

GUERNSEY FINANCIAL SERVICES COMMISSION

CODE OF PRACTICE FOR BANKS

Effective 24 November 2003

This Code of Practice is published by the Guernsey Financial Services Commission under section 36A of the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended for the guidance of persons licensed under that law.

This Code sets out sound principles of practice for banks but is not a statement of the Law. A failure to comply with this Code does not automatically make a bank liable to any sanction or proceedings but the Court may, and the Commission will, take into account any breach of this Code which is relevant to any decision which either of them has to make. The Commission may amend this Code from time to time after consultation with representative bodies.

1. Definitions

In this Code the following words have the following meanings:

“bank”	an institution which holds a banking licence
“banking licence”	a licence issued under section 6 of the Law
“person”	includes natural persons and any bodies corporate or unincorporate
“related companies”	has the meaning given in section 25 of the Law
“related counterparty”	group undertakings as defined by section 56(1) of the Law; or associated companies as recognised by current accounting standards followed in Guernsey; or directors, controllers, managers and their associates as defined in section 56(1) of the Law, or non-group companies with which the reporting bank’s directors, managers and controllers are associated.

A director (including an alternate director), manager and controller of the reporting bank is deemed to be associated with another company, whether registered or domiciled in the Bailiwick or overseas, if he holds the office of a director (or alternate

director) with that company (whether in his or her own right, or as a result of a loan granted by, or financial interest taken by, the reporting bank to, or in, that company, even by virtue of a professional interest unconnected with the reporting bank), or if he and / or his associates, as defined above, together hold 10% or more of the equity share capital of that company.

“staff”	includes directors and employees as well as indirect employees such as temporary or contract staff
“senior management”	a director or a person reporting directly to a director
“the Commission”	the Guernsey Financial Services Commission established under the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended.
“the Law”	the Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended
“Trading Book”	trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability or able to be hedged completely. In addition, positions should be frequently or accurately valued, and the portfolio should be actively managed.

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments include both primary financial instruments (or cash instruments) and derivative financial instruments. A financial asset is any asset that is cash, the right to receive cash or another financial asset; or the contractual right to exchange financial assets on potentially favourable terms, or an equity instrument. A financial liability is the contractual obligation to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.

Positions held with trading intent are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client services (eg matched principal broking) and market making. The following will be the basic requirements for positions eligible to receive trading book capital treatment:

clearly documented trading strategy for the position/instrument, approved by senior management (which would include expected holding horizon).

clearly defined policies and procedures for the active management of the position, which must include:

positions are managed on a trading desk;

position limits are set and monitored for appropriateness;

dealers have the autonomy to enter into/manage the position within agreed limits and according to the agreed strategy;

positions are marked to market at least daily and when marking to model the parameters must be assessed on a daily basis;

positions are reported to senior management as an integral part of the institution's risk management process; and

positions are actively monitored with reference to market information sources (assessment should be made of market liquidity or the ability to hedge positions for the portfolio risk profiles). This would include assessing the quality and availability of market inputs to the valuation process; level of market turnover, sizes of positions traded in the market, etc.

clearly defined policy and procedures to monitor the position against the bank's trading strategy including the monitoring of turnover and stale positions in the bank's trading book.

2. Integrity

Banks should conduct their business with integrity and should not attempt to avoid or contract out of responsibilities under this Code.

3. Know Your Customer

Banks should meet their obligations under law in connection with anti-money laundering and avoiding terrorist financing. Examples of laws under which such obligations occur include:

The Drug Trafficking (Bailiwick of Guernsey) Law, 2000
The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999
The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Regulations, 2002
The Terrorism and Crime (Bailiwick of Guernsey) Law, 2002

Banks should also comply with the Guidance Notes on the Prevention of Money Laundering, as amended, issued from time to time by the Commission.

4. Competence and Effective Management

Banks should:

have a policy statement on ethics and professional behaviour which is clearly communicated to all staff;

keep and preserve appropriate records of their business for at least the periods required by applicable law;

record, investigate and, as appropriate, act on complaints;

meet the minimum criteria for licensing as detailed in schedule 3 to the Law;

have a policy statement on staff recruitment and training and maintain a staff organisation chart which notes and records reporting lines;

record and monitor compliance with the Law and this Code.

