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GUIDANCE NOTE ON UP STREAMING**1) Background**

1.1 This paper provides additional Guidance on the following sections of the Banking Supervision (Bailiwick of Guernsey) (Amendment Law), 2003:

- Section 19 Control of Advertising - regarding the Transparency Statement and
- Section 24 Reports of Large Exposures - regarding up streaming limits (this is also an addition to the Commission's general Guidance on Large Exposures)

The Commission's policy on contingency planning is for reference and will, as stated below, only be applied to individual banks as and when necessary using the Commissions' general powers.

The Guidance Note (hereafter 'Note') follows closely an earlier Implementation Paper that was circulated to industry for comment.

1.2 In August 2008, the Commission issued a Consultative Paper entitled **Parental Up Streaming and the Introduction of Depositor Protection and Ombudsman Schemes** outlining the way forward on several key issues. One of these recommendations, on the need to set up a Depositor Compensation Scheme in Guernsey, has since been implemented.

1.3 This Note now picks up several other key issues in the 2008 paper around transparency, up streaming and contingency planning. The Note draws on industry responses to the 2008 paper, on the experience of the Commission in handling the recent financial crisis and on industry comments on an earlier Implementation Paper in 2009.

1.4 Several issues in the Consultative Paper were around local corporate governance. This is a major subject touching on corporate governance for regulated entities other than banks. This subject is not therefore dealt with here; but will be part of a wider discussion at a later date. Nevertheless, local bank boards are reminded of the continuing need to conduct adequate oversight of any concentration risk on their parent.

2) Introduction

- 2.1 In aggregate the greater part of bank assets in Guernsey are up streamed within the group either to the immediate parent or ultimate parent bank. This means that the well-being of most Guernsey banks depends on the immediate or ultimate parent (generically 'the parent').
- 2.2 General 'retail' depositors should be clear that this is the case and wording to this end needs to be built into advertising material.
- 2.3 The Commission itself must also take a view as to the strength of the parent and consider whether to limit, or indeed in extreme scenarios, remove exposure of the Guernsey bank to the parent. Traditionally the Commission has done this through establishing up streaming limits with specific banks. However it is an international norm that such limits should be set for all banks and the Commission therefore intends to extend its approach to all Guernsey bank subsidiaries.
- 2.4 A parent bank may be sufficiently at risk such that the Commission may decide to reduce an up streaming limit. It is optimal to do so in a way that the well being of the parent is minimally affected. It is therefore prudent to ensure that, where appropriate, the Commission should require specified Guernsey banks to have in place a contingency plan for the withdrawal of up streaming that addresses the operational issues of placing funds elsewhere and that gives a reasonable timeline for execution without destabilising the parent.
- 2.5 Branches of banks cannot be ring fenced in Guernsey. The Commission therefore will, as set out in the 2008 paper, discourage the use of branch structures for new licensed banks unless they are perceived to be systemically important at least in their ultimate home jurisdiction or are highly specialised in nature.

3) Transparency Statement

- 3.1 The following guidance is directed towards those banks that access the general 'retail' public (whether resident in Guernsey or not). Banks not in this category are not required to issue a transparency statement as it is assumed that their clients are sufficiently sophisticated and/or advised to undertake their own enquiries.

- 3.2 Licence holders should therefore state the following in literature and advertising (including websites) that invites the taking of deposits:

“[name of licence holder] places funds with (the parent) and thus its financial standing is linked to (the parent). Depositors may wish to form their own view on the financial standing of [name of the parent] based on publicly available information, including reports and accounts, obtainable from (insert details)”.

- 3.3 This phrasing is the same as that mandated by the Isle of Man Financial Services Commission (FSC). This should create efficiencies for banks that operate across both jurisdictions.

- 3.4 Banks may also use a shortened version:

“[name of licence holder] places funds with (the parent) and thus its financial standing is linked to (the parent). Publicly available information, including reports and accounts, is obtainable from (insert details)”.

- 3.5 Alternatively banks may use an equivalent version, agreed with the Commission.

- 3.6 Transparency also needs to apply to branches of the immediate or ultimate parent. So branches must be clearly identified as belonging to a particular legal entity in advertising literature. This is already a common business convention.

