by the board, for the review of its compliance with the requirements of these regulations and such policy shall include provision as to the extent and frequency of such reviews and ensure that a review of its compliance with these regulations is discussed and minuted at a meeting of the board at appropriate intervals, and in considering what is appropriate a financial services business must have regard to the risk. Doing so, the size, nature and complexity of the financial services business, its customers, products and services, and the ways in which it provides those products and services has to be taken into account. A financial business has also to ensure that any of its branch offices complies there with the requirements of these regulations.</p> <p>The Handbook requires banks as well to adopt a risk-based approach which involves risk identification and assessment, risk mitigation, risk monitoring as well as policies, procedures and controls.</p> <p>A financial services business must regularly review its business risk assessment so as to keep it up to date, prior to the establishment of a business relationship or the carrying out of an occasional transaction, undertake a risk assessment of that proposed business relationship or occasional transaction, regularly review any risk assessment so as to keep it up to date and, where changes to that risk assessment are required, it must make those changes, and ensure that its policies, procedures and controls on forestalling, preventing and detecting money laundering and terrorist financing are appropriate and effective, having regard to the assessed risk.</p> <p>In addition, the Code of practice for Banks states that banks should have a policy statement on ethics and professional behaviour which is clearly communicated to all staff.</p> <p>The Commission carries out AML/CFT through on-site visits to all banks. The visits are</p>
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	<p>prioritised on consideration of the perceived ML/FT risks in the banks' business.</p> <p>All banks also have a condition imposed on their licences to report material adverse events to the Commission. This includes a requirement to notify the Commission as soon as you become aware of any material adverse development surrounding the bank's operations including but not limited to the discovery of fraud or losses from unauthorised trading.</p> <p>Banks do report cases of alleged fraud and unauthorised dealing to the Commission. Rule 29 of the handbook requires the Board of a bank to ensure that the Commission is advised of any material failure to comply with the provisions of the Regulations and the rules in the Handbook and of any serious breaches of the policies, procedures or controls of the financial service business.</p> <p>The Regulations and Handbook require that a systematic approach is applied to a bank's overall risk management.</p> <p>Regulation 3 of the Handbook requires banks to carry out a suitable and sufficient business risk assessment and ensure it is reviewed and updated as the business evolves. Banks must identify their risk appetite and determine relationships that the bank will not accept.</p> <p>Rule 50 of the Handbook requires that for a financial services business to consider the extent of its potential exposure to the risk of money laundering and terrorist financing it must assess the risk of any proposed business relationship or occasional transaction. Based on this assessment, the financial services business must decide whether or not to accept each business relationship and whether or not to accept any instructions to carry out any occasional transactions.</p> <p>Certain other regulations in the Handbook stipulate details on the know your customer procedures, per example that any person purporting to act on behalf of the customer has to be identified and his identity and his authority to so act shall be verified, the beneficial owner and underlying principal shall be identified and reasonable measures shall be taken to verify such identity using identification data and such measures shall include, in the case of a legal person or legal arrangement, measures to understand the ownership and control structure of the customer. In addition is stipulated that a determination shall be made as to whether the customer is acting on behalf of another person and, if the customer is so acting, reasonable measures shall be taken to obtain sufficient identification data to identify and verify the identity of that other person.</p> <p>Enhanced customer due diligence means according to the Handbook obtaining senior management approval for establishing a business relationship or undertaking an occasional transaction, obtaining senior management approval for, in the case of an existing business relationship with a Politically Exposed Person, continuing that relationship, taking reasonable measures to establish the source of any funds and of the wealth of the customer and beneficial owner and underlying principal, carrying out more frequent and more extensive ongoing monitoring and taking other steps as would be appropriate to the particular business relationship.</p> <p>Politically exposed person are explicitly defined in the Handbook.</p> <p>Rule 70 requires that where the individual (or business relationship to which he is</p>
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	<p>connected) presents a high risk, a financial services business must consider whether additional verification checks are necessary.</p> <p>The data to be collected on an individual are stipulated in Rule 74. Accordingly, a financial services business must collect relevant identification data on an individual, which includes legal name, any former names (such as maiden name) and any other names used, principal residential address, date and place of birth, nationality, any occupation, public position held and, where appropriate, the name of the employer; and an official personal identification number or other unique identifier contained in an unexpired official document (for example, passport, identification card, residence permit, social security records, driving licence) that bears a photograph of the customer.</p> <p>Rule 51 provides that a financial services business must have documented procedures which will allow it to demonstrate how the assessment of each business relationship has been reached, and which take into account the nature and complexity of its operation.</p> <p>Rule 52 requires that a financial services business with a diverse customer base or where a wide range of products and services are available must develop a more structured and rigorous system to show that judgement has been exercised on an individual basis rather than on a generic or categorised basis.</p> <p>Rule 160 requires that where a financial services business has assessed, taking into account the high risk indicators, that the business relationship or occasional transaction is a high risk relationship – whether because of the nature of the customer, the business relationship, or its location, or because of the delivery channel or the product/service features available – the financial services business must ensure that its policies, procedures and controls require enhanced CDD measures to be undertaken as required in Regulation 5.</p> <p>Chapters 4, 5 and 6 of the Handbook set out the rules and provide guidance in respect of the Customer Due Diligence procedures to be undertaken by a financial services business in order to meet the requirements of the Regulations in circumstances where the risk of a particular business relationship has been assessed as high, medium or low.</p> <p>Regulation 8 (2) states that a financial services business must not enter into, or continue, a correspondent banking relationship with a shell bank, and take appropriate measures to ensure that it does not enter into, or continue, a correspondent banking relationship where the respondent bank is known to permit its accounts to be used by a shell bank.</p> <p>The determination of correspondent banking relationships was considered as part of the CFC/TF risk assessment review analysis following submission of the review business risk assessments of all Guernsey banks in February 2008. This continues to be considered as part of the on-site reviews of banks.</p> <p>Regulation 8 of the Criminal Justice (Proceeds of Crime) (Financial Services Business) Regulations 2007 as amended states that a financial services business must not enter into, or continue, a correspondent banking relationship with a shell bank. No correspondent accounts have been identified.</p> <p>In February 2008, following the introduction of the Regulations and the Handbook, all banks were required to submit a business risk assessment to the Commission pursuant</p>
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	<p>to Regulation 3 taking into account their customers, products and services and the way in which they provide those services.</p> <p>Further to the introduction of the Regulations and the Handbook a desk-based review of customer due diligence held by banks was carried out by the Commission. Where gaps were found banks were required to take corrective measures with a deadline for completion being imposed.</p> <p>The Commission's Banking Division has carried out a series of on-site Countering Financial Crime and Financing Terrorism (encompassing fraud prevention) inspections to banks since 1999. These visits focus on the assessment of customer related risk, customer due diligence; account opening, anti-money laundering, fraud prevention and countering the financing of terrorism controls.</p> <p>The Commission intends to review all banks AML/CFT systems against the new Regulations and Handbook in less than three years.</p> <p>An on-site visit for the Banking Division follows a pre-set process to ensure consistency. For example the Banking Division uses an internal questionnaire, modelled around the Regulations and Handbook, on its site-visits and also uses this as part of the audit trail. Appendix 13 is the questionnaire and Appendix 110 provides the 2009 On-site schedule, an example of the project overview to date, together with the 2010 On-site schedule.</p> <p>One of the constituent elements of the BSL Section 36C Annual Review requires banks to review whether any activity has been entered into in the course of the bank's business in respect of which no director of the institution has a sound knowledge and review whether there has been effective control by the bank's board of directors over every aspect of risk management (see attached Appendix 76 'Form AR').