

# **THE BANKING SUPERVISION (ANNUAL COMPLIANCE RETURN) RULES and GUIDANCE, 2021**

The Annual Compliance Return Rules, made in accordance with the Banking Supervision (Bailiwick of Guernsey) Law, 2020 (“the Law”), are set out in this document. Guidance, provided by the Guernsey Financial Services Commission (“the Commission”), can be found in blue boxes.

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## PART 1 INTRODUCTION

### 1.1 Application

- (1) The Banking Supervision (Annual Compliance Return) Rules, 2021 complement, and should be read in conjunction with, section 40 of the Law.
- (2) These Rules apply to all licensees unless specifically stated otherwise in the applicable rule.
- (3) The Commission may in its absolute discretion, by written notice to a licensee, exclude or modify the application of any provision of these Rules.
- (4) The Commission may issue supplementary guidance regarding the standards of conduct and practice expected in relation to any aspect of the regulatory framework. Such guidance will not constitute rules of the Commission.

## PART 2 SCOPE OF THE ANNUAL REVIEW

### 2.1 Application and scope

- (1) This Part applies to all banking licensees.
- (2) The Annual Review must include –
  - (a) the business carried on by the licensee; and
  - (b) the business carried on by any undertaking established by them.

#### **Guidance Note**

Part 2 applies to all banks – branches and subsidiaries.

Effective management of a business demands the existence of a framework where governance is monitored. The governance framework for a branch will be different to that of a subsidiary but, nevertheless, this Part applies. It is the responsibility of the branch senior management to ensure that the branch complies with the Annual Review requirements of the Law.

The branch corporate governance model should address issues at a local level, preferably through a branch management committee or similar governing body, and ensure that issues are reported upwards to the appropriate executive level within the parent bank.

Where a branch outsources a function to elsewhere in the Group or to a third party, the branch should review how it maintains oversight of the quality of that function, such that it can be satisfied that the function being carried out on its behalf meets Guernsey legal and regulatory requirements.

For each sub-category in section 40(2) of the Law, branch senior management should consider the governance in place at local level and, where applicable, how that particular area is reported upwards, such that it can be assured that, ultimately, the bank's parent board will have enough information to assess and control the risks of its branch within this jurisdiction.

## 2.2 Areas to be included in the Annual Review

- (1) A licensee must ensure that the following matters are reviewed as part of the Annual Review process.

### 2.2.1 Individual loans, asset classification, and loss provisioning which includes consideration of the on and off balance sheet exposures.

- (1) The Annual Review must provide assurance that –
  - (a) the bank has appropriate credit risk assessment processes and effective internal controls commensurate with the size and risk profile of its business;
  - (b) loans and assets are reliably classified on the basis of credit risk; and
  - (c) the bank's aggregate amount of individual and collectively assessed loss provisioning should be adequate to absorb estimated credit losses.

#### **Guidance Note**

The Annual Review should consider the adequacy of the policies and procedures for reviewing loans, asset classifications and provisioning, including both on and off balance sheet exposures.

### 2.2.2 Control systems

- (1) A review of the effectiveness of the control systems in place must be undertaken and must include-
  - (a) confirmation that pre-submission controls are in place to ensure the timely and accurate preparation and submission of all returns, required under the Law, to the Commission; and

- (b) ensure any inaccuracies in any information presented to the Commission under subsection (a) are identified, corrected, and reported to the Commission without further delay.
- (2) Where the required submissions have not occurred, or have been returned late, measures must be put in place to ensure that the oversight is not repeated.

**Guidance Note**

This relates to submission of monthly and quarterly returns, annual financial statements, notifications of changes in directors, managers, and controllers and large exposure notifications.

The Review should examine how returns and notifications are reviewed prior to submission to the Commission, to ensure that they are accurate. Changes in procedure that have been implemented to address any inaccuracies previously highlighted in returns or notifications should be reviewed, if applicable. The Annual Review could include reference to internal and external audit observations and recommendations if such a review has taken place during the period covered by the Annual Review.

2.2.3 Financial record keeping systems and data systems

- (1) A review of the reliability of all financial record keeping systems and all data systems must be undertaken, including, but not limited to –
- (a) any reports of errors and omissions;
  - (b) operational risk events;
  - (c) system breakdowns;
  - (d) records of write-offs;
  - (e) sundry losses;

- (f) complaints monitoring undertaken by compliance teams; and
  - (g) internal or external auditor reports submitted to the board for review.
- (2) Where errors have occurred, a review of the measures that have been put in place to prevent reoccurrence must be included.
- (3) Where a licensee outsources record keeping or the management and operation of data systems, including transaction monitoring and sanctions screening, to its group or a third party, the review must assess the arrangements in place to ensure the effectiveness of the service being performed and its compliance with local legal and regulatory requirements.

