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**Guernsey: Financial Sector Assessment Program Update—  
Detailed Assessment of Observance on Basel Core Principles**

This Detailed Assessment of Observation on Basel Core Principles on Guernsey was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in December, 2010. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Guernsey or the Executive Board of the IMF.

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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),<sup>1</sup> 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 insurance<sup>2</sup>), 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

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

<sup>2</sup> 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.<sup>3</sup> 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.

<sup>3</sup> 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 post</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**

<b>Principle 1.</b>	<b>Objectives, autonomy, powers, and resources.</b> 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.
<b>Principle 1(1).</b>	<b>Responsibilities and objectives.</b> 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 “<b>Commission</b>” or “GFSC”) are established in the <u>Financial Services Commission (Bailiwick of Guernsey) Law 1987</u> (the “<b>FSC(G)L</b>”) and related statutes (as amended), including the <u>Banking Supervision (Bailiwick of Guernsey) Law, 1994</u> (the “<b>BSL</b>”).</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"> <li>1. to take such steps as it considers necessary or expedient for effective supervision of finance business in the Bailiwick; and</li> <li>2. to counter financial crime (as defined) and of the financing of terrorism;</li> </ol> <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"> <li>• The Banking Supervision (Bailiwick of Guernsey) Regulations 1994 as amended;</li> <li>• Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing;</li> <li>• Code of Practice for Banks 2003;</li> <li>• Principle 1/1994/24 on large exposures;</li> <li>• Guidance on verification of prudential returns;</li> <li>• Guidance on trilateral discussions (March 1997);</li> <li>• Guidance issued under s1(a) and s1(b)(ii) of the Accounts Rules;</li> <li>• Guidance on prudential and statistical returns;</li> <li>• Code of Conduct on deposit advertisements;</li> <li>• Principles of conduct of finance business;</li> <li>• Principles of conduct of derivatives business;</li> <li>• Guidance on corporate governance;</li> <li>• Guidance on Basel II implementation; and</li> <li>• Principles for the Management of Credit Risk.</li> <li>• The Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 as amended</li> <li>• The Transfer of Funds (Guernsey/Alderney/Sark) Ordinance, 2007</li> <li>• Guidance on Liquidity Risk Management 2009</li> </ul>



	<ul style="list-style-type: none"> <li>• Implementation Paper on Upstreaming 2009</li> </ul> <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	<p>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.</p>
<b>Principle 1(2).</b>	<p><b>Independence, accountability and transparency.</b> Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.</p>
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"> <li>• has been absent from three (3) consecutive meetings without the Commission’s consent;</li> <li>• has become declared insolvent;</li> <li>• is incapacitated by physical or mental illness; or</li> <li>• is otherwise unable or unfit to discharge the functions of a Commissioner.</li> </ul> <p>If it appears to the States on the recommendation of the Policy Council that any member</p>

of the GFSC (including the Chairman):

- 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;

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).

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:

- 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.

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 –

- (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.

Notwithstanding ss. 4(1), the FSC(G)L further provides (ss. 7(1)(2)(2A)) that:

"The Policy Council may, after consulting the Commission, give the Commission –

- (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.

(2) It is the duty of the Commission, in carrying out any of its functions –

- (a) to take into account any guidance given under para. (a) of ss(1); and

(b) to act in accordance with any directions given under para. (b) of ss(1).

(2A) Any guidance or direction given under this section –

- (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.”

The Policy Council has never given the GFSC written guidance or directions contemplated by ss. 7(1)(2)(2A) of the FSC(G)L.

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.

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.

The GFSC is audited annually by external auditors and undergoes internal audit by a separate external audit firm.

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.

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.

Industry representatives indicated that the GFSC-BD and its staff have credibility based on their professionalism and integrity

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>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>
<b>Principle 1(3).</b>	<b>Legal framework.</b> 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	
<b>Principle 1(4).</b>	<b>Legal powers.</b> 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	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>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	
<b>Principle 1(5).</b>	<b>Legal protection.</b> 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	
<b>Principle 1(6).</b>	<b>Cooperation.</b> 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>

FIUs, Attorneys General and their respective Financial Services Commissions meet regularly.

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.

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.

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.

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.

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.

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.

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.

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>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><b><u>"Restrictions on disclosure of information"</u></b></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	<p>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.</p>
<b>Principle 2.</b>	<p><b>Permissible activities.</b> 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.</p>
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 "<b>deposit-taking business</b>".</p> <p>(The BSL (s1) provides that: "no person shall in the Bailiwick accept a deposit in the course of carrying on a <b>deposit-taking business</b> except under the authority of and in</p>



accordance with the conditions of a licence granted by the Commission under s6 (a “**banking licence**”).”)

“ **“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..”)

“ **“deposit-taking business”** has the meaning given in (BSL) s3,” (The meaning is as under:

“3(1)...a business is a **deposit-taking business**...if-

- (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.

3(2) A business is **not a deposit-taking business**...if in the normal course of business-

- (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.”)

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).