</p> <p>Under Section 9 of the BSL the Commission may impose conditions on a bank's licence. A contravention of a condition of a banking licence can be a ground for a license revocation. Conditions imposed that the bank is complying with its anti-money laundering obligations are not explicitly stated in section 9.</p> <p>In 2009, one bank had a licence condition imposed following an on-site visit which revealed weaknesses in particular on transaction monitoring. The bank has been part of a remedial action plan to deal with the licence condition.</p> <p>On notification of a Countering Financial Crime and Terrorist Finance on-site visit the Commission requires both branches and subsidiaries of a bank to submit pre-visit material. One element is a copy of the latest report by internal auditors of the bank relating to client take-on, countering financial crime and terrorist financing. The submitted report(s) is used to conduct desk based pre-on-site analysis.</p> <p>Internal audit and external expert reports are made available by a bank during an on-site visit at the request of the Commission.</p> <p>Regulation 15 requires banks to establish such other policies, procedures and controls as may be appropriate and effective for the purposes of forestalling, preventing and detecting money laundering and terrorist financing and to establish and maintain an effective policy, for which responsibility must be taken by the board, for the review of its compliance with the requirements of these Regulations and such policy shall include</p>
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	<p>provision as to the extent and frequency of such reviews.</p> <p>The Banking Division gains assurance that banks have established policies and processes to designate compliance officers at the management level through ongoing prudential supervision, the section 36C annual review which requires banks to review the control systems to ensure that there has been effective control by the board of directors or management board of a branch over every aspect of risk management, and in particular its CFC/TF on-site visits.</p> <p>Regulation 12 requires that a financial services business shall appoint a person of at least management level as the money laundering reporting officer and provide the name and title of that person to the Commission and the Financial Intelligence Service as soon as is reasonably practicable and, in any event, within fourteen days starting from the date of that person's appointment, nominate another person to receive disclosures, under Part I of the Disclosure Law and Section 15 of the Terrorism Law ("nominated officer"), in the absence of the money laundering reporting officer, and ensure that any relevant employee is aware of the name of that nominated officer. In addition a financial services business has to ensure that where a relevant employee, other than the money laundering reporting officer, is required to make a disclosure under the Terrorism Law, that this is done by way of a report to the money laundering reporting officer, or, in his absence, to a nominated officer.</p> <p>Section 22A of the BSL requires banks to notify the Commission of a proposal to appoint a manager and obtain the Commission's approval of the appointment. The Commission requires a Personal Questionnaire to be submitted by all bank staff at level of manager or above, including the MLRO, in order for the Commission to be able to make a judgement of fit and properness.</p> <p>Paragraph 35 of the Handbook states conditions regarding the appointment of the MLRO and deputy MLRO. Among others both have to be employed by the financial services business (exception provided regarding administered banks), have to be resident in Guernsey, must have sufficient resources to perform his duties, must have access to the CDD records, must be available on a day to day basis, have to report directly to the Board and must be fully aware of both his obligations and those of the financial services.</p> <p>Regulation 13 requires that a financial services business shall maintain appropriate and effective procedures, when hiring employees, for the purpose of ensuring high standards of employee probity and competence.</p> <p>A bank's screening policies and processes are reviewed during the CFC/TF on-site visits.</p> <p>Regulation 13 of the Handbook states that a financial services business shall ensure that relevant employees receive comprehensive ongoing training in the relevant enactments, these Regulations and the Handbook, the personal obligations of employees and their potential criminal liability under these Regulations and the relevant enactments, the implications of non-compliance by employees with any rules or guidance made for the purposes of these Regulations, and its policies, procedures and controls for the purposes of forestalling, preventing and detecting money laundering and terrorist financing.</p> <p>A financial services business shall identify relevant employees who, in view of their particular responsibilities, should receive additional and ongoing training, appropriate to</p>
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	<p>their roles and must provide such additional training.</p> <p>During the Commission's CFC/TF on-site visits the existence and extent of ongoing training is assessed. Where it is necessary the on-site team identify specific areas requiring additional training of staff including correct identification of risks in customer relationships.</p> <p>The Handbook requires banks to have clear policies and process for reporting financial services abuse to the appropriate personnel within the bank.</p> <p>Paragraph 35 states that the MLRO and any deputy MLROs that are appointed must have sufficient resources to perform his duties.</p> <p>Paragraph 273 of the Handbook states that a financial services business must have appropriate and effective internal reporting policies, procedures and controls to ensure that all employees of the financial services business know to whom within the financial services business and in what format their suspicions must be reported, all suspicion reports are considered by the MLRO and where the MLRO makes a decision not to make a disclosure to the FIS, the reasons for the decision not to disclose are documented and retained and once a disclosure has been made to the FIS, the MLRO immediately informs the FIS where subsequent, relevant information or documentation is received.</p> <p>The Commission reviews records of suspicious transaction reports made by staff to the MLRO and disclosures to the FIS during on-site visits to confirm compliance with these requirements.</p> <p>Section 49(5) of the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999 states that a disclosure made to a police officer or to any other person or body under the provisions of regulations under subsection shall not be treated as a breach of any obligation as to secrecy or other restriction upon the disclosure of information imposed by statute or contract or otherwise and shall not involve the person making it in any liability of any kind to any person by reason of such disclosure.</p> <p>The Commission has an obligation to make disclosures to the FIS and has done so. Disclosures are made under the Terrorism and Crime (Bailiwick of Guernsey) Law, 2002, and The Disclosure (Bailiwick of Guernsey) Law, 2007.</p> <p>If the Commission did not have in place adequate procedures for reporting suspicious transactions under the CJL then it would be in breach of Regulation 12 of the Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 as amended.</p> <p>The FSC and BSL Laws permit the Commission to share information if it is for the purpose of the investigation prevention or detection of crime or with a view to the investigation of, or otherwise for the purposes of, any criminal proceedings.</p> <p>The Commission shares such information with both domestic and foreign financial sector supervisory (and law enforcement) authorities. This is carried out using the gateways contained in the Money Laundering (Disclosure of Information) Laws (MLDIs), The Disclosure (Bailiwick of Guernsey) Law, 2007, Section 44 of the BSL and Section 21 of the FSC Law. The MLDIs state in connection with reports on the proceeds of crime</p>
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	<p>that no obligation or secrecy or confidence or other restriction on the disclosure of information to which any person may be subject, whether arising by statute, contract or otherwise, shall be regarded as being contravened by reason of the disclosure by that person or be any of his officers, servants or agents to Her Majesty's Procureur or Comptroller, to any member of the salaried police force of the Island of Guernsey, to any officer of customs and excise any officer or servant of the Guernsey Financial Services Commission authorised by the Commission to receive disclosures for the purpose of this Law.</p> <p>Section 44 of the BSL states that, information relating to the business or other affairs of a person (including a bank) may be disclosed under the following circumstances (inter alia) that the disclosure of information for the purpose of enabling or assisting a relevant supervisory authority in a country outside the Bailiwick to exercise its supervisory functions.</p> <p>Section 21 of the FSC Law states that the Commission may disclose information if such a disclosure appears to the Commission to be (inter alia) for the purpose of the investigation, prevention or detection of crime or with a view to the investigation of, or otherwise for the purposes of, any criminal proceedings, in connection with the discharge of any international obligation to which the Bailiwick is subject, or to assist, in the interests of the public or otherwise, any authority which appears to the Commission to exercise in a place outside the Bailiwick functions corresponding to any of the functions of the Commission.</p>
Assessment	Compliant
Comments	It should be noted that many relevant rules on money laundering are included in the Handbook for Financial Services Business on Countering Financial Crime and Terrorist Financing. According to the opinion of the Law Officers of the Crown and the Commission, the rules in the Handbook are legally binding, although this has not been tested in the courts.
Principle 19.	Supervisory approach. An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.
