

THE LICENSEES (CAPITAL ADEQUACY) RULES and GUIDANCE, 2021

CONSOLIDATED TEXT

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¹ S.I. No. 134 as amended by The Licensees (Capital Adequacy)(Amendment) Rules, 2022.

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PART 1 INTRODUCTION

1.1 Application

- (1) The Licensees (Capital Adequacy) Rules 2021 replace The Licensees (Capital Adequacy) Rules, 2010².
- (2) The Commission may in its absolute discretion, by written notice, exclude or modify the application of any provision of these Rules.
- (3) 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.

Guidance Note: This document takes a two-level approach –

- the Rules set out the standards to be met; and
- guidance notes present suggested ways of showing compliance with the Rules.

Licensees may adopt alternative measures to those set out in the guidance so long as it is possible to demonstrate that such measures achieve compliance.

The text contained in shaded boxes contains guidance from the Commission and does not form part of the Rules.

² G.S.I. No. 29 of 2010.

Guidance Note

The Capital Adequacy Rules recognise that there will be some occasions where the Rules for financial resources requirements and liquidity requirements will not take into account the nature and complexity of the licensee's business.

Such an occasion might be, for example, due to foreign exchange risk, risk of counterparty default, off-balance sheet assets or liabilities (including contingent liabilities) or principal positions which the licensee has taken.

Accordingly the Board of the licensee should consider an appropriate level above that required in these Rules and evidence that consideration.

In assessing the above, as a minimum, the Board should consider the calculations laid out in Schedule 1. These calculations are intended to be a framework.

In addition, the Commission will consider adjustments, or modification, to the Rules to allow amendments to the financial resources requirement and liquidity requirement calculation. However, the Commission will not consider such modifications or adjustments where they would permit the licensee to not meet the solvency test defined in the Companies (Guernsey) Law, 2008.

PART 2 FINANCIAL RESOURCES

2.1 Financial resources requirement

- (1) A licensee must, at all times, [maintain –
- (a) for the designated trustee or designated custodian of an open-ended collective investment scheme, net assets of not less than £4,000,000;
 - (b) for the designated administrator of a collective investment scheme, net assets of not less than £100,000 or the amount equal to the expenditure-based requirement as shown by the latest annual financial statements submitted to the Commission, whichever is greater;]³
 - (c) in the case of an entity which does not fall under (a) or (b) but is licensed, authorised, or registered under –
 - (i) The Banking Supervision Law⁴;
 - (ii) The Insurance Managers and Insurance Intermediaries Law⁵;
 - (iii) The Insurance Business Law⁶; or
 - (iv) The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. Law⁷,

³ Amended by *The Licensees (Capital Adequacy)(Amendment) Rules, 2022*.

⁴ The Banking Supervision (Bailiwick of Guernsey) Law, 2020, Order In Council No. XX of 2020.

⁵ The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002, Order In Council No. XXII of 2002.

⁶ The Insurance Business (Bailiwick of Guernsey) Law, 2002, Order In Council No. XXI of 2002.

⁷ The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2020, Order In Council No. XIX of 2020.

[capital and solvency requirements as set out in the relevant law,]⁸
where confirmed, in writing, by the Commission;

- (d) in the case of a licensee with no physical presence, meaning staff and premises, in the Bailiwick which does not fall under (a), (b), or (c) [net assets the higher of –
 - (i) £10,000; or
 - (ii) An amount which is, in the opinion of the directors, sufficient to meet its commitments and to withstand the risks to its business]⁹
- (e) [in all other cases net assets of not less than £25,000 or the amount equal to the expenditure-based requirement, whichever is greater.]¹⁰

- (2) Licensees must follow the framework for the calculation of financial resources requirements as set out at Schedule 1.

⁸ Amended by *The Licensees (Capital Adequacy)(Amendment) Rules, 2022*.

⁹ *Ibid.*

¹⁰ *Ibid.*

[PART 2A INSURANCE ARRANGEMENTS]¹¹

2A.1 Insurance arrangements

- (1) A licensee must maintain insurance cover which is commensurate with the size and nature of the business. Cover must include professional indemnity insurance and insurance against employee dishonesty or fraud.

