Guernsey Financial Services Commission

Industry Presentations – 23 November 2012

Banking Division Presentation: Review of Banking Sector Supervision in 2012

Philip Marr, Director

Slide 2 - PURPOSE OF REVIEW

- In essence the industry seminar provides an opportunity for a supervisory round-up. Specifically it is worth reviewing how the Commission has performed against the sector's key objectives for 2012 as set out in our annual report for the year ended December 2011. It is also worth considering "what is in the regulatory pipeline?"

Slide 3 - CORE SUPERVISION - OVERVIEW

- The core supervision is around the on-going banking supervision of licensees. I would like to give you a rapid overview of what that involves:
- Intensive supervision of subsidiary banks with a capital adequacy and liquidity adequacy focus.
- The focussed supervision of branch banks – with liquidity and systems and controls emphasis.
- It also involves licensing of new banks – well, we haven't been very active on that score latterly but we have had some credible enquiries.
- I should also point out that managing the surrender of exiting banks is not always straight forward particularly if they establish a trust to accommodate the on-going liabilities relating to the bank's dormant accounts.
- Ownership changes in the banking sector and changes of controllers are very regular corporate events and our experience is they are invariably complex, even for intra-group changes of controller events and they involve a lot of work to understand precisely what is going on.
- Policing the perimeter – we use this expression to describe our activities in relation to our dealings with situations where we identify bank like structures or deposit like products.

Slide 4 - CORE SUPERVISION – CONTINUED

- For subsidiaries we have seen the further refinement of the ICAAP/SREP programme – progress has been made here and I can commend most of the subsidiary licensees for having absorbed the lessons from the first 2 cycles. The good news is that we now have mature discussions about the supporting methodology behind each of the additional risks particularly the risks generated under Pillar 2. The additional benefit is: the process has been much quicker this time as in practice we have only had to home in on one or two key risks at each bank where we felt further attention could be applied. I should add that this is a dynamic process and we do try to flag new or developing issues for the next ICAAP round – so there is ample time to consider. Please remember when you are preparing your next ICAAP. You should refer to your final Individual Capital Guidance letters for guidance on those issues.

Slide 5 - APPROACH TO BRANCHES

- Continuation of branch prudential visits – more fully this is the continuation of the re-activation of branch prudential visits which went 'on-hold' in the crisis and its aftermath. So reactivation has been beneficial by way of catch up with several of the bigger branches. As you know some include complex treasury functions holding liquid assets for the group but others have more simple upstreaming functions. Key issues in the economic recession are how does the bank respond to the low interest rate and capital hungry environment – does the bank actively bid for deposits or is it deleveraging? We also want to know: how is HO upstreaming and intergroup pricing determined. This is not always transparent so our focus will be on: what is the value to the group of the branch in Guernsey. We hope we can maintain the progress here but the reality is that there is a risk of resource stretch because of the centralisation process.

Slide 6 - DELIVERY OF AML/CFT PROGRAMME

- Delivery of the AML/CFT programme – our objective is listed as continuing the three year cycle. This objective is now in a state of change as we bring into force the AML centralised division which will include Steve Chandler who is a key member of the banking team to be in the new division from the outset. As has been mentioned elsewhere the centralised AML Division has the potential for greater consistency of assessments and aspiration for quicker turnaround of reports. With the adoption of a Risk Based Approach it is likely that banks may be seen more frequently than in the past because of the centralised resource and the adoption of the risk based approach where it is perceived that private banking and wealth management is one of the areas where Guernsey is most vulnerable to AML threats. However it is early days yet for the new AML Division. Separately you should be aware that the recently announced changes to the AML Handbook reflect feedback from industry and in particular in the area of risk profiling we have addressed the "one high, all high" approach and there is now a more flexible approach.

Slide 7 - INTERNATIONAL ENGAGEMENT

- Attendance at the Group of International Finance Centre Supervisors ("GIFCS") meeting and the International Conference of Banking Supervisors ("ICBS"): The GIFCS meetings provide one of our important opportunities for interaction with fellow Crown Dependencies Jersey and the Isle of Man and also with peer financial centres elsewhere, Gibraltar, Bermuda, Cayman Islands, BVI and Bahamas. This year we invited Philip Nicol-Gent from the trust and fiduciary division to attempt to launch an initiative to revisit and refresh the statement of best practice for trust and fiduciary practitioners which was successful. In the trust and fiduciary sphere that is the nearest there is to an international standard. The fact that we each as jurisdictions have active (and regulated) trust and fiduciary sectors is a major factor which underpins the fact that we have mutual interests between the banking and fiduciary sectors.
- Participate in colleges of supervisors : These continue and we will have done six this year. I have just returned from Bermuda from a college hosted by the Bermuda Monetary Authority in respect of the Bank of NT Butterfield. However there are also other more frequent but cost effective colleges and we participated in one recently by teleconference hosted by the Central Bank of Cyprus.
- Bi-lateral meetings with home supervisors: these continue, sometimes on specific transaction issues such as change of controller, otherwise they are set up as meetings with a bank by bank overview and the home supervisor briefing on wider developments.