- 3.7 In the 2008 Consultative Paper the Commission raised the question whether Guernsey subsidiaries should use some standard phraseology around public commitments given by the parent bank to the subsidiary. There was little consensus on this in industry responses. Some respondents argued that any commitment from a “guarantor” who in fact is guaranteeing himself was valueless. Others on the other hand argued that it would be misleading to exclude a statement of parental support.

- 3.8 The Commission takes the view that it might confuse consumers were a subsidiary of an overseas bank to be barred from making any or no reference at all to potential support from the parent. On the other hand, such consumers need to appreciate that the parent might also be a source of risk as well as strength. Accordingly, the Commission is of the view that a statement of support from the parent is acceptable as it will now be balanced by the transparency statement, as set out above.

- 3.9 One source of confusion in the mind of the public has been the use of the word ‘guarantee’ or, less commonly, ‘indemnity’. These terms can be mistakenly perceived by consumers to imply an impossibility of insolvency. To avoid this impression, the Commission hereby prohibits the use of these terms by banks in statements about parental support.

4) Up Streaming Limits

- 4.1 In order to meet international standards (for example articles 111 and 113 of Directive 2006/48/Ec of the European Parliament and of the Council), the Commission must agree (or waiver) intra-group large exposure limits, even for loans with a maturity of under one year. For the avoidance of doubt, the Commission accepts that the business model of many banks in Bailiwick is to supply intra-group liquidity. The purpose of setting limits is simply to ensure a more formalised approach. In many cases therefore the Commission will agree in effect a waiver.
- 4.2 The Commission therefore will allocate each bank, on an individual basis, an appropriate limit for the up streaming of deposits to the parent or elsewhere within the group. Limits will be renewed by the GFSC on an annual basis or more frequently should there be concerns about the parent. Limits will not be made public by the Commission.
- 4.3 In considering the limit for a bank, the Commission will have due regard to:
- The business model of the bank, e.g. deposit taker or lender to parent group only or diversified asset base
 - The quality of oversight of the parent by the local board with particular reference to the effectiveness and independence of non-group non-executive directors
 - The relative strength of the parent (as reflected in ratings etc.)
 - The likelihood of governmental support of the parent
 - The risk appetite of the Commission
- 4.4 The limit applies solely to direct assets held, but this includes bonds issued by the parent. Indirect parental exposures (e.g. through guarantees) will not be included in the limit, unless it is otherwise decided by the Commission.
- 4.5 Direct exposures to other companies in a banking group will be aggregated and the above rules will apply to the aggregated number.

4.6 The limit is for the purposes of regulation and should not influence the normal counterparty due diligence process undertaken by the board; as well as any business considerations which may limit up streaming. The board will also need to verify that up streaming to the group is not so large that the group is dependent on such funding, thus making it more difficult for the Guernsey entity to withdraw up streaming. Each subsidiary therefore should set internal limits for parental/group counterparty exposure. The Commission will ask all subsidiaries to inform it formally of the subsidiary's internal limit as a percentage of total assets annually or if it is adjusted during the year. In so far as these internal limits change, the Commission will need formally to agree as such changes will materially affect the business plan.

5) Contingency Planning for Subsidiaries

5.1 The Commission itself will not require that all banks have in place a contingency plan. However, it intends, where it sees fit and in particular circumstances and where it perceives that the parent bank may pose a risk to the Guernsey bank, to require the Guernsey bank to have in place a contingency plan for the withdrawal of up streaming.

5.2 In doing this the Commission will ensure that:

- The parent is never dependent (i.e. without it the parent will become insolvent) for funding on the Guernsey subsidiary (this may for instance require the Commission to limit the up streaming level)
- Withdrawal can take place so far as possible at a time and in a manner that will not cause the failure of the parent (this may for instance lead the Commission to require the withdrawal of funding at a time when the threat to the parent bank may be limited)

6) Contingency Planning for Branches

6.1 For branches, the GFSC may insist on a contingency plan whereby the branch in Guernsey would have the ability to close down in an orderly fashion in the event that the Commission considers that branch depositors to be at risk. The Commission does not anticipate that such a contingency plan for branches would normally be required.

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