5. Credit Procedures

Banks should:

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ensure that prudent credit granting and investment criteria, policies, practices and procedures are approved, implemented and periodically reviewed by bank management and directors

ensure that policies, practices and procedures include:

- a sound and well documented credit granting and investment process;
- a requirement for the maintenance of appropriate credit administration, measurement and on-going monitoring and reporting processes (including asset grading / classification and a periodic credit review);
- systems to ensure adequate controls over credit risk;

ensure that credit and other decisions are made free of conflicting interests, on an arm's length basis and free from inappropriate pressure from outside parties;

ensure that the assessment of any credit decision includes not only an assessment of the identity and geographical location of the borrower and other parties involved in the credit transaction, but also of the quality and geographical location of any assets forming the collateral for such credit transactions (for example the quality, type and location of any property and real estate);

ensure that major credit or investments (or those considered to be high risk or not part of the bank's mainstream activities) are agreed and approved at a senior management level;

ensure that management information systems provide senior management with sufficient information to carry out their duties in a prudent manner and that the systems provide essential details on the condition of loan and / or investment portfolios;

ensure that mechanisms are in place to frequently assess the strength of guarantees and appraising the worth of collateral in support of credit facilities;

ensure that valuation of loan or guarantee collateral reflects the net realisable value;

implement a system to classify loans when they are a number of days in arrears (eg 30, 60, 90 days). (Refinancing of loans that would otherwise fall into arrears should not result in improved classification of such loans);

ensure that valuation, classification and provisioning for large credits are conducted on an individual item basis;

ensure that transactions with related counterparties exceeding specified amounts or otherwise posing special risks are subject to approval by the bank's board of directors;

ensure that banks have procedures in place to prevent persons benefiting from loans and guarantees being part of the loan assessment or decision process;

other than for money market placements, set limits for loans or guarantees to related counterparties and implement systems to monitor loans and guarantees (other than money market placements) to related counterparties through an independent credit administration process;

ensure that policies and procedures give due regard to the identification, monitoring and control of country risk and transfer risk. Exposures should be monitored under such procedures on an individual country, end-borrower and end-counterparty basis,

implement policies and procedures to monitor and evaluate developments in country risk, sectoral risk and transfer risk and apply appropriate countermeasures including (where appropriate) stress testing the loan portfolio or particular concentrations of the portfolio; and

set percentages or guidelines (or decide for each individual loan) on the appropriate provisioning either for classes of loans or for each individual loan.

6. Trading Procedures

For banks that operate an active Trading Book, banks should:

ensure they have suitable policies and procedures related to the identification, measuring, monitoring and control of market risk;

ensure that they have set appropriate limits for various market risks, including their foreign exchange business; and

ensure that the above policies, procedures and limits are monitored under information, risk management and control systems which are adequate to provide compliance.

7. Risk Management

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. These processes must include appropriate board and senior management oversight.

Bank's risk management processes should address:

Liquidity Risk

- there should be good management information systems on liquidity positions and the associated risks;
- liquidity control should be managed centrally;
- net funding requirements should be analysed under alternative scenarios;
- consideration should be given to diversification of funding sources, stress testing and contingency planning;
- liquidity management should separately address all currencies used by the bank or its clients.

Interest Rate Risk

- there should be good management information and stress testing of interest rates and the associated interest rate risk.

Foreign Exchange Risk

- there should be good management information and stress testing of foreign exchange positions and the associated foreign exchange risk.

Operational Risk

- there should be a robust and independent internal audit function;
- procedures should be in place to counter external fraud and other financial crime;
- adequate system security and data protection procedures should be established;
- procedures should be in place to address internal fraud and negligence including the taking out of adequate and appropriate professional indemnity insurance cover;
- sound business resumption plans should be in place;
- procedures should be in place covering major system modifications and in preparation for significant changes in the business environment.

Reputational Risk

- procedures should provide continual vigilance through sound and comprehensive customer acceptance procedures to assess the reputational risk of taking on particular clients and to limit and control risk exposures in assets and liabilities including assets under management;
- a clear external communication policy should be established which addresses media contact and advertisements (including web site content).

8. Responsibilities of the Board of Directors

The board of directors of banks are responsible for banks having in place internal controls that are adequate for the nature and scale of the bank's business.

9. Audit

The internal audit function should report direct to a parent undertaking with a demonstrable level of independence from local senior management or to an audit committee which can provide the requisite independence and experience. The Commission will consider the nature, complexity, and risk of a bank's activities in assessing the efficacy of the internal audit function.

Audit committees should include experienced non-executive directors.

10. Capital Adequacy

Banks should have an internal process to assess their overall capital adequacy in relation to their risk profile.

Banks should have systems in place to ensure that their minimum calculated risk asset ratio does not fall below the minimum risk asset ratio prescribed by the Commission.

11. Co-operation with Regulatory Bodies

Banks should deal openly and honestly and co-operate with the Commission and any other regulatory authorities to whose consolidated supervision they are subject.

Guernsey Financial Services Commission
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