

**WEIGHTING**

**Q 1: My bank up-sources its treasury function to a Group specialist centre in London. BIPRU 3.2.25 states that a firm is not required to comply with BIPRU 3.2.20 (calculation of risk weighted amounts under the standardised approach) in the case of exposures to counterparties within the same UK consolidated group and may apply a 0% risk weighting to the exposure. Will this rating apply to banks in Guernsey?**

**A 1:** The simple answer is no. Guernsey is not within the UK. For example, this means that for banks adopting the Standardised Approach to Credit Risk who upstream their deposits to a AAA rated parent bank, the exposure would be weighted at 20 % (as it is under Basel I). The Commission regards up-sourcing to parent entities as a concentration risk issue and will be examining the risk as part of the Pillar 2 Process.

**Q 2: When I make placements with a bank which has a parent bank with a high credit rating do I look to the rating of the subsidiary or of the parent bank when determining the risk weightings under Section D of Module 1?**

**A 2:** You must weight placements with banks (section D) according to the credit rating of the subsidiary bank you are contracting with, regardless of the rating of the parent bank.

**Q 3: My bank lends to funds of funds these are not rated by credit agencies although the underlying funds may be. Under Basel I as these are regulated funds, a 20% rating has applied. What will be the position under Basel II?**

**A 3:** Under the standardised approach unrated funds are treated as corporates and a 100% rating will apply. However if the exposure is secured on assets in the fund, which are eligible collateral under credit risk mitigation, then the effective weighting of the exposure might be reduced. Partial collateralisation is recognised in both approaches to credit risk mitigation.

**Q 4: What if I do not hold LTV information on a residential mortgage?**

**A 4:** The loan should be weighted at 50% if all the other criteria for residential mortgages are met.

**Q 5: Our bank provides lending facilities to clients who use the funds for the purchase of properties. However we do not offer “mortgage” products as would be the case through a “high street” bank. Do we report these loans in the “Residential Mortgages” section of the BSL/2?**

**A 5: There are three possible places for reporting loans to purchase properties.**

- For loans that meet the criteria laid out in Appendix H you should report under lines H.1, H.2 or H.3 (depending on the LTV and whether LTVs are available)

- If the loan is secured on residential property but does not meet the criteria laid out in Appendix H then it should be reported in line H.4 (100% risk weighting).
- If the loan is not *secured* on residential property then it should be reported in the relevant line of section G. Of course if you can take advantage of credit risk mitigation so the loan might attract a lower risk weight, for example if the loan is cash-backed then its weighting would be transferred to line F.4.

**Q 6: How do I weight my exposure to the States of Guernsey?**

**A 6:** The Crown Dependencies Commissions have jointly agreed to treat exposures to all of their governments as if they were exposures to AAA rated governments. This gives such exposures a 0% weighting. However this does not apply to bodies owned by the States of Guernsey. Such Public Sector Entities (PSEs) are also treated as though they are PSEs of a AAA rated government so they attract a weighting of 20%.

**Q 7:** Module 1 & 2 - guidance note M.9c states “where a bank has entered into a so called “uncommitted facility” and it is apparent that the facility is commercially (if not legally) committed, consideration should be given to applying a capital charge to such a facility under Pillar 2 (the ICAAP) which might be equivalent to the charge that would be applicable if there was a legally enforceable commitment.” Does the Commission have any additional guidance as to what CCF should be applied to these facilities?

**A 7:** We would expect to see the minimum CCFs as detailed below to be applied by banks.

	<b>Basel I</b>	<b>Basel II</b>	<b>Commission Guidance</b>
CCF for undrawn committed facilities with maturity of less than one year	0%	20%	20%
CCF for undrawn committed facilities with maturity of more than one year	50%	50%	50%
CCF for undrawn uncommitted facility with maturities of less than one year	0%	See guidance note M.9c *	10%
CCF for undrawn uncommitted facilities with maturity of more than one year	0%	See guidance note M.9c *	25%

\* “Where a bank has entered into a so called “uncommitted facility” and it is apparent that the facility is commercially (if not legally) committed, consideration should be given to applying a capital charge to such a facility under Pillar 2 (the ICAAP) which might be equivalent to the charge that would be applicable if there was a legally enforceable commitment.”