**Guidance Note**

The Annual Review could include reference to relevant internal and external audit observations and recommendations if such a review has taken place during the period covered by the Annual Review.

2.2.4 Business activity undertaken without director knowledge

- (1) The review must be satisfied that the business is undertaking activities consistent with –
- (a) Board expectations; and
  - (b) the scope of knowledge and experience of the directors.
- (2) Where the licensee is a branch the review must –
- (a) consider how local management maintain oversight of the various aspects of the business; and
  - (b) provide a description of how these activities are reported to the parent bank.



- (3) Where a director of a parent board has direct responsibility for any aspect of the branch, the individual and their areas of responsibility must be identified.

#### **Guidance Note**

Assurance that business is being undertaken, in accordance with the above, might be through obtaining reviews undertaken at board meetings of business strategy, risk and compliance reports, product development and sales performance.

Examples of how activities are reported to the parent bank include reporting to an individual director on the parent bank board, or to a committee or other meeting of the parent bank.

#### 2.2.5 Responsibilities and conduct of the Board

- (1) The responsibilities and conduct of the Board must be reviewed in line with The Finance Sector Code of Corporate Governance (“the Code”)<sup>1</sup>.
- (2) The Annual Review must provide assurance that an effective corporate governance process is in place which is appropriate to the nature, scale, and complexity of the licensee’s business.
- (3) The Commission must be informed when a licensee is subject to compliance with, or is required to report against, a non-Commission, equivalent code and a comparison must be carried out between local governance measures and the first seven principles of the Code<sup>2</sup>.

#### **Guidance Note**

The Finance Sector Code of Corporate Governance, comprising eight principles and underlying guidance, sets a framework of good corporate governance against which licensees’ governance standards can be measured.

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<sup>1</sup> The Finance Sector Code of Corporate Governance is available on the Commission’s website, <https://www.gfsc.gg>.

<sup>2</sup> Principle 8 in shareholder relations is not relevant for the purposes of this review.

In performing the review, the self-assessment of compliance with the Code (or non-Commission equivalent code where relevant) should be considered. The extent of the self-assessment should reflect the nature, scale, and complexity of the bank.

Although the Code does not apply to branches the Commission will be expecting branch management to compare their local governance framework and their engagement with the parent bank's board to the Code's principles. Branches should consider how the principles are met by reference to both the local governance at branch level and the oversight from the parent board.

#### 2.2.6 Risk management

- (1) The Annual Review must consider whether the Board has ensured that a risk management process is in place which is commensurate with the risk profile of the licensee and that –
  - (a) a sound risk management culture is established;
  - (b) risk-taking policies and processes are developed which are consistent with the risk management strategy and the established risk appetite;
  - (c) uncertainties attached to risk measurement are recognised;
  - (d) appropriate limits are established that are consistent with the risk appetite, risk profile, and capital strength and that they are understood by, and regularly communicated to, relevant staff; and
  - (e) senior management monitor and control all material risks consistent with the approved strategies and risk appetite.
- (2) Where the licensee is a branch, the review must consider how the risks, to which the Guernsey branch is exposed, are considered and reviewed at local management level and how these are reported to the appropriate executive level within the parent bank.

- (3) All licensees must identify the individuals, employed within the Bailiwick, who are responsible for risk management<sup>3</sup>.

**Guidance Note**

In the case of branches the Annual Review should consider whether risk appetite and the risk management policy are imposed by the parent, or whether the branch has a significant input into these policy areas in order to tailor them to the environment in which the branch operates.

2.2.7 The control environment

- (1) The Annual Review must assess whether the licensee has an internal control framework that is adequate to establish a properly controlled operating environment for the conduct of its business, including –
- (a) organisational structure including, but not limited to –
    - (i) definitions of duties and responsibilities, including clear delegation of authority;
    - (ii) decision-making policies and processes; and
    - (iii) separation of critical functions;
  - (b) accounting policies and processes including, but not limited to –
    - (i) reconciliation of accounts;
    - (ii) control lists; and
    - (iii) information for management;

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<sup>3</sup> In accordance with section 9 of Schedule 2 of the Law.