Description	<p>The BD carries out both on and off-site supervision of banks to maintain comprehensive risk profiles of licensees.</p> <p>On-site supervision includes both annual prudential visits and visits carried out by BD including CFC/TF, credit and thematic reviews such as outsourcing and business continuity planning. The CFC/TF review includes interviewing and challenging staff at several levels of the bank using a standard template. Samples of client files are also reviewed. The credit reviews are carried out at licensees with lending as a significant business line. A pro-forma questionnaire is used for these visits and staff at various levels are interviewed and credit files examined. A similar procedure is adopted for thematic reviews.</p> <p>Off-site work includes analysis of monthly and quarterly statistical, locational and prudential returns. The quarterly prudential returns are verified in arrears on a sample basis (sampled by GFSC staff) by external auditors who must report exceptions to the GFSC. Annual accounts and external auditor's management letters are also reviewed and analysed by the BD.</p> <p>SREP work is a mixture of on and off-site work. The GFSC has also developed</p>

	<p>procedures for the SREP.</p> <p>The annual off-site review (BSL:s36A) is copied to the GFSC and this includes the licensees' own assessments of the risks they face and how those risks are managed and mitigated.</p> <p>The GFSC undertakes an annual risk grading review of all licensed institutions. This entails completion by analysts of a risk grading review questionnaire for each licensee. Upon the questionnaire's completion by the analyst a number of meetings are held within the BD where each analyst will present his/her findings. The meeting provides challenge and in some cases additional support for the analyst's conclusions. Licensees can then be graded either "high", "medium" or "low".</p> <p>One purpose of the risk grading is to determine the supervisory programme. However, in 2008 and 2009 this cycle was broken due to the need to deal with the banking crisis. For example, a crisis at the parent of Fortis had to be dealt with even though the subsidiary of this bank was not rated as high-risk by the GFSC. In addition, the need to deal with licensees at-risk required large amounts of BD staff time. Moreover, in 2009 one priority was the processing of the ICAAPs of all banks, whatever their internal rating, so as to passport them all onto Basel II. Now that the banking system is more stable, risk gradings – informed by ICAAPs – are again at the heart of GFSC's supervision.</p> <p>Other off-site supervision includes monitoring media and the market place; exchanging information with other supervisors and law enforcement agencies and visits from head office personnel, directors, compliance officers, MLROs, external auditors and visiting regulators. Trends are also monitored through consolidated statistics gathered from the various prudential and statistical returns. Cross-sectoral issues within Guernsey are routinely raised and resolved within the GFSC, as a unified regulator, at the fortnightly Head of Departments meetings and the Commissioners' meetings. Presentations are made to the Commissioners by the BD regarding material issues at each Commissioners' meeting and periodic presentations are made regarding banking sector statistics.</p> <p>The level of grading is a driver for the GFSC's supervisory work. A high risk licensee may have an annual on-site visit for credit reviews and CFC/TF as well as the normal prudential visits, and BSL (s36C) reviews; medium risk banks may also be visited annually for prudential visits and over a two year cycle for CFC/TF; low risk licensees may be visited by the GFSC biennially for prudential visits and for CFC/TF reviews over a three year cycle.</p> <p>Analysis of quarterly prudential returns and audited accounts (with audit reports) provides information to check that licensees meet their requirements for large exposures, capital requirements and loan provisioning. It also ensures that they are meeting their requirements to produce audited accounts in the manner and at a time determined by the GFSC.</p> <p>On-site visits also help to ensure the minimum criteria for licensing (BSL: Sched. 3) are being met and that the Regulations and Handbook are being followed. Credit reviews are also used to help assess licensees' compliance with "minimum criteria", with Principle 1/1994/24, with loan classification requirements of the BSL/1, with the Code of Practice for Banks and with the Basel Committee's Principles for the Management of</p>
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	<p>Credit Risk.</p> <p>Two of the conditions imposed on all licences are:</p> <p>“there shall be no significant change in the nature of the business conducted without prior consultation with the Commission;” and</p> <p>“Senior management should notify the Commission as soon as they become aware of any material adverse development surrounding the bank’s operations including but not limited to:</p> <ul style="list-style-type: none"> • breaches of legal obligations; • breaches of prudential supervisory requirements; • the discovery of fraud or losses from unauthorised trading; • decisions to write off bad debts or to make new specific loan provisions; • involvement by the bank or its senior staff in litigation; or a significant deterioration in profitability.” <p>In addition, licensees’ external auditors are required to communicate to the GFSC</p> <p>“circumstances which are such as to give the auditor or other person reasonable cause to believe –</p> <p>(a) that any of the criteria specified in Schedule 3 of the Law is not or has not been fulfilled or may or may not have been fulfilled in respect of the licensed institution of which he is auditor or in relation to which his report is made, as the case may be; or</p> <p>(b) that the circumstances are likely to be of material relevance to the exercise, in relation to the said licensed institution, of the Commission’s functions under the Law or under these Regulations.”</p> <p>under section 3 of the Banking Supervision (Bailiwick of Guernsey) Regulations, 1994.</p> <p>In addition, the BSL (s23; s24) requires licensees to notify the GFSC of an acquisition in their capital of a significant shareholding by an investor or the assumption, by the licensee, of a large exposure. The BSL (s 22) requires licensees to notify the GFSC within 14 days of becoming aware of a change in a directorship or manager. Permission in writing from the GFSC is required (BSL: s22A) before a director or manager may be appointed. Moreover, a licensee must notify the GFSC of changes to auditors (BSL: s32) and auditors must inform the GFSC if they intend to resign before the expiration of their term of office or if they are to qualify a licensee’s accounts.</p> <p>The GFSC encourages licensees to have an open relationship with it and expects that they will alert it to issues as they arise. Recently, a few licensees raised with the Commission issues relating to fund of funds exposures.</p> <p>A five quarterly comparison of prudential returns is carried out along with a system that flags any variances in figures over a percentage (e.g. 10%) from quarter to quarter. Ratio analysis and cross checking is also carried out. This analysis and a general review of prudential and statistical returns are used as an input to prudential meetings. In addition, analysis of data on an <i>ad hoc</i> basis is often carried out and used as a factor</p>
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	to determine on-site planning. For example, an analysis of loan books of licensees and of previous visits carried out was used in 2006 to plan the schedule for on-site credit reviews. The BD has adequate information system and staff members with significant experience in analysis and production of statistics.
Assessment	Compliant
Comments	
Principle 20.	Supervisory techniques. An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Description	<p>All on-site and off-site work in the BD is undertaken by the same set of staff. (As a result, the sort of communication problems that can emerge when there is a split between on-site and off-site, as identified by the FSA in its Northern Rock report, are avoided.) Visits to licensed institutions are generally undertaken by Division staff alone, although there are sometimes joint visits with the Policy and International Affairs Division (e.g. on AML/CFT) or one or more of the other regulatory Divisions. Off-site work is generally not contracted out to third parties.</p> <p>The on-site or off-site work programme is determined for the start of each calendar year. In the past all licensees received a prudential visit at least once a year and an on-site visit at least every other year. The revised risk grading approach will change this routine so that the more risky banks will be visited more and less risky less.</p> <p>The annual balance of work may change dependent on developments during the year. For example in 2008 there was a concentration of AML/CFT visits after review of business risk assessments following the introduction of the new Regulations and Handbook. In 2008, due to the need to focus on particular banks during the credit crunch, some prudential visits were substituted with off-site statistical analysis. The mix of focus of work therefore changes in response to business requirements.</p> <p>The GFSC assesses its effectiveness by empirical evidence. Senior management closely review on-site visits and other work to ensure that standards are high and that work is consistent. In addition, Deputy Directors from other regulatory Divisions carried out a peer review of the BD and had to report to the GFSC's Audit and Risk Committee whether or not they felt that international standards are being met. The GFSC has also been subjected to many reviews (e.g. FATF/OGBS, FSF, UK Home Office (Edwards Report), FATF (NCCT), IRS (QI) and IMF), to an external and internal audit function and in addition to the specially commissioned Promontory Report. Finally, the GFSC's annual report is laid before the Island's parliament each year and its activities are thus subject to public scrutiny.</p> <p>The process for planning on-site visits is detailed in the BD's Procedures Manual including Guidance for on-site visits and re-visits.</p> <p>“SCHEDULING</p> <p>A schedule of planned visits is arranged in Autumn each year following risk assessment of banks by a risk assessment panel [consisting of the Assistant and Deputy Director and the Director], for implementation in the following calendar year. Liaison with other Divisions about scheduling is necessary to avoid timing issues. The schedule is renewed and adapted throughout the year where necessary to account for workload and changes in risk assessment.</p>