Guidance Note:

The PII policy can be in the form of commercial insurance, as commonly seen in the market, or captive insurance. Both forms are accepted given the risk is transferred from the licensee or its group. The policy may or may not have the term “professional indemnity insurance” included in its description.

The consideration, by a licensee of its insurance requirements, should be clearly documented, at local board or senior management level, to demonstrate how the decision was made. The Commission expects all licensees, whether or not they are part of organisations with offices elsewhere, to consider the insurance requirements for the entities in the Bailiwick.

Where a local operation is part of a group and the local board or management do not consider the cover available, to the Guernsey licensee, to be adequate, the Commission expects the Board, or management, to make arrangements to maintain appropriate cover. This may include purchasing a separate policy for the local operation.

¹¹ This Part was inserted by *The Licensees (Capital Adequacy)(Amendment) Rules, 2022*.

2A.2 Minimum indemnity limit and excess of the PII policy

(1) For the designated trustee, or designated custodian, of an open-ended collective investment scheme, and the designated administrator of a collective investment scheme, the minimum indemnity limit for any one claim, and in the aggregate, must equal or exceed the greater of -

(a) three times relevant income; or

(b) £1,000,000,

where the relevant income is based on the latest audited financial statements or, for new businesses, the estimated figure for the first year.

(2) A licensee with no physical presence, meaning staff and premises, in the Bailiwick which does not fall under rule 2A.2 (1), must maintain PII cover which is, in the opinion of its directors, sufficient to meet its commitments and to withstand the risks to its business.

(3) In all other cases, the minimum indemnity limit for any one claim, and in the aggregate, must equal or exceed the greater of -

(a) three times relevant income; or

(b) £250,000,

where the relevant income is based on the latest audited financial statements or, for new businesses, estimated figures for the first year.

(4) For the purposes of this Part, "relevant income" means income from controlled investment activity and any other regulated activity, where applicable.

Guidance Note:

The relevant income should be based on the latest audited financial statements at the time of PII renewal.

Insurance cover based on a prior year's audited financial statements does not need to be amended before the next annual renewal following the release of the following year's financial statements. However, a licensee should consider whether to arrange additional cover if the audited financial statements show a material increase in relevant income.

Income from "other regulated activity" will include income from regulated activity within the meaning of the Fiduciaries Law, where applicable.

- (5) Notwithstanding (1) to (3), a licensee is not required to have aggregate insurance cover exceeding £10,000,000 provided that the Board of the licensee has considered and decided that such level of cover is appropriate and sufficient for its business. The licensee must be able to evidence the Board assessment if requested by the Commission.

Guidance Note:

Subrule 2A.2(6) is also applicable to a licensee which is a part of a group and relies on PII cover provided by the group. For this case, the consideration should ensure that the group PII policy is appropriate for the licensee.

EXCESS:

Consideration should be given to the excess per claim on the PII policy and whether it is appropriate for the licensee taking into account its financial position. Specifically, the licensee should ensure that it will be able to fund the excess if a claim is made on the PII policy.

- (6) Where the licensee also carries out unregulated activities, the licensee must consider whether the minimum indemnity limit of its PII policy, and scope of the PII cover, are appropriate for its businesses, considering possible claims that may also arise from unregulated business.

- (7) Where a licensee also holds a licence under another Regulatory Law, the licensee must meet the PII rules under whichever regime requires the highest aggregate minimum indemnity limit, unless otherwise instructed by the Commission.

2A.3 Scope of cover

- (1) A licensee must maintain, at all times, cover for –
- (a) negligence, errors, or omissions by the licensee or its employees;
 - (b) any liability for the dishonest or fraudulent acts of employees which may fall on the licensee;
 - (c) liabilities of its employees who, in the course of their duties to the licensee, perform functions in their own names;
 - (d) liabilities which the licensee might incur, in any jurisdiction, in which it should reasonably foresee that it may be held liable for damages and costs;
 - (e) where relevant, ombudsman awards; and
 - (f) legal defence costs.

Guidance Note:

EMPLOYEE – The Law defines “employee” as “an individual who has entered into or who works under (or, where the employment has ceased, who worked under) a contract of employment.