- (c) checks and balances, including, but not limited to –
  - (i) segregation of duties;
  - (ii) cross-checking;
  - (iii) dual control of assets; and
  - (iv) double signatures; and
- (d) safeguarding assets and investments including, but not limited to -
  - (i) physical control; and
  - (ii) computer access

and taking into account the licensee's risk profile.

- (2) The Annual Review must also assess whether there is a robust and independent internal audit function.

### **2.3 Timing and frequency**

- (1) The Annual Review must –
  - (a) be returned as part of the Annual Compliance Form;
  - (b) be submitted in accordance with rule 6.2; and
  - (c) must cover the same period as the licensee's financial year.

## 2.4 Exceptions

- (1) Where the Annual Review reveals errors or shortcomings in compliance, with any of the areas set out in Rule 2.2, these must be identified in the “Exceptions” section of the Annual Compliance Form, including –
  - (a) the nature of the non-compliance;
  - (b) the cause of the non-compliance;
  - (c) the duration of the non-compliance; and
  - (d) the steps taken to remedy the position.

### **Guidance Note**

Licensees should provide a short summary of the problem identified, its cause, its duration and the steps taken, by the bank, to remedy the situation.

A shortcoming could be, for example, a late return to the Commission or a failure to obtain the Commission’s approval before effecting the appointment of a director or a manager.

Other examples could include the launch of a product of which the Board was unaware, or significant internal audit findings in relation to systems and controls.

If no errors or shortcomings have been identified, there is no need to populate the “Exceptions” part of the form.

## PART 3 STATEMENT ON COMPLIANCE WITH LICENCE CONDITIONS

### 3.1 Application

- (1) This Part applies to all banking licensees.

### 3.2 Compliance with standard conditions

- (1) The licensee must complete Statement B of the Annual Compliance Form with reference to its compliance with the standard conditions imposed on its banking licence.
- (2) Where the licensee believes that it has not been in full compliance then the “Exceptions” section must be completed including –
  - (a) the nature of the non-compliance;
  - (b) the cause of the non-compliance;
  - (c) the duration of the non-compliance; and
  - (d) the steps taken to remedy the position.

### 3.3 Compliance with additional conditions

- (1) The licensee must complete Statement B with reference to its compliance with any additional conditions imposed, by the Commission, on its banking licence.
- (2) Where the licensee believes that it has not been in full compliance then the “Exceptions” section must be completed including –
  - (a) the nature of the non-compliance;

- (b) the cause of the non-compliance;
- (c) the duration of the non-compliance; and
- (d) the steps taken to remedy the position.

### 3.4 Timing and frequency

- (1) Statement B must –
  - (a) be returned as part of the Annual Compliance Form;
  - (b) be submitted in accordance with rule 6.2; and
  - (c) cover the same period as the licensee's financial year.

#### Guidance Note

As part of the licensing process, the Commission will normally impose a standard set of conditions on all banks at the point that the licence is issued. The Commission, in exercise of its powers under section 8 of the Law, has imposed standard conditions (i) to (iv) below on the licence of all Guernsey banks and standard condition (v) on the licence of Bailiwick incorporated banks only.

*(i) There shall be no significant change in the nature of the business conducted without prior consultation with the Commission.*

*(ii) Completed prudential returns are provided to the Commission and any other such similar returns that may from time to time be required. The Commission will on occasion require an institution to provide confirmation from an external auditor that prudential returns accurately reflect the business on the reporting date.*

*(iii) You should not establish a branch/sub-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.*

*(iv) You should notify the Commission as soon as you become aware of any material adverse development surrounding the bank's operations including but not limited to:*

- *breaches of legal obligations;*

- *breaches of prudential supervisory requirements;*
- *the discovery of fraud or losses from unauthorised trading;*
- *decisions to write off bad debts or to make new specific loan provisions;*
- *involvement by the bank or its senior staff in litigation; or*
- *a significant deterioration in profitability.*

*(v) No repayments of capital or payment of dividends may be made without the prior written consent of the Commission.*

Occasionally, it may be necessary to impose additional conditions on individual banks, according to the circumstances specific to that bank.

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## PART 4 STATEMENT ON COMPLIANCE WITH LIQUIDITY STRESS TESTING

### 4.1 Application

- (1) This Part only applies to licensees who are banks incorporated in the Bailiwick.

### 4.2 Compliance with the requirement to undertake liquidity stress testing

- (1) Licensees, incorporated in the Bailiwick, must undertake liquidity stress testing on a frequency appropriate to the scale and nature of the risk and, at a minimum, once per financial year.
- (2) Licensees must complete Statement C, of the Annual Compliance Form, confirming that –
  - (a) it has stress tested its liquidity; and
  - (b) the results, vulnerabilities, and resulting actions have been considered by the Board.