We believe the above approach takes into account the fact that although undrawn uncommitted facilities maybe less onerous for banks legally there are always commercial considerations to be taken into account and hence a charge should be recognised when considering Pillar II add-ons. Our recommended CCFs also take into account that over time only a certain percentage of the undrawn uncommitted facilities are drawn down at any one point in time and hence the capital held to offset this can be less than that of a committed facility.

### **REPORTING**

**Q 8: Why would a bank choose to apply the Simplified Standardised Approach to Credit Risk?**

**A 8:** If a bank intended to make material money market placements with a low rated bank (such as a parent bank) in a country which attracts a high ECA score, then applying the SSA would mean a lower capital charge. For example a bank with money market placements with a CC rated parent, based in the UK, would attract a 20% weighting under the SSA but a 150% weighting even for a short term placement under the Simplified Approach. The Commission will expect banks applying the SSA to have shown in their ICAAPs that they have adequately addressed their credit and concentration risks and, where they cannot demonstrate this, mitigants (which might include an additional capital charge) would be applied through the SREP process.

**Q 9: When deciding whether a property-backed loan qualifies as a residential mortgage do I examine the LTV at the time the loan was agreed?**

**A 9:** LTVs should be assessed on a regular basis, making use of relevant indices and market information where appropriate. The Commission will need to be persuaded of the relevance of any index used to the property market in which the residential property is based.

**Q 10: How should I report past due exposures?**

**A 10:** For non-mortgage loans secured against collateral which is eligible under credit risk mitigation and if the CRM still remains valid then the risk weight of the past due exposure remains unchanged. For residential mortgages, when past due for more than 90 days, they must be risk weighted at 100%, net of specific provisions. If past due but specific provisions are at least 20% of their outstanding amount, the risk weight applicable to the remainder of the loan can be reduced to 50%.

The unsecured portion of any loan that is past due for more than 90 days, net of specific provisions, including partial write-offs, is risk-weighted as follows:

150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan;  
100% risk weight when specific provisions are between 20% and 50% of the outstanding amount of the loan; and  
50% risk weight when specific provisions are at least 50% of the outstanding amount of the loan

**Q 11: What do I do if I want to use a different approach to calculating Interest Rate Risk on the Banking Book to that described in Module 10 to the BSL/2?**

**A 11:** You should arrange to meet with the Commission so that you can satisfy the Commission that the approach you are adopting captures your bank's interest rate risk effectively and provides a useful measure of that risk. You should consult the Basel Committee's paper: "*Principles for the Management and Supervision of Interest Rate Risk*" before arranging to meet the Commission to ensure that what you are proposing fits within the Basel Committee's recommendations.

**Q 12: My bank does not have any market risk – do I need to submit Module 4 of the BSL/2?**

**A 12:** You should ensure that your bank has no market risk. Module 4 refers to market risk in the banking book as opposed to market risks in the trading book. Many banks reported aggregate net short open positions on the old BSL/1 form, i.e. they have market risks in the banking book. If you are satisfied that your bank does not have any market risk a nil return, blank Module 4 should be submitted as a positive affirmation that no market risk exists in the bank.

