

Guidance on the Annual Compliance Form for Banks

Purpose of this form

The purpose of this form is to streamline the Section 36C annual review process that was in place prior to 2015 and to confirm that the bank is reviewing other key areas, not prescribed by section 36C, on at least an annual basis.

This pro forma has two versions and these guidance notes cover both versions:

- The *Annual Compliance Form for banks incorporated in the Bailiwick* should be completed by all subsidiary banks in the Bailiwick. This pro forma requires the bank to attest to four separate statements (A to D) and to clearly indicate whether any exceptions to these statements have been identified by the bank.
- The *Annual Compliance Form for branches of banks incorporated outside the Bailiwick* should be completed by all branch banks in the Bailiwick. This pro forma requires the bank to attest to two separate statements (A and B only) and to clearly indicate whether any exceptions to these statements have been identified by the bank.

From 1 January 2015 onwards, all banks are requested to complete and submit this Annual Compliance Form. The Form AR, which was associated with the Section 36C annual review process, is no longer required.

Rather than asking for documentary evidence of compliance when the Annual Compliance Form is submitted, the Commission would ask to see evidence as part of its next PRISM-related Full Risk Assessment of each bank. The only exception to this approach would be where the Annual Compliance Form points to issues that the Commission feels that it needs to seek further information on at the time, or an issue arises subsequent to the submission of the form but before the next scheduled Full Risk Assessment.

Timing of submission of this form

This Annual Compliance Form should be submitted every twelve months and for its first year of operation (i.e. 2015) it should be submitted no more than twelve months after the 2014 submission of the bank's Form AR.

In terms of timing, section 36C of the Banking Supervision (Bailiwick of Guernsey) Law 1994 requires a section 36C review to be undertaken once every financial year and certainly no less frequently than every 15 months. However, other items that this Annual Compliance Form relates to are annual reviews; i.e. no less frequently than every 12 months. In terms of timing therefore, the Commission suggests that the section 36C review also runs to a 12 month cycle (as is already the practice for most banks) in order to allow this Annual Compliance Form to be submitted every 12 months.

Guidance on Statement A – section 36C annual review

Statement A relates to all Guernsey licensed banks.

All banks, regardless of whether they are branches or subsidiaries, are required to complete an annual review once every financial year and no less regularly than every fifteen months. This is a requirement of section 36C of the Banking Supervision (Bailiwick of Guernsey) Law, 1994 (“the Law”).

Previously banks had been required to complete a Form AR and submit this to the Commission, setting out how they complied with each relevant subsection of section 36C (1) of the Law. From 2015 onwards banks will still need to go through the process of completing and documenting their annual review (and guidance in the next section describes what should be considered and articulated in such a review) but they will no longer be required to describe to the Commission in detail how they comply. This Annual Compliance Form, which replaces the Form AR, is designed to highlight any errors or areas of improvement identified by the bank as a result of the annual review.

If the bank’s annual review has revealed errors or shortcomings in the bank’s compliance with one or more subsections of section 36C (1) then these should be identified in the “Exceptions” part of the Annual Compliance Form. Please 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 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 pro forma.

Please note that for subsidiary banks, the Commission would expect the Board to consider the results of the annual review, as has been the practice in previous years with the Form AR.

What to cover in a section 36C annual review

This guidance sets out the range of issues to be covered by all banks in the course of reviewing the bank’s compliance with the sub sections of section 36C (1) of the Law. These issues will be broadly the same, regardless of whether the bank is a subsidiary or a branch. However, further information is available immediately below for branches of banks incorporated outside the Bailiwick.

Branches and the section 36C Annual Review

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, the requirements of section 36C apply and it is the responsibility of 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 36C (1) 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.

Matters to be considered by all Guernsey licensed banks in the section 36C annual review

36C.1(a) The review of the institution's individual loans and asset classification and loss provisioning (including on and off balance sheet exposure)

The Annual Review should provide assurance that:

- *the bank has appropriate credit risk assessment processes and effective internal controls commensurate with the size and risk profile of its business (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);*
- *loans and assets are reliably classified on the basis of credit risk; and*
- *the bank's aggregate amount of individual and collectively assessed loss provisioning should be adequate to absorb estimated credit losses.*

36C.1(b)(i) Review whether the bank has in place control systems which are effective to ensure that all returns and other documents required by the Law to be submitted to the Commission are duly submitted

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 Annual Review should confirm that pre-submission controls are in place to ensure timely and accurate preparation and submission of returns and notifications. Where the required notifications have not occurred or have been late measures should be put in place to ensure that the oversight is not repeated.

36C.1(b)(ii) Review whether the bank has in place control systems to ensure that any inaccuracies in any such returns and other documents are identified, corrected and reported to the Commission expeditiously

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.

36C.1(c) Review whether financial record keeping systems and data systems are reliable

The Annual Review should seek assurance on the reliability of financial record keeping and data systems. Relevant areas which should be considered include but are not limited to, reports of errors and omissions, operational risk events, systems breakdowns, records of write-offs, sundry losses, complaint monitoring undertaken by compliance teams and internal or external auditor reports submitted to the board for review. Where errors have occurred, a review of what measures have been put in place to prevent a recurrence of the error should be included. Where a licensee outsources record keeping or the management and operation of data systems (including transaction monitoring and sanctions screening) to its group or to a third party, the review should assess the arrangements in place to ensure the effectiveness of the service being performed and its compliance with local legal and regulatory requirements.

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.

36C.1(d) Review whether any activity has been entered into in the course of the institution's business in respect of which no director has a sound knowledge.