### 4.3 Exceptions

- (1) Where Statement C reveals errors or shortcomings in compliance these must be identified in the “Exceptions” section of the Annual Compliance Form, including –
  - (a) the nature of the non-compliance;
  - (b) the cause of the non-compliance;

- (c) the duration of the non-compliance; and
- (d) the steps taken to remedy the position.

#### 4.4 Timing and frequency

- (1) Statement C must –
  - (a) be returned as part of the Annual Compliance Form;
  - (b) be submitted in accordance with rule 6.2; and
  - (c) cover the same period as the licensee’s financial year.

##### **Guidance Note**

The Commission’s Guidance on Liquidity Risk Management sets out the Commission’s minimum expectations regarding stress testing.

Statement C provides the Commission with comfort that the bank has stress tested its liquidity on at least an annual basis and that the results, vulnerabilities and resulting actions have been discussed by the Board.

## PART 5 INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

### 5.1 Application

- (1) This Part only applies to licensees who are banks incorporated in the Bailiwick.

### 5.2 Compliance with the requirement to review capital adequacy

- (1) The Board must regularly review the ICAAP to ensure that –
  - (a) the ICAAP continues to capture all relevant risks facing the licensee; and
  - (b) the level of capital remains adequate for the licensee and the risks it faces,on a frequency appropriate to the scale and nature of the risk and, at a minimum, once per financial year.
- (2) Licensees must complete Statement D, of the Annual Compliance Form, confirming that –
  - (a) the Board has reviewed the ICAAP;
  - (b) the licensee has maintained regulatory capital at a level compliant with the individual capital guidance set by the Commission; and
  - (c) the level of capital held is adequate given the licensee's risk profile.

### 5.3 Exceptions

- (1) Where Statement D reveals errors or shortcomings in compliance these must be identified in the “Exceptions” section of the Annual Compliance Form, including –
  - (a) the nature of the non-compliance;
  - (b) the cause of the non-compliance;
  - (c) the duration of the non-compliance; and
  - (d) the steps taken to remedy the position.

### 5.4 Timing and frequency

- (1) Statement D must –
  - (a) be returned as part of the Annual Compliance Form;
  - (b) be submitted in accordance with rule 6.2; and
  - (c) cover the same period as the licensee’s financial year.

#### **Guidance Note**

The Commission will set minimum regulatory capital for subsidiary banks in line with its engagement model.

The ICAAP is a living document and should form part of a subsidiary bank’s planning and risk management framework.

The regularity of the review is for the individual bank to decide, but a review should take place at least once per financial year.

Statement D provides the Commission with comfort that the Board regularly reviews capital adequacy in light of the risk profile of the bank.

## PART 6 NOTIFICATIONS TO THE COMMISSION

### 6.1 Application

- (1) This part applies to all banking licensees.

### 6.2 Return of the Annual Compliance Form

- (1) Every licensee must ensure that the Annual Compliance Form is correctly completed in relation to –
  - (a) Statement A concerning the Annual Review;
  - (b) Statement B concerning compliance with licence conditions;
  - (c) Statement C concerning compliance with the requirement to carry out liquidity stress testing;
  - (d) Statement D concerning compliance with the requirement for the Board to review the ICAAP; and
  - (e) The Corporate Governance Statement.
- (2) The Annual Compliance Form must be completed and returned to the Commission, –
  - (a) for licensees incorporated in the Bailiwick, within three months of the end of the financial year that it covers; or
  - (b) for licensees that are not incorporated in the Bailiwick, within one month from the publication of the audited accounts of the main group for the financial year that the Annual Compliance Form covers.

### **6.3 Requirement for immediate notification**

- (1) A licensee must notify the Commission immediately on the discovery that there are deficiencies within any of the areas covered by the Annual Compliance Form.
- (2) Any notification, made under this rule, must include details of any proposed remedial steps.
- (3) The licensee must provide the Commission with any documents or evidence, requested by the Commission, to demonstrate that remedial steps have been undertaken.

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## PART 7 GENERAL PROVISION

### 7.1 Interpretation

- (1) In these Rules terms have their ordinary meaning unless specifically defined in the Law or in these Rules.
- (2) Other words and expressions have the same meanings as they have in the Law.

## PART 8 CITATION AND COMMENCEMENT

### 8.1 Citation and commencement

- (1) These rules may be cited as the Annual Compliance Return Rules, 2021.
- (2) These rules come into force on 1<sup>st</sup> November 2021.