	<p>The Commission is responsible for setting out the dates on which the Commission will visit the bank. Banks are informed of the on-site visit by letter, issued approximately one month before the visit so that the Commission team has an opportunity to review pre-visit material supplied by the bank and establish working papers.</p> <p>Banks should request changes to on-site visit timing in writing. Changes to planned dates will only be accepted if there are serious operational difficulties that might affect the ability of the bank to perform its functions e.g. the implementation of major systems change at the time of the planned visit. The Director of Banking or Deputy Director of Banking must authorise changes and the reason documented on file. In addition to the risk of undue influence by the bank, the Commission is committed to a tight schedule and changes can have a significant impact on onward scheduling of visits.”</p> <p>There are also sections in this Guidance (available on staff PCs) on pre-visit analysis, evidence gathering, scoring, post visit analysis and on-site re-visits.</p> <p>The scheduling process will remain the same going forward although the distribution of on-site visits will change as a result of the new Risk Rating approach.</p> <p>Commission staff carry out on-site visits using consistent methodology, responsibilities, objectives and outputs maintained by the use of pro-forma questionnaires by staff and review of all findings letters by both the Director and Deputy Director of Banking.</p> <p>For on-site visits banks are given an Advice Letter explaining the objectives of the visit with documentation requested beforehand. After a visit, banks receive an Exception Letter setting out any material gaps and setting out a timeline for remedial action. Completion of the remedial action is approved by the analyst.</p> <p>The GFSC attaches importance to accurate record-keeping of all on-site or off-site meetings. The quality of the Division's record-keeping in this respect was noted in the Promontory Review.</p> <p>On-site visits to banks in the CFC/TF and fraud prevention visit cycle, the credit review cycle and the annual cycle of prudential meetings (held at banks) all cover corporate governance issues and ascertain the corporate governance processes at banks. This is attained by a combination of interviews, completion and evaluation of questionnaires, and assessment of documents provided by the banks. They are also used to verify information provided by banks, obtain further information from banks and follow up issues of concern. If necessary a follow up on-site review is conducted to ensure appropriate remedial action has been carried out.</p> <p>Off-site work includes analysis of monthly and quarterly statistical, locational and prudential returns. The quarterly prudential returns are verified in arrears on a sample basis (sampled by GFSC staff) by external auditors who are required to report exceptions to the GFSC. Another important off-site tool is the process whereby licensees must submit copies of their annual reviews to the GFSC (BSL:s36). Analysis and follow up of these reviews provide important insights into licensees. Other off-site supervision includes monitoring media and the market place; exchanging information with other supervisors and law enforcement agencies and visits from head office</p>
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	<p>personnel, directors, compliance officers, MLROs, external auditors and visiting regulators. Annual accounts and external auditor's management letters are also reviewed and analysed by BD staff.</p> <p>The GFSC meets MLROs, Heads of Risk and Compliance, Non Executive Directors (NED) and business heads at on-site visits and at prudential meetings. The GFSC routinely asks for sight of internal audit reports if there have been material shortcomings identified.</p> <p>The GFSC periodically meets executives, including risk officers for the parent; and group NEDs at prudential meetings.</p> <p>Going forward, the frequency of the on-site visits will be determined by the risk assessment referred to earlier under CP19 (EC1).</p> <p>Exceptionally, and where particular problems arise, the GFSC requires the presence of key senior banking personnel. (The assessors were made aware of one such meeting with a licensee's NED and the CEO regarding breaches concerning the timeliness in advising the GFSC of material events.</p> <p>The GFSC assesses management quality by personal contact and by requiring directors, company secretaries, money laundering reporting officers (MLROs) and managers reporting directly to the Board to complete and submit a Personal Questionnaire (PQ). This form identifies the person and records their personal and business history, other business interests, their qualifications and experience, and their reputation and character. It is a requirement that the GFSC must be notified immediately of any material changes to the facts declared in a PQ, by way of a personal declaration (Form PD). If it is more than 5 years since a PQ was completed then a new PQ (rather than a Form PD) must be completed.</p> <p>Regular meetings are held with management either at annual prudential meetings, during on-site visits or during frequently held meetings to discuss <i>ad hoc</i> developments. In addition, market intelligence on management can be useful. GFSC executives and staff find this contact and information provides a useful framework from which to assess effectiveness and quality of management.</p> <p>The CFT/TF on-site visit methodology requires the on-site team to consider directors' responsibilities and corporate governance in respect of CFT/TF policies and procedures. Additionally, licensees must submit an annual corporate governance review that assists the GFSC in assessing the strength of the Board. The assessors were made aware of a recent example of the GFSC taking action to improve Board governance resulting in the appointment of a new CEO and identifying a prospective new non-executive director.</p> <p>Internal audit in respect of licensees is generally provided by group internal audit who are typically suitably robust, competent and independent of business lines and management. Although internal audit reports often form part of licensees' Annual Review submissions, sole reliance is not placed on these.</p> <p>All on-site visits are followed up with a closing meeting with management and a formal "exit letter" detailing all exceptions which is first reviewed by the Director of Banking and his Deputy before being sent out. General findings from off-site work are either raised on an <i>ad hoc</i> basis with management via a letter, or are raised during annual prudential</p>
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	meetings with management. The Commission also systematically provides meeting feedback to licensees summarising the action points.
Assessment	Compliant
Comments	
Principle 21.	Supervisory reporting. Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Description	<p>Forms MA/1, BSL/1 BSL/2 and LOC/1 all have to be completed by licensed institutions. A condition is imposed on all licences that:</p> <p style="padding-left: 40px;">“completed prudential returns are provided to the Commission and any other such similar routine returns that may from time to time be required. The Commission will on occasion require an institution to provide confirmation from an external auditor that prudential returns accurately reflect the business on the reporting date.”</p> <p>Form MA/1 includes monetary aggregate statistics, form BSL/2 requires data on on- and off-balance sheet liabilities and assets, profit and loss, capital adequacy, liquidity, large exposures, loan loss provisioning, foreign and exchange rate related contracts, loan classification, staffing, maturity of on and off balance sheet items and deposit currencies. Form LOC/1 includes data on the geographical location of all assets and liabilities by currency.</p> <p>Ahead of the full adoption of Basel II in 2009 - and following a pilot survey - the GFSC issued Basel II compliant modules (Form BSL/2) to every licensed subsidiary and branch in Guernsey. From Q1 2008, the licensed institutions have completed these modules, in the same manner in which form BSL/1 was completed, in order to meet their continuing reporting obligations to the GFSC. The BSL/2 forms continue to give similar profile information such as on- and off-balance sheet assets and liabilities, profit and loss and other such information as listed above while also ensuring that the calculation of the capital resources requirement is compliant with Basel II.</p> <p>Economic sector asset concentrations are picked up from large exposure notifications and from discussions at annual prudential meetings.</p> <p>Due to recent economic difficulties, the GFSC has placed several licensed institutions on enhanced surveillance and has asked for supplementary information, including daily or weekly liquidity monitoring. The resulting assessment, “Banks under Scrutiny”, is submitted to the Commissioners.</p> <p>The GFSC’s Guidance on Verification of Prudential Returns states that reports should be (paragraph 7(d)):</p> <p style="padding-left: 40px;">“prepared, in the case of Guernsey subsidiaries, using the same accounting policies as those applied in the current period of statutory accounts;”</p> <p>The GFSC’s Guidance under the Banking Supervision (Accounts) Rules, 1994 (s1(a)) prescribes the following valuation rules;</p> <p style="padding-left: 40px;">“Debt securities are held for long term investment and included at cost adjusted</p>