The BSL (s37) states (*inter alia*):

- “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.
- (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.”

Any use of ‘bank’ or a similar term in a name would be referred to the BD for permission under the BSL.

	<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	
<b>Principle 3.</b>	<p><b>Licensing criteria.</b> 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 (Schd. 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>

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.

The BSL (s6(2)) provides:

“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.

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.

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:

- 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 of 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.

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.

The BSL (s36B) stipulates a minimum capital requirement at L1 million “or such other sum as the Commission may by regulation prescribe”. No such regulation has been made.

The BSL (Sched.3; para.3) states that:

- “(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.
- (2) In determining whether a person is a fit and proper person to hold a particular position, regard shall be had to –
- (a) his probity, competence, experience and soundness of judgment for fulfilling the responsibilities of that position;
  - (b) the diligence with which he is fulfilling or likely to fulfil those responsibilities;
  - (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;
  - (d) his educational and professional qualifications, his membership of professional or other relevant bodies and any evidence of his continuing professional education or development;
  - (e) his knowledge and understanding of the legal and professional obligations to be assumed or undertaken;
  - (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 -
    - (i) the Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991,
    - (ii) the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999,
    - (iii) the Drug Trafficking (Bailiwick of Guernsey) Law, 2000,
    - (iv) the Terrorism and Crime (Bailiwick of Guernsey) Law, 2002,
    - (v) the Disclosure (Bailiwick of Guernsey) Law, 2007,
    - (vi) the Transfer of Funds (Guernsey) Ordinance, 2007, the Transfer of Funds (Alderney) Ordinance, 2007 and the Transfer of Funds (Sark) Ordinance, 2007,
    - (vii) any legislation implementing European Community or United Nations sanctions and applicable in the Bailiwick, or
    - (viii) any other enactment prescribed for the purposes hereof by regulation of the Commission, and
  - (g) his policies, procedures and controls to comply with any rules, codes, guidance, principles and instructions referenced under paragraph 1A.
- (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-

(a) committed any offence, and in particular any offence involving fraud or other dishonesty or involving violence,

(b) contravened any provision contained in or made under -

(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 -

(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"),

(c) engaged in any business practices (whether unlawful or not) -

(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

(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.

(4) For the purposes of subparagraph (3) and for the avoidance of doubt,

(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

in the British Islands or elsewhere.”

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:

**“DECLARATION**

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.

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.

I undertake to inform the Commission, without delay, of any material changes to the information supplied in this form.”

Thus they are required to update information provided to the Commission in a form PQ (or PD).

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.

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, *inter alia*, 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.

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, *inter alia*, 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).

The licence application is submitted to a inter-divisional assessment committee

	<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 style="padding-left: 40px;">"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 style="padding-left: 40px;">(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	
<b>Principle 4.</b>	<b>Transfer of significant ownership.</b> 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>

“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.”

The BSL (ss14(1)) stipulates that the GFSC’s prior 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.)

“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.”

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):

“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.”

Given the quotations above, the GFSC does not 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:

“The Commission may serve notice of objection under this section if it is not satisfied-

- (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.”

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.



The BSL (s16 and s17) provides the GFSC powers to take action where a change of control occurs without its approval:

**“16. Contraventions by controllers**

A person who-

- (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;

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.

**17. Restrictions on sale of shares.**

(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.

(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-

(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.

(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.

(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

(a) until the end of the period within which an appeal can be brought against the notice of objection;

	<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>
<b>Principle 5.</b>	<p><b>Major acquisitions.</b> 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.</p>
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>

notes to banks' audited accounts.

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 all 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.)

Moreover, neither laws nor regulations provide precise criteria by which to judge individual **proprietary** acquisitions and investments proposals.

A condition imposed on every licence is that:

"there shall be no significant change in the nature of the business conducted without prior consultation with the Commission;"

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.)

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.)

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:

"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."

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:

"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>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 <b>prior</b> 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>
<b>Principle 6.</b>	<b>Capital adequacy.</b> 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

and Statistical Returns.

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%.

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:

" (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-

(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.

(3) The particular factors mentioned in sub-paragraph (2)(b) are-

(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."

Through Basel II, specific capital charges are now being made for bank specific risks identified through the Supervisory Review and Evaluation Process (SREP).

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.

Off balance sheet exposures are captured through regulatory returns and are factored into the RAR.

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.

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>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	
<b>Principle 7.</b>	<p><b>Risk management process.</b> 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.</p>
Description	The Code of Practice for Banks issued under section 36A of the BSL states at

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.

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.

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.

Local banks benefit significantly through adoption of group wide risk management policies and processes.

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.

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.

ICAAP submissions must be agreed by the Board.

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 or a failure to implement high level policies. This includes liquidity, capital, and large exposures.

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.

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.

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

management understands the key management information.

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.

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.

The SREP process has required subsidiaries to identify Pillar 2 risks; whilst the Commission has required subsidiaries to maintain regulatory capital levels above 8%.

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.

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.

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.

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:

- 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

















































































