Slide 8 - CREDIT BOOK ONSITE REVIEWS

- We have restarted the structured reviews of credit books for those banks actively providing credit facilities and please remember that not all banks in Guernsey are active in lending and so may not have a credit function. This had been one of the activities which was stopped during and immediately after the crisis period as we concentrated our resources on a risk based approach. It has been instructive to return to that process to see the current state of credit books and what credit quality issues have been presented. We have had to use a consultant here in tandem with the analysts and senior analysts because I for one have been engaged with the centralisation project at the Commission. During an onsite we will review procedures and practice in credit assessment, credit authorisation (including operation of the credit committee), credit administration and the annual review process. What we find is that the onsite enhances our understanding of credit risk appetite and credit quality and you won't be surprised to know we have seen some changes since 2008 especially in appetite for particular types of property lending.

Slide 9 - OTHER DEVELOPMENTS

- We have completed the revision of the Code of Conduct on advertising in conjunction with the AGB, it has been completely rewritten and that is now on the website.
- At the start of the year we introduced a standard licence condition for subsidiary banks requiring them not to repatriate capital or pay dividends without our prior

consent. That has been a useful exercise from our point of view as we have been able to validate that both executive and the boards of banks have properly considered the issues before paying away either dividends or retained earnings in the form of capital including the effect on the ICAAP. Clearly some requests from Group for a dividend do in reality amount to a repatriation of capital and we need to have current information on the capital of a bank to perform our supervisory function. We have been diligent in turning those requests around very quickly and no-one has missed any formal or self- imposed deadlines.

- Our objective to review the large exposures policy and issue guidance is continuing and Andrea will give you a synopsis of where we are and what the issues will be as we approach consultation. With our resource constraints that has unfortunately involved some slippage but we are aware of what the main issues are and Andrea will present them later.

Slide 10 - ENGAGEMENT WITH INDUSTRY AND GOVERNMENT

- Engagement with industry and government continues: this seminar is part of that process but we also engage with the AGB, Policy Council, Fiscal and Economic Policy Group ("FEPG"), Commerce and Employment and the regular GIBA meetings.
- Our final objective for 2012 was to monitor developments in the proposals to implement the so called "Vickers" UK ring-fenced banks recommendations: that, indeed, has been one of the key areas where we have liaised with the AGB, Commerce and Employment and the Policy Council. We have also liaised actively with our counterparts in Jersey and the Isle of Man. This remains a difficult and challenging area and we remain in dialogue with HM Treasury and have put several questions to them in order to clarify what would be in the art of the possible and what would be the pre-conditions for inclusion of UK retail banks in the Crown Dependencies within the ring-fence. I should add that there is now a parallel ringfence regime for UK building societies so we will be monitoring developments proposed on that front as well. The latest UK position on all this is in the White Paper on "Sound banking – delivering reform" published by HM Treasury in October.

Questions in our panel sessions.

Slide 11 - WHAT'S NEW IN REGULATION?

- What is new in regulation? The Basel Committee has confirmed the revised Core Principles at its recent International Conference. I would regard that as a post crisis review and reorganisation including the addition of a new corporate governance principle. However that systematic review also incorporates some previous additional criteria as essential criteria and before the next IMF assessment we will have to undertake a full self- assessment against those revised core principles. Audrey Branch will be attending a Financial Stability Institute Seminar in Basel which will give us more information on the implementation of those standards.

- Other items in process: Basel III – we have issued a paper jointly with Jersey and the IOM on that. The impact on the Crown Dependencies is not large as most of the issues are at the group consolidated level and will be addressed there. The discussion document involves several questions about the practicalities of liquidity management. Your comments by 12 December please. The Basel Committee itself was until recently still continuing its work on definitions of the liquidity coverage ratio and the NSFR. It is also refining its measurement methodology for its leverage ratio. Much of the discussion on the liquidity front was on the scale and type of high quality liquid assets to be held as a buffer or cushion against stress situations.
- Systemically important banks continue to be a challenging issue: there has also been some consideration around domestic systemically important banks as opposed to global systemically important banks and indeed there is some overlap there. In the UK the issue of the Vickers ringfencing solution is one approach to the issue around "too big to fail".
- One new issue that we understand Basel will be addressing is to revisit large exposures. Given we already had that on our objectives list that was somewhat of a surprise. However I have quizzed them on this point but there does not appear to be any major crisis driven trigger behind this, it is more that the whole subject has not been discussed since 1988 and is due for updating. Certainly concentration risk issues have developed into both the systemic risk element (e.g. because of sovereign exposures) and individual bank level risk. Like ourselves Basel is currently in the process of drafting a consultative document and there will be questions to be resolved about the definition of a large exposure and the treatment of sovereigns. We suspect there will be no change in the fundamentals and for substantial banks. A large exposure limit may still remain around the current conventional level of 25% of capital base.
- Don't forget our role in policing the perimeter. In the current environment we are seeing schemes that have deposit like features and organisations that appear to be holding out to be a bank. We have seen an upsurge in this area post-crisis and it is an area that has required us to increase the resource commitment.
- Plenty to do – in summary, so have you. We are alert to the difficult environment for banks low interest environment and the challenges on profitability.