	<p>for amortisation of premium and accretion of discounts. Other investments held for the long term are included at cost. Other instruments are included in the balance sheet at market value with any resultant profits and losses included in the profit and loss account.”</p> <p>Data is collected from all licensees monthly, quarterly and annually, and also on an <i>ad hoc</i> basis (e.g. prior to and also during prudential meetings or on-site visits). All data is analysed by the BD and used in preparation for prudential meetings, on-site work or as input for other regulatory actions. Currently, all licensed institutions must submit data at the same frequency, although selected licensees (those with holdings of debt) provide data for the IMF annually.</p> <p>Data is collected from all licensees at the same dates which represent the same periods. Consolidated data is selected from four banks with Jersey branches.</p> <p>The GFSC has never been refused access to a licensed institution’s information or to any director, manager or staff member. Licensees have always provided all information (including that on an <i>ad hoc</i> basis) to the GFSC as requested by the BD. The BSL (s25) provides the GFSC broad powers for obtainment of supervisory information, as under:</p> <p style="text-align: center;"><u>“Power to obtain information and documents.”</u></p> <p>25. (1) The Commission may by notice in writing served on a licensed institution require the institution to provide the Commission-</p> <p style="padding-left: 40px;">(a) at such times or intervals and in respect of such periods as may be specified in the notice, with such information as the Commission may reasonably require for the performance of its functions under this Law;</p> <p style="padding-left: 40px;">(b) with a report, in such form as may be specified in the notice, by a person who is an accountant or has relevant professional skill and who is nominated or approved by the Commission on, or on any aspect of, any matter in relation to which the Commission may require information under paragraph (a).</p> <p>(2) The Commission may -</p> <p style="padding-left: 100px;">(a) by notice in writing served on a licensed institution, require it to produce, within such time and at such place as may be specified in the notice, such documents or documents of such description as may be so specified;</p> <p style="padding-left: 100px;">(b) authorise any of its officers, servants or agents, on producing evidence of his authority, to require a licensed institution to furnish him forthwith with such information and documents as he may specify, being such information or documents as the Commission may reasonably require for the performance of its functions under this Law.</p> <p>.....</p> <p>(5) If it appears to the Commission to be desirable in the interests of the</p>
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	<p>depositors or potential depositors of a licensed institution to do so, the Commission may also exercise the powers conferred by this section in relation to any body corporate which is or has at any relevant time been-</p> <ul style="list-style-type: none"> (a) a holding company, subsidiary or related company of the licensed institution; (b) a subsidiary of a holding company of the licensed institution; (c) a holding company of a subsidiary of the licensed institution; or (d) a body corporate in the case of which a shareholder controller of the licensed institution, alone or with associates, is entitled to exercise, or control the exercise of, more than 50 per cent of the voting power at a general meeting. <p>Failure to file prudential returns with the GFSC on time is a breach of a licence condition. The BSL (s9(5)) states:</p> <p style="padding-left: 40px;">“An institution which contravenes any condition of a banking licence is guilty of an offence.”</p> <p>Under the FSC(G)L (s11I), the GFSC, after consultation with the Policy Council, by regulation may make such provision as it thinks fit in respect of the charging of administrative financial penalties for the late filing or delivery of documents or information required to be filed or delivered. To date, no such regulations have been made.</p> <p>GFSC’s management notes that, under the FSC(G)L, the GFSC already has powers under its Law to enforce (subject to appeal) discretionary financial penalties should the necessity arise (e.g. in cases of tardy or inadequate filings of prudential returns):-</p> <p>“11D. (1) Where the Commission is satisfied that a licensee, former licensee or relevant officer -</p> <ul style="list-style-type: none"> (a) has contravened in a material particular a provision of, or made under, the prescribed Laws, or (b) does not fulfil any of the minimum criteria for licensing specified in the regulatory Laws and applicable to him, <p>it may, subject to the provisions of Section 11E, impose on him a penalty in respect of the contravention or non-fulfilment of such amount not exceeding £200,000 as it considers appropriate.”</p> <p>To-date, the GFSC has not found it necessary to impose a fine for tardy or inadequate filings of prudential returns.</p> <p>Returns are required to be signed by a person considered to be senior enough to commit the licensee (see “Front Sheet” notes in the GFSC’s Guidance to Prudential and Statistical Returns.)</p>
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	<p>Inaccurate returns are required to be re-submitted if errors are significant. If returns are not completed accurately or there is deliberate mis-representation this could be regarded as a breach of the minimum criterion for licensing that a licensed institution “will conduct its business in a prudent manner” (BSL Sched. 3 s6 (1)) and as such the licence may be made subject to conditions (BSL:s9(4)) or, in the extreme case, revoked (BSL:s8(1)).</p> <p>A condition on all licences states that the “(GFSC) will on occasion require an institution to provide confirmation from an external auditor that prudential returns accurately reflect the business on the reporting date”.</p> <p>Supervisory returns are verified on a sample basis by external audit. The GFSC selects each year, in arrears, one of the four quarterly returns submitted by each licensee. The auditors have to verify the contents of that return to the licensee’s books and records. Details of how to verify a return and what the auditor’s opinion should state are given in the GFSC’s Guidance on Verification of Prudential Returns.</p> <p>The BSL (ss25(1)) empowers the GFSC to establish the scope of the work to be performed by an external expert in regard to a licensed institution and the standards to be followed in its conduct:</p> <p>“The (GFSC) may by notice...served on a licensed institution require the institution to provide the (GFSC) –</p> <p style="padding-left: 40px;">b. with a report in such form as may be specified in the notice, by a person who is an accountant or has relevant professional skill and who is nominated or approved by the (GFSC) on, or on any aspect of, any matter in relation to which the (GFSC) may require information (for performance of its functions under the BSL).”</p> <p>The GFSC uses external experts (auditors) for both routine validation (the verification of prudential returns on a sample basis) and also to conduct a review of specific aspects of a licensee’s business. The assessors were informed (by licensee executives) of a recently concluded example of the latter – concerning the control environment of a licensee - in the course of the assessment.</p> <p>The Banking Supervision (Bailiwick of Guernsey) Regulations, 1994 state:</p> <p style="padding-left: 40px;">“3 (1) Matters are to be communicated to the Commission as mentioned in Section 33(1) of the Law [BSL] by an auditor or other person described in that section in the circumstances specified in paragraph (2).</p> <p style="padding-left: 120px;">(2) The circumstances referred to in paragraph (1) are circumstances which are such as to give the auditor or other person reasonable cause to believe –</p> <p style="padding-left: 160px;">(a) that any of the criteria specified in Schedule 3 of the Law [BSL] is not or has not been fulfilled or may not have been fulfilled in respect of the licensed institution</p>
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	<p>of which he is auditor or in relation to which his report is made, as the case may be; or</p> <p>(b) that the circumstances are likely to be of material relevance to the exercise, in relation to the said licensed institution, of the Commission's functions under the Law [BSL] or under these Regulations.</p> <p>(3) The provisions of this regulation shall also apply in relation to former licensed institutions."</p> <p>The BSL states: -</p> <p>"Communications by auditors to Commission.</p> <p>33. (1) No duty to which an auditor of a licensed institution or a person appointed to make a report under Section 5(5) or Section 25(1)(b) is subject is contravened by reason of his communicating in good faith to the Commission, whether or not in response to a request made by it, any information or opinion on a matter to which this section applies and which is relevant to any function of the Commission under this Law.</p> <p>(2) In relation to an auditor of a licensed institution, this section applies to any matter of which he becomes aware in his capacity as auditor and which relates to the business or affairs of the institution or any associated body thereof."</p> <p>Auditors have communicated matters of concern to the GFSC in the past.</p>
Assessment	Largely Compliant
Comments	<p>The rating reflects three factors. First, GFSC accepts certification from an official "senior enough to commit the licensee". Standard practice in certain jurisdictions is to require the CEO and the CFO/Comptroller to provide certification. As respects imposition of penalties for "late filing...of information required....", at the time of the mission's on-site work, the GFSC had yet to set in place regulations to impose administrative penalties contemplated by the FSC(G)L. Implementation of Section 6B of the Banking Supervision (Bailliwick of Guernsey) Regulations 2010, which came into operation on 30 April 2010, will rectify this omission. Lastly, the FSAP team became aware in the course of their work of the mis-classification of one significant transaction involving asset-backed securities where the misclassification continued on the .balance sheet over several quarters.(GFSC had been informed of the transaction before its execution.)</p>
Principle 22.	<p>Accounting and disclosure. Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.</p>
Description	<p>The BSL (Sched.3 (s6) – Minimum Criteria for Licensing) states:</p> <p>"6(2)(d) An institution shall not be regarded as conducting its business in a prudent manner unless it maintains.... (i) adequate accounting and other records of its business and (ii) adequate systems of control of its business and records.</p> <p>(4)(c) For the purposes of sub-paragraph 2(d)-</p>

