

**GUIDANCE NOTE 1996/1:
FLOWS OF INFORMATION
TO PARENT BANKS**

GUIDANCE NOTE 1996/1 : BANK AUDITORS' REPORTS ON FLOWS OF INFORMATION TO PARENT BANKS

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FLOWS OF INFORMATION TO PARENT BANKS : NOTES FOR AUDITORS

1. INTRODUCTION

The following are quoted in the Board of Banking Supervision's report on the collapse of Barings as being the most material principles of the 1987 Basle Concordat and Document of Understanding between the Basle Committee and Offshore Group of Banking Supervisors:

- “(a) Effective supervision of banks' foreign establishments requires a sharing of responsibilities between host and parent authorities and contact and co-operation between them;
- (b) Host and parent authorities should try to satisfy themselves that banks' internal control include comprehensive and regular reporting between foreign establishments and head office;
- (c) If a host authority has reason to suspect problems of a material nature in a foreign establishment it should take the initiative to inform the parent authority. If serious problems arise in a foreign establishment the host authority should consult with the parent authority to seek possible remedies;
- (d) Host authorities should ensure that adequate data can flow to parent authorities, particularly in relation to large exposures;
- (e) Where a host authority discovers an exposure which it considers should be drawn to the attention of the parent authority the host authority should take the initiative in doing so;
- (f) Host authorities are responsible for foreign establishments operating in their territories, while parent authorities are responsible for them as part of larger banking groups. Such responsibilities are both complementary and overlapping;
- (g) Consolidated supervision does not reduce host authorities' responsibilities for foreign establishments operating in their territories”

In this context items (b) and (d) have the most relevance. The report also includes the following pertinent observations:

“the Bank (of England) is required under the Act to take into account risks elsewhere in a group which might affect the authorised institution. Accordingly, Bank supervision was primarily focussed on BB&Co (and BSB), but the Bank was required to take into account the activities of other parts of the Barings Group insofar as they might affect the reputation and financial soundness of BB& Co.”

“Because the Bank views consolidated supervision as a complement to, rather, that a substitute for, supervision of a bank alone....it sets limits for the exposure of the bank ...to the rest of the group of companies of which the bank is a member. In the absence of a higher limit....being agreed in respect of a particular group company, the maximum exposure of the bank....to the rest of the group must be in aggregate no more than 25% of the bank’s unconsolidated....capital base; this restriction is known as ‘the connected lending limit’”.

2. INFORMATION FLOWS

Being mindful of the above the Commission is concerned that banks that operate as subsidiaries in Guernsey (ie not branch operations) are indeed providing all information to their parent organisations on a regular and timely basis to ensure that those parent banks (and their (home) regulators) are aware of all information that is required for them to effectively monitor the risk and financial soundness of the parent and any contingencies that might affect the status and reputation of the banking group.

The frequency with which information is prepared, its level of detail and the amount of narrative, analysis and explanation will depend on the level of management to which it is addressed and on the scope and type of business carried out in the Island.

Some types of information will be needed on a more frequent basis than others and it may be appropriate for some to be presented on a basis of breaches from agreed limits by way of exception reports.

Information should be provided to parent banks to enable them to ascertain group-wide:

- (i) the state of affairs of the institution;
- (ii) the operational results of the institution both on a cumulative basis and by discrete period and to give comparison with budgets and previous periods;
- (iii) assets and liabilities and how they have been valued;
- (iv) off-balance sheet positions and how they have been valued;
- (v) income and expenditure showing how it relates to different categories of assets and liabilities and off-balance sheet positions;

- (vi) exposure to each type of risk, compared to the relevant limits established by the directors in their large exposure policy statements and any limit the Commission has insisted on.

3. STAFF RESPONSIBILITIES

The Barings report further notes that:

“One of the consequences of the ambiguities in the IBG/BIB organisational structure was that some members of management believed that responsibility for certain activities (eg equity derivatives, BFS) rested with other managers, who deny they had such responsibility. This resulted in confusion and a pervasive lack of management control over these activities.”

It is important that banking groups should have documented the high level controls in the organisation, defining and allocating responsibilities, identifying lines of reporting for all aspects of the enterprise’s operations, including the key controls and giving outline job descriptions for key personnel. The delegation of authority and responsibility should be clearly specified with regard to information flows.