**Q 13: For the Standardised Approach to Operational Risk under what business line should I classify my bank's private banking activities?**

**A 13:** Retail banking (12%).

**Q 14: For the Standardised Approach to Operational Risk under what business line should I classify my bank's placements with its parent bank?**

**A 14:** Commercial banking (15%)

**Q 15: BSL/2 General Guidance page 2 – The notes state that reporting entities should use the middle market rate in London at 4pm as the exchange rate to convert data into sterling. Our bank currently uses the month end rate supplied by the parent bank. Can we still assume that this appropriate under form BSL/2?**

**A 15:** The parent bank rate is acceptable if it is as close to London as your particular system allows.

**Q 16: Where does the unaudited (current year) profit get reported?**

**A 16:** Module 6 Liabilities line F.3.7 includes Revenue Reserves and Own Funds and unverified profits.

**Q 17: Interest payable is reported separately in Liabilities, but there is no provision for interest receivable, does this get allocated to the underlying transactions as in Module 1?**

**A 17:** Interest payable is reported on Liabilities Line F.3.1 and interest receivable can be reported on Assets Line E.7.3 Debtors and Prepayments.

**Q 18: Where does the mark-to-market revaluation (PRV & NRV) of outstanding FX deals get reported? (This used to be on line 10 or 20 of the BSL/1).**

**A 18:** These can be reported under Other Liabilities F.3.8 and Other Assets E.7.6.

**Q 19: Where do we report “on balance sheet” fair valuation changes in respect of certain off balance sheet instruments. These replacement values are currently reported on BSL/1 lines 10 or 20: *other liabilities or other assets* and comprised fair valuation changes on:**

- 1. interest rate swaps hedging a bond portfolio;**
- 2. a one-off credit contingent fx option;**
- 3. outstanding fx deals;**
- 4. options attached to “enhanced return” fiduciary deposits.**

**A 19:** These can be reported on the Assets E.7.6 'Other Assets' line or Liabilities F.3.8 'Other Liabilities' in Module 6.

**Q 20: a) Module 1 F.3, is this just for physical gold or does this include unallocated gold held with correspondents? (ie similar to a foreign currency nostro account).**

**b) Also, on Module 6 E.1.3, which class of gold would be reported here, allocated, un-allocated or held by other third parties?**

**A 20:** a) If it is gold held on a bank's balance sheet but held in a nostro for the bank, this should be included as gold under F.3 – the asset held by the bank is gold, even if not in Guernsey, just like US Dollars held in the USA is still US Dollars on a Guernsey balance sheet.

b) All gold held on the bank's balance sheet as an asset wherever held so long as you have an entitlement to gold and the bank's risk is therefore to gold.

**Q 21: Module 4 Market Risk: The input figures do not require a minus or plus sign per Section 2.5 in the guidance notes. How would the net position long or short then be identified if offsets are not shown as a negative?**

**A 21:** The formulae take the figures entered as liabilities or gross sales as negative figures.

**Q 22:** Under Module 6 F.3.4, should a deferred tax be reported as a negative liability?

**A 22:** Yes.

**OTHER**

**Q 23:** What do I need to do if my bank wishes to use the comprehensive approach to credit risk mitigation?

**A 23:** You should contact the Commission who will discuss with you the feasibility of your bank adopting the comprehensive approach to CRM. This is particularly important if your bank is planning to use its own internal estimates of market price volatility and foreign exchange volatility (haircuts). The Commission will also need to be satisfied that your auditors are comfortable verifying any quarterly returns you submit if you move to the comprehensive approach.

**Q 24:** My bank is thinking of operating a trading book. What should I do?

**A 24:** You need to discuss this at the earliest opportunity with the Commission. Once the Commission is satisfied that your bank has adequate resources and controls to operate a trading book a discussion will be held under the SREP process to agree what capital charge should be applied to mitigate the trading book market risk.

**Q 25:** Module 5 – does settlement risk apply to money market placements that treasury place out with approved counterparties each day?

**A 25:** Yes, it is intended to capture securities and investment dealing. Settlement risk occurs when a bank is exposed because it has sold securities and has not received the cash or it has paid for securities and has not received them. When a bank makes a money market placement it is not buying or selling a security – the only settlement is the clearing of the electronic transaction. The Settlement risk report is not designed to capture money market placements (although it might apply to transactions in money market instruments like FRNs and CDs if they have not settled).