	<p>(i) records and systems shall not be regarded as adequate unless they are such as to enable</p> <p>(A) the business of the institution to be managed prudently, and</p> <p>(B) the institution to comply with the duties imposed on it by or under this Law.....</p> <p>(ii) in determining whether those systems are adequate the (GFSC) shall (without limitation) have regard to the functions and responsibilities in respect of them of any of the institution's directors."</p> <p>Section 36C of The BSL (s36C) also requires a licensed institution to review- at least annually - whether its financial record keeping systems and data systems are reliable and, as well, to review whether it has in place control systems which are effective to ensure that all returns and other documents required by or under the BSL to be submitted to the GFSC are duly submitted and that any inaccuracies in any such returns and other documents are identified, corrected and reported expeditiously. Equally, shortcomings or deficiencies must be reported to the GFSC immediately, along with proposed remedies.</p> <p>The BSL (s31) requires audited accounts to be made publicly available. In addition, the Banking Supervision (Accounts) Rules, 1994 state:</p> <p>"1. In the case of a licensed institution incorporated in the Bailiwick –</p> <p>(a) audited accounts of the institution containing at least the information (including notes and statements) set out in guidelines issued from time to time by the Commission shall be drawn up to dates at intervals not exceeding twelve months unless other arrangements have been specifically agreed in writing with the Commission.</p> <p>(b) not later than three months after each date to which the said audited accounts are drawn up, except with the prior specific written consent of the Commission –</p> <p>(i) a copy thereof shall be delivered to the Commission; and</p> <p>(ii) either those audited accounts or abridged accounts containing at least the information set out in guidelines issued from time to time by the Commission shall be available to any person on request; and</p> <p>(c) the auditor's report on the accounts of the licensed institution shall include, <i>inter alia</i>, statements on the following matters:</p> <p>(i) the basis of the auditor's opinion;</p> <p>(ii) whether, in the auditor's opinion, the accounts (and, in the case of group accounts submitted by a holding company, the group accounts) show a true and fair view and have been properly prepared in accordance with applicable accounting standards and also in accordance with the provisions of the Law and of the Companies (Guernsey) Law, 1994; and</p>
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	<p>(iii) as regards the abridged accounts as described in paragraph (b)(ii) of this rule, a statement to the effect that they have been drawn up in accordance with the provisions of the Law and in a manner authorised by the Commission; and in the case of such abridged accounts the auditor's report shall also include a verbatim copy of the auditor's report on the audited accounts.</p> <p><u>A licensed institution whose principal place of business is outside the Bailiwick</u></p> <p>2. In the case of a licensed institution whose principal place of business is outside the Bailiwick the latest audited accounts of the main group shall be:</p> <p>(i) delivered to the Commission not later than one month following publication; and</p> <p>(ii) available to any person on request."</p> <p>The GFSC's Guidance issued under the Banking Supervision (Accounts) Rules (s1(a)). 1994 requires a director's report to be included in the audited accounts of Guernsey-incorporated licensed institutions.</p> <p>The financial statements of the two licensees reviewed by the assessors both included the qualitative and quantitative information itemized in EC 9.</p> <p>Financial statements are reviewed by BD staff to ensure that disclosures required by the GFSC's Guidance issued under the Banking Supervision (Accounts) Rules (s1(a)), 1994 are made.</p> <p>The GFSC's Guidance issued under the Banking Supervision (Accounts) Rules (s1(a)), 1994 requires auditors preparing audited accounts to value investments as follows:</p> <p>"Debt securities are held for long term investment and included at cost adjusted for amortisation of premium and accretion of discounts. Other investments held for the long term are included at cost. Other instruments are included in the balance sheet at market value with any resultant profits and losses included in the profit and loss account."</p> <p>and require profit and loss accounts which include provisions for loan losses.</p> <p>It also requires auditors to provide an opinion that accounts are prepared in accordance with Accounting Standards issued by the Accounting Standards Board ("ASB") i.e. GAAP. The financial statements of the two licensees reviewed by the assessors both bore basis-of-audit-opinion statements that the auditors had "conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board" and both gave an opinion "in accordance with United Kingdom Auditing Standards". International Standards on Auditing (UK and Ireland) determine (as do US and Canadian generally accepted auditing standards) that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities, derivatives, asset securitizations and the adequacy of</p>
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	<p>internal controls.</p> <p>The BSL (ss25(1)) empowers the GFSC to establish the scope of the external audit of a licensed institution and the standards to be followed in its conduct:</p> <p>“The (GFSC) may by notice...served on a licensed institution require the institution to provide the (GFSC) –</p> <ul style="list-style-type: none"> c. with a report in such form as may be specified in the notice, by a person who is an accountant or has relevant professional skill and who is nominated or approved by the (GFSC) on, or on any aspect of, any matter in relation to which the (GFSC) may require information (for performance of its functions under the BSL).” <p>The FSC(G)L (s11B(1)) permits the GFSC to make a disqualification order against the auditor of a licensee where it is satisfied that the auditor:</p> <ul style="list-style-type: none"> a. has failed to comply with any duty imposed upon him by or under the regulatory Laws, or b. is for any other reason unfit...(whether by reason of lacking the necessary skills or resources to carry out effectively his responsibilities as auditor or otherwise) <p>or that for any other reason it is in the interests of the public or any class thereof to do so.</p> <p>The GFSC publishes aggregate information on the banking system in quarterly web releases, in its annual report, through the BIS, IMF and Bank of England and in the local press.</p>
Assessment	Compliant
Comments	
Principle 23.	Corrective and remedial powers of supervisors. Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.
Description	<p>High level supervisory concerns are taken up with senior management and, where required, the Board. Even where these do not result in license conditions, the GFSC makes it clear how remedial action is to be executed and agrees a timeline (in writing to the licensee) for completion. For high level issues, follow-up is assured through surveillance of the Directors, who in some cases also report to the GFSC's Director General and possibly even the Commissioners. (Examples of this were remedial action programs undertaken by several banks around the Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing).</p> <p>Problem bank situations have, to date, only arisen as a result of failure of the parents of Guernsey licensed institutions. In each case the GFSC has actively participated in deciding when and how to effect an orderly resolution of the problem. Examples are the case of the Guernsey-incorporated subsidiary of Northern Rock PLC and that of Landsbanki Guernsey Limited. In the latter case, the GFSC convened a meeting on 6th October 2008 which included HM Procureur. After discussion, the board of Landsbanki Guernsey Limited decided that night to apply to the Royal Court for an administration order and this was supported by the GFSC.</p>

	<p>The Companies (Guernsey) Law, 2008 (see below) gives administrative provisions to the legislation that allows companies in difficulty to continue as a going concern in order that creditors may recover what they are owed.</p> <p>“Application for administration order.</p> <p>375. (1) An application for an administration order may be made by –</p> <p style="padding-left: 40px;">(e) the Commission, in respect of supervised companies and companies engaged in financial services business”</p> <p>Where, in the GFSC’s view, a licensed institution is not complying with laws, regulations or supervisory decisions or is engaged in unsafe and unsound practices or when depositor’s interests are otherwise threatened, the BSL (s9;s10) affords the GFSC powers to impose conditions on licences and to revoke a banking licence. (Any institution which contravenes any condition of a banking licence is guilty of an offence under the BSL (s9(5)).)</p> <p>Conditions may be imposed “at any time” after granting a banking licence and may be “such conditions in respect of the licence as it (GFSC) thinks fit” (s9(1)). A condition may be varied or rescinded.</p> <p>To protect Northern Rock (Guernsey) Limited customers (and to protect Guernsey’s reputation) in light of events unfolding in the Northern Rock plc crisis, the GFSC placed conditions on the licence of the Guernsey subsidiary. Moreover, widely held market concerns over both the Iceland’s economy and Icelandic banks - together with events in financial markets - led to the GFSC imposing four conditions on the licence of Landsbanki Guernsey Limited in order to support the bank at a time of stress and thereby protect depositors.</p> <p>In serving notice to revoke a banking licence, the GFSC has powers to give the bank such directions:</p> <p style="padding-left: 40px;">“as appear to the (GFSC) to be desirable in the interests of the institution’s depositors or potential depositors, whether for the purpose of safeguarding its assets or otherwise.”</p> <p>In imposing a condition on, or revoking, a banking licence the GFSC must give written notice of its intention and, further, of the licensed institution’s right to appeal under the BSL (s18).</p> <p>Measures available to the GFSC to address scenarios described in EC3 would primarily be achieved by imposition of a license condition (BSL: s9), as under::</p> <p style="padding-left: 40px;">“9(4) Without prejudice to the generality of subsection (1), the conditions which may be imposed in respect of a banking licence may make provision as to the duration of the licence and for the protection of the institution’s depositors or potential depositors; and such conditions may-</p> <p style="padding-left: 80px;">(a) require the institution to take certain steps, to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way:</p>