The Annual Review should seek assurance that the business is undertaking activities consistent both with the board's expectations and within the scope of knowledge and experience of its directors. Examples of how this assurance might be obtained include reviews undertaken at board meetings of business strategy, risk and compliance reports, product development and sales performance.

For branches, consideration of how local management maintain oversight of the various aspects of the business should be included, along with a description of how these activities are reported upwards to the parent bank (e.g. to an individual director on the parent bank board, or to a committee or other meeting of the parent bank). If any director of the parent board has direct responsibility for any aspect of the branch, the individual and their area(s) of responsibility should be identified.

36C.1(e) Review the responsibilities and conduct of the institution's board of directors with respect to corporate governance principles

Banks incorporated in the Bailiwick

This section addresses compliance with the Finance Sector Code of Corporate Governance. The Code, which comprises eight principles and underlying guidance, sets a framework of good corporate governance against which licensees' governance standards can be measured. The Commission should be notified if a bank is subject to compliance with or reporting against a non-Commission, equivalent code. The Annual Review should provide assurance that an effective corporate governance process commensurate with the nature, scale and complexity of the business is in place.

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.

Branches of banks incorporated outside the Bailiwick

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. A review of how local governance operates in the context of the first seven principles is therefore required (principle 8 on shareholder relations is not relevant). Branches should consider how the principle is met by reference both to the local governance at branch level and the oversight from the parent board.

36C.1(f) Review whether there has been effective control by the institution's board of directors over every aspect of risk management.

The Annual Review should consider whether the Board has ensured that a risk management process is in place which is commensurate with the risk profile of the bank and that:

- (a) a sound risk management culture is established throughout the bank;*
- (b) policies and processes are developed for risk-taking, that 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 bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and*
- (e) senior management take the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.*

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. The Review should also address how risks to which the Guernsey branch is exposed are considered and reviewed at local management level and how these conclusions are passed on to the appropriate executive level within the parent bank so that the parent bank's board can take ultimate responsibility.

As part of the Review, all banks should identify the individual(s) employed in the Bailiwick who are responsible for risk management in accordance with 6C of Schedule 3 of the Banking Supervision (Bailiwick of Guernsey) Law 1994.

36C.1(g) Review the institution's control environment

The Annual Review should assess whether the bank has an internal control framework that is adequate to establish a properly controlled operating environment for the conduct of its business, taking into account its risk profile. The control framework should address:

- (a) organisational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g. clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g. business origination, payments, reconciliation, risk management, accounting, audit and compliance);*
- (b) accounting policies and processes: reconciliation of accounts, control lists, information for management;*

- (c) *checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and*
- (d) *safeguarding assets and investments: including physical control and computer access.*

The Annual Review should also assess whether there is a robust and independent internal audit function.

Guidance on Statement B – Licence Conditions

Statement B relates to all Guernsey licensed banks.

As part of the licensing process, the Commission imposes a standard set of licence conditions on all banks at the point that the licence is issued. The Commission, in exercise of its powers under section 9 of the Banking Supervision (Bailiwick of Guernsey) Law 1994, has imposed standard conditions (i) to (iv), below, on the licence of all Guernsey banks and standard condition (v), below, 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.

Statement B covers compliance with both the set of standard licence conditions set out above plus any further conditions specific to an individual bank. If the bank believes that it has not been in full compliance with a particular condition, then details should be given in the “Exceptions” part of the Annual Compliance Form. Please provide details of the nature of the exception, its cause, duration and the steps taken by the bank to remedy the position.

Guidance on Statement C – Liquidity Stress Testing

Statement C relates to banks incorporated in the Bailiwick only. It is not applicable to branches of banks incorporated outside the Bailiwick.

The Commission's Guidance on Liquidity Risk Management, published in July 2009, requires Bailiwick incorporated licensees to undertake liquidity stress testing on a frequency appropriate to the scale and nature of the risk, but as a minimum, at least annually. These requirements are contained in the Enhanced Liquidity Approach ("ELA") to which all Bailiwick incorporated banks are subject. A link to this document on the Commission's website can be found here: <http://www.gfsc.gg/The-Commission/Policy%20and%20Legislation/Guidance-on-Liquidity-Risk-Management.pdf>

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.

If the bank believes that it has not been in full compliance with Statement C, then details should be given in the "Exceptions" part of the Annual Compliance Form. Please provide details of the nature of the exception, its cause, duration and the steps taken by the bank to remedy the position.

Guidance on Statement D – Individual Capital Adequacy Assessment Process (ICAAP)

Statement D relates to banks incorporated in the Bailiwick only. It is not applicable to branches of banks incorporated outside the Bailiwick.

The Commission will set minimum regulatory capital as part of the Full Risk Assessment for the bank and this process is now referred to as the "ICAAP+". This means that the majority of subsidiary banks can expect to submit an ICAAP+ roughly every three years for a Medium High Impact bank and roughly every four to five years for a Medium Low impact bank.

The ICAAP is a living document and should form part of a subsidiary bank's planning and risk management framework. On that basis, the Board should regularly review the ICAAP to ensure that risks are captured as the business evolves and that the level of capital remains adequate for the business and the risks it faces. The regularity of the review is for the individual bank to decide, but a review should take place at least annually.

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

If the bank believes that it has not been in full compliance with Statement D, then details should be given in the "Exceptions" part of the Annual Compliance Form. Please provide details of the nature of the exception, its cause, duration and the steps taken by the bank to remedy the position.