For the purposes of subrule 2A.3(1)(a), the policies should cover current and former employees and any person under contract to perform services or duties to or on behalf of the licensee. (Note – time limitation may apply to the period of cover for former employees and will be dependent on the date of cessation of employment.)

Guidance Note -continued:

In meeting subrule 2A.3(1)(b), some licensees may rely on a different insurance instrument for indemnity against such liabilities, provided that the licensee is satisfied with such insurance arrangements. Insurance policy wordings vary greatly, and licensees should consider whether its policy provides the required cover. For instance, these may be covered under ‘crime’, ‘fraud’, or ‘fidelity’. Some policies may contain limitations on ‘dishonest or fraudulent acts’, such as a carve out on deliberate dishonest acts. Where there is such limitation, or exception, the licensee should assess whether the policy is considered appropriate for its business.

Subrule 2A.3(1)(e) – applies to licensees which carry out activities within the scope of the Channel Islands Financial Ombudsman.

2A.4 Captive insurance

- (1) Where a licensee relies on captive insurance to meet requirements under this Part, the captive insurer must be licensed under the Insurance Business Law¹², or a captive insurer of an equivalent status in Jersey, Gibraltar, Bermuda, Isle of Man or a country which is a full member of OECD.

Guidance Note:

NOTIFICATIONS RELATING TO PII

Principle 10 of the Principles of Conduct of Finance Businesses states that “A financial institution should deal with the Commission in an open and co-operative manner and keep the Commission promptly informed of anything concerning the financial institution which might reasonably be expected to be disclosed to it”.

When a licensee makes a notification, under a PII policy to their insurer, the licensee should consider whether a notification should also be made to the Commission.

¹² The Insurance Business (Bailiwick of Guernsey) Law, 2002, Order In Council No. XXI of 2002.

PART 3 LIQUIDITY RESOURCES

3.1 Liquidity resources

- (1) This rule does not apply to licensees who follow the financial resources requirements set out in rule 2.1 (1)(c).
- (2) The licensee must maintain, at all times, a liquidity requirement which is the greater of either –
 - (a) £10,000; or
 - (b) 10% of annual audited expenditure.

PART 4 NOTIFICATIONS

4.1 Immediate notification

- (1) A licensee must notify the Commission, immediately, where –
 - (a) it is in breach of its financial resources requirement or liquidity requirement; including setting out, in writing, the steps that it is taking, or has taken, to remedy the breach;
 - (b) it anticipates being in breach of its financial resources requirement within one month; including setting out, in writing, the steps that it proposes to take to avoid the breach;
 - (c) it's auditor intends to qualify the accounts;
 - (d) the liabilities of a subsidiary of the licensee exceed the subsidiary's assets;
 - (e) the liabilities of the parent company of the licensee exceed the parent company's assets.

PART 5 GENERAL PROVISION

5.1 Interpretation

- (1) In these Rules terms have their ordinary meaning unless specifically defined in the Law or in these Rules.
- (2) In these Rules the following definitions should be followed -

“accounting reference date” means the date to which the licensee’s accounts are prepared;

“adjustments” means –

- (a) deductions for non-current assets which includes any investment in a subsidiary, debtors arising from sales or other transactions to associates, any deficiencies where the liabilities of a subsidiary of a licensee exceed its assets, and any other assets specified, in writing, by the Commission; and
- (b) additions for creditors arising from purchases or other transactions from associates and other liabilities specifically permitted in both cases, in writing, by the Commission; and
- (c) deduction of the amount of the excess on the licensee’s PII policy;

“annual audited expenditure” means either –

- (a) an estimate of budgeted expenditure for the first twelve months which is submitted to the Commission, in the case of a licensee which has not yet commenced its controlled investment business; or
- (b) the expenditure as stated in the reported results in the immediately preceding period’s audited financial statements

and, in either case, excluding any remuneration to directors whether through salary, bonuses, or other benefits; this should exclude fees and commissions payable which are directly attributable to fees and commissions receivable and should also exclude depreciation and amortisation of non-current assets;

“audited financial statements” has the meaning given to it in rule 4.2 of The Licensees (Conduct of Business) Rules, 2021;

“carry value” is the value of the item carried in the balance sheet, determined by reference to GAAP;