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	<p>(b) impose limitations on the acceptance of deposits, the granting of credit or the making of investments;</p> <p>(c) prohibit the institution from soliciting deposits, either generally or from persons who are not already depositors;</p> <p>(d) prohibit the institution from entering into any other transaction or class of transactions;</p> <p>(e) require the removal of any director, controller, manager or employee;</p> <p>(f) specify requirements to be fulfilled otherwise than by action taken by the institution;</p> <p>(g) require the furnishing to the Commission, at such times, intervals and places as may be specified by the Commission, of such information and documents, and of accounts of such description, in such form and containing such information and particulars, as may be so specified.</p> <p>(h) prohibit, restrict or impose limitations on the carrying on of deposit taking business, or any class or description of deposit-taking business in or from within any place, or any particular place, outside the Bailiwick-</p> <p style="padding-left: 40px;">(i) by the institution itself;</p> <p style="padding-left: 40px;">(ii) by any undertaking established by the institution (including without limitation any branch or subsidiary thereof); or</p> <p style="padding-left: 40px;">(iii) through or by means of a relationship with any person (including without limitation, a relationship of partnership, affiliation or association)"</p> <p>or by applying to the Court for an injunction under the BSL (ss 35(3)) which states, <i>inter alia</i>:</p> <p style="padding-left: 40px;">“(3) An injunction..... may be granted on such terms and conditions, and may contain such incidental, ancillary, consequential or supplementary provision, as the Court thinks fit including, without prejudice to the generality of the foregoing, provision for the appointment of a receiver or other person to exercise such powers as the Court may consider necessary or expedient for the purpose of ensuring that any assets subject to the injunction are not disposed of or otherwise dealt with in contravention of the injunction, including powers to locate, ascertain, hold, gather in, sequester or take possession or control of any such assets.”</p> <p>The GFSC also has power (BSL: s14; s15) to withhold approvals of intending shareholder controllers or withdraw acceptance of existing shareholder controllers (see CP 4).</p>
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	<p>The BSL (s17A) empowers the GFSC to issue orders against persons considered not “fit and proper” as defined in minimum criteria for licensing (BSL:Sched.3) prohibiting them from performing functions in relation to a deposit taking business.</p> <p>The BSL (Sched.3; Minimum Criteria for Licensing (s6)) states, in part:</p> <p><u>“Business to be conducted in prudent manner</u></p> <p>“6(1) The institution conducts.... its business in a prudent manner.</p> <p>(2)an institution shall not be regarded as conducting its business in a prudent manner unless;</p> <p>(a) it maintains a capital base...of an amount which the (GFSC) considers appropriate</p> <p>(4)(a) For the purposes of subparagraph 2(a), an appropriate amount is</p> <ul style="list-style-type: none"> (i) an amount commensurate with the nature and scale of the institution's operations; and (ii) of an amount and nature sufficient to safeguard the interests of the institution's depositors and potential depositors, having regard to <ul style="list-style-type: none"> (A) the nature and scale of the institution's operations; (B) the risks inherent in those operations and in the operations of any other institution in the same group so far as capable of affecting the institution, and (C) any other factors appearing to the (GFSC) to be relevant.” <p>The GFSC sets a minimum Risk Asset Ratio (RAR) for each licensed institution which it monitors through prudential reporting. If the RAR to within 1 per cent of the minimum, the GFSC raises the issue with management and, if necessary, will take appropriate measures to request injection of further capital voluntarily. (If cooperation was not forthcoming, the GFSC could impose license conditions and, at the extreme, revoke the licence.)</p> <p>The GFSC may impose conditions on a bank's licence to “require the removal of any director, controller or manager” (BSL: ss9(4)(e)). Directions from the GFS when serving notice to revoke a bank's licence may also “require the removal of any director, controller or manager” (BSL: ss12(2)(e)). In regard to injunctions issued by the Court (BSL:s35) on the application of the Commission, the following is stated:</p> <p>“(35)(2) If on the application of the (GFSC) the Court is satisfied that a person may have been guilty of a contravention mentioned in subsection (1)(a), the Court may grant an injunction restraining him or any of his associates or controllers from disposing of or otherwise dealing with any assets or class or description of assets while the suspected contravention is investigated.”</p> <p>Under The FSC(G)L, the GFSC has powers to enforce discretionary financial penalties:-</p> <p>“11D. (1) Where the (GFSC) is satisfied that a licensee, former licensee or relevant officer -</p>
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	<p>(a) has contravened in a material particular a provision of, or made under, the prescribed Laws, or</p> <p>(b) does not fulfil any of the minimum criteria for licensing specified in the regulatory Laws and applicable to him,</p> <p>it may, subject to the provisions of Section 11E, impose on him a penalty in respect of the contravention or non-fulfilment of such amount not exceeding £200,000 as it considers appropriate.</p> <p>Generally the GFSC's communication with a licensed institution's management and Board is a mix of verbal and written communication. The GFSC has found the range of available actions described above as adequate and effective in the enforcement of its instructions and requirements. (The assessors were made aware of one example from the last few years where the GFSC successfully made it clear that a different CEO was required.)</p>
Assessment	Compliant
Comments	
Principle 24.	Consolidated supervision. An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Description	<p>The GFSC is aware of the structure of the banking groups which supply the jurisdiction's licensed institutions either as Guernsey-incorporated subsidiaries or branches. Regular bi-lateral meetings are held with the bulk of the home supervisors concerned and, as well, with other host supervisors of members of those same banking groups.</p> <p>There are currently no banking subsidiaries of Guernsey-incorporated banks and only four overseas branches; all in Jersey.</p> <p>As unitary regulator, the GFSC is aware of the overall structure of operations and activities of the group in Guernsey (see also CP 5, regarding the prior permission requirement of the GFSC for branches and subsidiaries.).</p> <p>The GFSC's functional structure seeks to ensure that staff responsible for supervising a bank is also aware of local activities of other parts of the bank and its subsidiaries, including investment business and insurance activities.</p> <p>The BSL (ss25(5) through(8)) provides broad powers to obtain information in developing an overall group perspective (see ss25(5) reproduced below);</p> <p>“ (5) If it appears to the Commission to be desirable in the interests of the depositors or potential depositors of a licensed institution to do so, the Commission may also exercise the powers conferred by this section in relation to any body corporate which is or has at any relevant time been-</p> <p>(a) a holding company, subsidiary or related company of the licensed institution.</p> <p>(b) a subsidiary of a holding company of the licensed institution;</p>

	<p>(c) a holding company of a subsidiary of the licensed institution; or</p> <p>(d) a body corporate in the case of which a shareholder controller of the licensed institution, alone or with associates, is entitled to exercise, or control the exercise of, more than 50 per cent of the voting power at a general meeting.</p> <p>(The BSL (s27) affords similar capacity to that above to an Inspector appointed by the GFSC. How (and whether) that capacity could be used in practical terms has not been tested.)</p> <p>All activities of a licensed institution are discussed during annual prudential meetings. Any investment, insurance or fiduciary activities in Guernsey is subject to licensing and regulation by the GFSC. The BD works closely with sister Divisions in an effort to be fully aware of risks those activities might bring to the banking license holder. The risks of non-banking activities carried out by the parent of a bank are also considered (in light of potential reputational risk to the group). Finally, non-banking risks in non-Guernsey subsidiaries are also closely monitored. Where activities of such subsidiaries are significant, their accounts are required and Guernsey management are expected to know the risks to the bank in their non-Guernsey entities. Bilateral discussions are held with regulators of overseas subsidiaries of Guernsey-licensed banks. Periodic on-site visits are also made to the overseas non-bank subsidiaries.</p> <p>The GFSC has certain powers to implement prudential standards on a consolidated basis. As regards large exposures, where a licensed institution has subsidiaries which are not licensed institutions, the GFSC <u>may by notice</u> direct that consolidated reporting occur (BSL:(ss24(3))). The GFSC measures capital adequacy on a consolidated basis.</p> <p>Under guidance issued under s1 (a) of the Banking Supervision (Accounts) Rules, 1994 banks are required submit consolidated annual audited financial statements.</p> <p>The BD works with sister Divisions and overseas regulators to ensure that information on financial condition, risk management and controls are well understood for material subsidiaries and branches of Guernsey licensed institutions. Bilateral meetings are also held annually with home supervisors in the UK, Switzerland, Jersey, Isle of Man, Cyprus and Bermuda (which together are home or consolidated supervisors of the majority of Guernsey-licensed institutions). The GFSC also periodically attends college and regulator meetings (recently in Chicago, Bermuda, Athens and Brussels). As noted elsewhere, the GFSC requires annual written confirmation from each overseas regulator that the latter's bank is in compliance with regulatory requirements and in satisfactory condition with respect to soundness and overall financial position, and that in its supervisory activities such regulator will continue to take into account the business in Guernsey in satisfying itself as to the overall prudential soundness of the group on a consolidated basis. Moreover, the overseas regulator is required to disclose whether it has imposed any special conditions on the bank which are relevant to the business in Guernsey, and whether there are any issues or information for the GFSC's attention.</p> <p>(The GFSC has sought to improve the structure of relations with home regulators. To this end it has written a code of practice, now adopted by the OGBS, and sought agreement from the CEO of the UK FSA on adopting elements of the code. This matter remains outstanding.)</p>