4. ACTION PROPOSED

The Commission is, therefore, proposing that auditors of locally incorporated Guernsey banks should examine the upstreaming of information from banks to their parent organisation(s) and report on them along the lines of Appendix 1. Banks will be asking their auditors to carry out this work at the next annual audit by means of an appointment letter similar to that at Appendix 2. Work carried on in connection with this request is **not** intended to be part of the audit itself and should not be relied upon on that basis.

**GUERNSEY FINANCIAL SERVICES COMMISSION
JULY 1996**

APPENDIX 1 : BANK AUDITORS' REPORT ON INTERNAL CONTROL SYSTEMS – UPSTREAMING OF INFORMATION

THE DIRECTORS, XYZ BANK LIMITED

Dear Sir(s)

In accordance with your letter of instruction dated [], a copy of which is attached, we have examined the systems for upstreaming of information of [name of institution] which were in existence during the [year/period] ended []. The areas examined comprised [].

Appendix 1 to this report summarises the key risks faced by the institution in this area, the key controls in place to ensure adequate information flows and our overall assessment of the control environment which the institution relies on for the procedures we were required to examine in accordance with your letter of instruction dated []. Appendix 2 gives an outline of the organisational structure of the group together with a brief description of the nature and approximate volume of flows of information carried out between the institution and other group companies. Appendix 3 gives a brief outline of the work we undertook together with an indication of the nature of testing of the key controls, as identified in Appendix 1, which we carried out.

Respective responsibilities of directors, bank auditors and the Guernsey Financial Services Commission (“the Commission”).

As directors of [name of institution] you are responsible for establishing and maintaining adequate accounting and internal control systems. In fulfilling that responsibility, estimates and judgements must be made to assess the expected benefits and relative costs of management information and of control procedures. The objective is to provide reasonable assurance that assets are safeguarded against loss from unauthorised use or disposition, that banking and market risks are properly monitored and evaluated, that transactions are executed in accordance with established authorisation procedures and are recorded properly, and to enable you to conduct the business in a prudent matter.

We, as your auditors, have been requested to form an independent opinion, based on our examination, on the accounting and other records and internal control systems in the area specified in paragraph 1 (above) and to report our opinion to you. We are required to report those exceptions which, individually or collectively are in our opinion, significant and result in there not being reasonable assurance that the requirements set out in the Commission's Guidance Note 1996/1 (“the Guidance Note”) are satisfied.

It is the Commission's responsibility to judge, in the light of the contents of the requested report and other information about [name of institution] which is available to it, whether

[name of institution] meets the authorisation requirements of Schedule 3 of the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as regards the maintenance of adequate systems of control of the bank's business and records.

Because of inherent limitations in any accounting and internal control system, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that management information and control procedures may become inadequate because of changes in the conditions or that the degree of compliance with those procedures may deteriorate.

Basis of opinion

Our examination has been carried out having regard to the Guidance Note. Such an examination includes an assessment of the nature of the accounting and other records and of the design of the internal control systems, together with testing of these records and controls on a sample basis.

Opinion

EITHER [Except for the matters set out in Appendix 4 of this report], in our opinion *having regard to the nature and scale of* [name of bank]'s business, during the [year/period] ended[], the established accounting and other records and internal control systems in the areas examined by us were established and maintained in accordance with the requirements of the Guidance Notes.

OR For the reasons set out in Appendix 4 to this report, in our opinion, *having regard to the nature and scale of* [name of bank]'s business, during the [year/period] ended [], the accounting and other records and internal control systems in the areas examined by us were not established and maintained with the requirements of the Guidance Note.

Yours faithfully

[name of bank audit firm]
Chartered Accountants

APPENDIX 2 : LETTER TO BANK AUDITORS FROM MANAGING DIRECTORS OF GUERNSEY BANKS (SUBSIDIARIES ONLY).

Dear Sir

Audit for year end [balance sheet date]

In accordance with a request I have received from the Superintendent of Banks at the Guernsey Financial Services Commission (“the Commission”) you are requested to carry out the following review of [name of bank]’s internal control systems:

Mindful of Guidance Note 1996/1, issued by the Commission, you are to examine the flows of information from [name of bank] up to our parent organisations in the [name of group] group.

This is to be done in conjunction with [name of bank]’s 1996 annual audit and your report to the board of directors (copied to the Commission) should be submitted within six weeks of [balance sheet date].

Yours faithfully