“client” means any person with, or for whom, the licensee carries on, or intends to carry on, controlled investment business;

“current assets” means assets falling to be realised within one year of the accounting reference date;

“current liabilities” mean liabilities due to be realised within one year from the accounting reference date;

“expenditure-based requirement” means a figure equal to 25% of the licensee’s annual audited expenditure;

“generally accepted accounting principles (“GAAP”)” includes those accepted in –

- (a) the UK;
- (b) the United States; or
- (c) any other country approved in writing by the Commission;

“liquidity requirement” means the value of current assets minus current liabilities less loans to group companies, which must be at least equal to 10 per cent of annual audited expenditure, or £10,000, whichever is the greater as per rule 3.1;

“margin requirement” means the margin required by the exchange or clearing house over which the derivative is being traded;

“net assets” means total assets less total liabilities after adjustments of the licensee and calculations required by Schedule 1;

“total assets” means assets of any type which will include non-current assets, and current assets, including debtors;

“total liabilities” means liabilities of any type which will include creditors and provisions for liabilities and charges;

“total revenue” means revenue of any type which will include commissions, investment management fees, advisory fees, interest and dividends.

PART 6 TRANSITIONAL ARRANGEMENTS, REVOCATIONS, CITATION AND COMMENCEMENT

6.1 Transitional Arrangements

- (1) Confirmations, issued by the Commission under rule 2.2.3 of The Licensees (Capital Adequacy) Rules, 2010, will be accepted as having been issued under these Rules.
- (2) Any other exclusion or modification granted by the Commission, under The Licensees (Capital Adequacy) Rules, 2010, will continue to apply where the Law and these Rules provide scope for such exclusions and modifications.
- (3) [Licensees must comply with the amendments made to these Rules, by the Licensees (Capital Adequacy)(Amendment) Rules, 2022, at their next insurance renewal following the date on which the Licensees (Capital Adequacy)(Amendment) Rules, 2022 come into force.]¹³

6.2 Revocations

6.2.1 Revocation of The Licensees (Capital Adequacy) Rules, 2010

- (1) The Licensees (Capital Adequacy) Rules, 2010 are revoked.

6.3 Citation and commencement

- (1) These rules may be cited as the Capital Adequacy Rules, 2021.

¹³ This transitional provisions was added by the Licensees (Capital Adequacy)(Amendment) Rules, 2022.

(2) These rules come into force on 1st November 2021.

SCHEDULE 1
FRAMEWORK FOR THE CALCULATION OF FINANCIAL RESOURCES
REQUIREMENT

Net Assets

Net assets after adjustments		X
Less: <i>Contingent liabilities that require disclosure or provision under GAAP</i>		X
<i>Position risk</i>		X
<i>Counterparty risk</i>		X
Net assets after adjustments, contingent liabilities, and risks		X

Position Risk

Sovereign Debt	5% of carry value	X
Daily-dealing Money Market		
Open-ended CIS ¹⁴	5% of carry value	X
Other Marketable Debt	10% of carry value	X
Listed/Publicly Traded Equities	25% of carry value	X
Open-ended and Closed-ended CIS (excluding daily-dealing CIS, as above)	25% of carry value	X
Other derivative products (as referred to in Sch. 1 to the Law)	25% of carry value <i>or</i> 4 times initial margin requirement, <i>whichever is greater</i>	X
Illiquid current assets (defined as being more than 90 days)		X
Position Risk		X

¹⁴ Collective Investment Scheme.

Counterparty Risk

Exposure to any one counterparty is at least 25% of financial resources req.	15% of excess over 25%	X
Exposure to any one counterparty is at least 50% of financial resources req.	40% of excess over 25%	X
Counterparty Risk		X

Guidance Note:

Margin Requirement

The margin requirement may only be used as a measure for calculating the position of risk of derivative products if it is considered, by the board of the licensee, to appropriately reflect that risk.

Counterparty Risk

For the purposes of calculating the counterparty risk, the Commission recognises that not all unsettled bargains should be included. Accordingly, the provisions above only apply to bargains which are unsettled after 15 days (unless the bargain is subject to a legally enforceable guarantee).

Any money held at a bank with terms of less than 90 days should also be excluded from the counterparty risk.