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	<p>The GFSC may impose conditions on a bank's licence circumscribing a branch or subsidiary's range of activities (BSL: ss9(4)(h)). Given the limited activities of licensed institutions, the GFSC has not had extensive recourse to this power, although certain institutions have received direction to diversify asset mix so as to reduce exposure to their parents and affiliates. In certain instances, receipt of such direction has led to the licensed institution surrendering its license and ceasing operations in Guernsey.</p> <p>In the few cases where Guernsey-licensed institutions have active overseas subsidiaries, the GFSC has ensured that sufficient management information is provided to Guernsey-based management. The GFSC uses the BSL (s36C(d)(f)) review process to obtain information on senior management of subsidiaries and branches to satisfy itself that they are fit and proper. Active subsidiaries must submit audited accounts to GFSC.</p> <p>The adequacy of oversight of a licensed institution's foreign operations is assessed in the GFSC's programme of annual prudential meetings and on-site supervision. (As noted above, there are currently no banking subsidiaries of Guernsey-incorporated banks and only four overseas branches; all in Jersey.)</p> <p>During overseas on-site visits, information reporting, compliance, internal controls and oversight are considered. In addition, during prudential meetings and on-site visits in Guernsey oversight of overseas branches and subsidiaries is discussed. Overseas operations are also subject to oversight by the host supervisor and external audit.</p> <p>Conditions may be imposed on a licensed institution to restrict the scope of its business or "prohibit, restrict or impose limitations on the carrying on of deposit taking business, or any class or description of deposit-taking business in or from within any place, or any particular place, outside the Bailiwick by the institution itself or by any undertaking established by the institution (including without limitation any branch or subsidiary thereof) or through or by means of a relationship with any person (including without limitation, a relationship of partnership, affiliation or association" (BSL:ss9(4)).</p> <p>The GFSC does not permit Guernsey-licensed institutions to conduct foreign operations of a higher risk profile or in jurisdictions with a markedly different supervisory regime.</p>
Assessment	Compliant
Comments	
Principle 25.	Home-host relationships. Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Description	<p>Reference is made to CP 1(6)(ECs 2;3) and CP 24 on information sharing.</p> <p>The GFSC operates primarily as a host regulator for branches and Guernsey-incorporated subsidiaries of banks incorporated elsewhere. It engages regularly with home regulators of those licensed institutions and, as well, with host regulators of those Guernsey-incorporated banks having branches or subsidiaries of-Island. The level of this dialogue appears adequate for each supervisor's respective roles and responsibilities in the normal course, but limitations vis-a-vis home regulators were apparent in the extreme situations encountered in 2007 and 2008.</p> <p>Letters are exchanged each year with home regulators of banks in Guernsey to confirm</p>

	<p>the banks' good standing in their home jurisdiction. Where appropriate, the GFSC copies its letters to a Guernsey-licensed institution to the home regulator. (Recent examples were provided to the assessors.)</p> <p>The only jurisdiction where Guernsey-incorporated banks currently have significant overseas operations is Jersey and the GFSC enjoys a good working relationship with its Jersey counterpart extending, in one instance, to a joint meeting with an institution active in both jurisdictions (MOUs were agreed with the Jersey Financial Services Commission in 1998).</p> <p>For the mechanism of surveillance of parental supervisors of banks see CP 24.</p> <p>In practice the GFSC has found that it alone initiates contact with the home supervisor when there are developments in the parent bank. In practice, the GFSC notes that in crisis situations, home supervisors do not give it key information relating to the parent, even though the Guernsey operation helps fund the latter. The most recent examples of this were in relation to the UK FSA and the Icelandic FME.</p> <p>The GFSC takes care to ensure that the home supervisor is aware of material issues in Guernsey. In particular, the GFSC meets the UK FSA and FINMA at least once a year, and meets other home supervisors periodically. It copies letters licensed institutions to the relevant home supervisor when there is a material issue and briefs them by 'phone if any urgent material issues arise. The GFSC appears proactive in trying to create a dialogue between itself and the home supervisor, periodically asking the home supervisor for information on particular points. The asymmetry of the home/host relationship is a limiting factor to dialogue.</p> <p>Guernsey has no "indigenous" (domestic) banks; its regulatory requirements apply equally to all licensed banks, all of which are branches or subsidiaries of overseas banking groups.</p> <p>As a matter of policy, a letter is always sent to the home country supervisor before licensing a bank in Guernsey requiring the home country supervisor to confirm (<i>inter alia</i>):</p> <p>"(a) that you have no objection to the establishment of the branch/subsidiary in Guernsey;</p> <p>(b) that you are satisfied with respect to the soundness of the bank and its overall financial position; and</p> <p>(c) that, in supervising the bank, you will be taking into account their transactions in Guernsey and satisfying yourselves as to the overall prudential soundness of the group on a consolidated basis."</p> <p>A license is never granted until the home country supervisor has confirmed these facts. However, the support of the home supervisor by itself is insufficient for the GFSC to issue a licence. In all instances, the GFSC assesses whether the home supervisor undertakes consolidated supervision.</p> <p>The GFSC has supported (and usually been present at) numerous on-site visits to Guernsey licensed institutions by regulators based in Bermuda, Canada, Germany, Jersey, the Netherlands, Switzerland, UK and the USA. No objection has ever been</p>
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	<p>raised over such visits which have been carried out with the full cooperation of the GFSC and the licensees concerned.</p> <p>No shell banks operate in Guernsey.</p> <p>An administered bank may establish and be licensed in Guernsey with all functions outsourced under formal agreements to a separate licensed bank which provides day-to-day administration and, as well, senior management and board members. All books and records must be kept on the Island and the operations subject to annual audit conducted in Guernsey.</p> <p>The GFSC and the UK FSA have agreed to monthly discussions centered on institutions with Guernsey incorporated subsidiaries. As a matter of convention, the GFSC will discuss the implications of information received from another supervisor and, as far as possible, keep them informed of any relevant developments.</p>
Assessment	Compliant
Comments	<p>While CP 25 has been assessed "Compliant", the events of mid-September/early October 2008 underlined limitations in the Home-host relationship between the GFSC and the home supervisor of several of the largest Guernsey-licensed deposit-takers, the UK FSA. Essential Criterion 3 of CP 25 reads, in part:</p> <p>"3. The home supervisor provides information to host supervisors, on a timely basis, concerning:</p> <ul style="list-style-type: none"> • where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries." <p>From enquiries made in the course of this assessment it appears that the Commission did <u>not</u> receive timely warning of what has been termed the "acute system wide-pressures on financial institutions" (see Bank of England: Financial Stability Report (Oct. 2008; Issue No. 24) and which ultimately gave rise to the system-wide support package announced by the UK authorities on 08 October 2008. The asymmetry of the relationship disadvantages the GFSC; while the Guernsey-licensed institutions are important for the Guernsey financial system they are less so on a banking group basis and, consequently, for the supervisor of the consolidated group. In dealing with this asymmetry, the assessment recognizes the GFSC's initiatives in; (a) ensuring that depositors are aware of the status of their deposits in Guernsey-licensed institutions; (b) striving to obtain from home supervisors a periodic written statement indicating whether they have any knowledge of any significant problems of which the GFSC should be aware concerning those institutions for which the home supervisor has primary responsibility; and (c) the GFSC's practice of reducing where it believes warranted the level of permitted exposure to the parent.</p>