Guernsey Financial Services Commission

Consultation Paper on Amendments to the Banking Rules on Accounts, Disclosure, & Large Exposures

Issued 16 March 2021

Contents

Responding to the Consultation Paper

Responses to this Consultation Paper are welcomed before 11 May 2021.

You can send your response to us via the Consultation Hub section of the Commission's website (www.gfsc.gg).

https://consultationhub.gfsc.gg

Introduction

Purpose of the Consultation Paper

The purpose of this Consultation Paper is to seek feedback from stakeholders and interested parties on the issues contained in the paper and the proposed revisions to the relevant rules and guidance issued under the *Banking Supervision (Bailiwick of Guernsey) Law, 2020*[1] ("The Law"), which is intended to replace the *Banking Supervision (Bailiwick of Guernsey) Law 1994*[2]. This includes the Banking (Accounts) Rules 1994 and the Large Exposure Policy.

The proposals in this Consultation Paper are relevant to all institutions in Guernsey that hold a banking licence ("Licensed Institutions") under The Law.

The Commission is committed to meeting international standards to ensure the continuing credibility of Guernsey as an international financial services centre. We are also committed to introducing rules, on a proportionate basis, to implement standards which take proper account of the economic wellbeing of the Bailiwick and the firms which operate in it; as well as safeguarding depositors.

The Commission has been considering internally the updates to the Basel III standards finalised in December 2017 (sometimes colloquially referred to as Basel IV) and how best to implement them in a way that makes sense for the local banking sector. Given that the implementation date has been deferred by one year to 2023 we do not intend to consult on these issues now.

The above exercise highlighted a number of areas where the Commission's supervisory framework needed to be updated to meet the Basel Framework for banking regulation. It is the policy of the Commission to adopt international standards that are proportionate to the scale and nature of the Bailiwick's industry. The proposals in this consultation are intended to address those points.

The areas addressed in this paper are:

- Accounting Information and Disclosure
  - The Commission proposes to clarify the accounting standards Licensed Institutions incorporated in the Bailiwick may use and update the existing disclosure requirements to include a limited amount of key regulatory information.
- Large Exposures and Upstreaming
  - The Commission proposes to update its large exposure and upstreaming regime to bring it more fully in line with international standards and reduce concentration risk, while making a number of allowances for the nature of the local industry. This will only effect Licensed Institutions incorporated in the Bailiwick.

[1] The 2020 Banking Law: Banking Supervision (Bailiwick of Guernsey) Law, 2020 - Guernsey Legal Resources
[2] The 1994 Banking Law: Banking Supervision (Bailiwick of Guernsey) Law, 1994

The Commission is also planning to update the sign off and verification requirements for its banking regulatory returns. We are taking this opportunity to inform licensees of this change.

The key aims of the proposals in this Consultation Paper are to:

- enhance the effectiveness, clarity and transparency of the regulatory requirements;
- increase the information available for stakeholders;
- reduce concentration risk in order to increase the soundness of the banking sector and protect depositors; and
- meet international standards.

The content of this Consultation Paper is at the proposal stage and does not prejudge any final decision to be made by the Commission.

Next Steps

The closing date for the Consultation Paper is 11 May 2021. Responses to this Consultation Paper will be considered by the Commission prior to issuing new rules and guidance under The Law.

Part 1 – Accounting Information and Disclosure

The proposals in this section apply to Licensed Institutions incorporated in the Bailiwick.

1.1 Accounting rules

The Commission proposes to require licensed institutions to use one of a number of specific accounting standards permitted by the Commission. The proposal would apply to subsidiary banks, which are incorporated in the Bailiwick but not to licensees incorporated elsewhere (branches).

Rationale

It is important that accounts prepared by licensees conform to acceptable international accounting standards and provide the robust financial reporting and information required by the Commission. The Basel Framework[3] includes an obligation that "*banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion*[4]*".*

All licensed institutions are required to prepare accounts containing the information specified in the law and other guidelines issued by the Commission. The current rules[5] date back to 1994 and do not specify which accounting standards should be used. Guernsey based banks make use of several different accounting standards, including various IFRS and national GAAP standards.

The standards proposed are internationally recognised and are already in use by the banks incorporated in the Bailiwick. They meet the Commission's reporting requirements and are in line with the principles of the Basel Framework.

Proposal

The Commission proposes to update its rules to specify relevant accounting standards to ensure that licensed institutions which are incorporated within the Bailiwick continue to use appropriate standards that meet the Commission's requirements.

The existing (1994) rules will be replaced by the *Banking Supervision (Accounts, Disclosure & Reporting) Rules 2021*, as set out in Annex A. The new rules will require banks to use one of the following accounting standards approved by the Commission for the purpose of financial reporting:

- IFRS;

[3] Basel Framework – Core Principles BCP01 - The core principles (bis.org)
[4] Principle 27 of the Basel Core Principles: BCP01 - The core principles (bis.org)
[5] *The Banking Supervision (Accounts) Rules, 1994* which came into effect 1 October 1994

- UK GAAP; and
- US GAAP.

As this covers the range of standards in use by licensed institutions incorporated within the Bailiwick, no licensed institution would be required to change the accounting standard it currently uses. The Commission may approve the use of a different accounting standard by a licensee or potential licensee on a case by case basis.

A number of bank branches are part of groups which adopt different accounting standards. Since they are incorporated outside the Bailiwick, they will not be affected by this proposal.

Consultation questions

Respondents are asked to comment on:
1. Should the GFSC specify relevant accounting standards for Licensed Institutions? If not, why not?
2. Should additional accounting standards be included in this list? If so, which standards and why?

1.2 Disclosure

The Commission proposes to update its rules on disclosure to modernize its approach and improve accessibility and the range of information reported, to bring us closer into line with the Basel Principle. In particular, the principle that supervisors should require that banks should regularly publish information which fairly reflects their financial performance and risk exposures.

This proposal applies to licensed institutions which are incorporated within the Bailiwick (subsidiary banks).

Rationale

Disclosure of information is an existing obligation for all licensed institutions (bank branches and subsidiary banks) operating in Guernsey, and has been for many years, in line with section 31 of the *Banking Supervision Law 1994*, and *The Banking Supervision (Accounts) Rules 1994*.

Under the current (1994) Rules, Licensed Institutions incorporated in the Bailiwick of Guernsey (subsidiary banks) are required to make a copy of their audited accounts and auditor's report available to any person on request. For Licensed Institutions incorporated in the Bailiwick of Guernsey, the accounts provided must be audited and include at least the information set out in guidelines[6] issued by the Commission from time to time. Other licensed institutions (branches) are required to provide to the Commission and make available on request the audited accounts of the main group.

The BCBS (Basel Committee on Banking Supervision) sets out the core principles which reflect minimum standards that should be applied by all banking supervisors. Within the Basel Core Principles, BCP 28[7] specifies that supervisors should require banks to "*regularly publish information on a consolidated and where appropriate solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures and corporate governance policies and processes".* It goes on set out the essential criteria relating to this principle, including that the supervisor determine the required disclosure of qualitative and quantitative information and that the supervisor or other government agency effectively review and enforce compliance with disclosure standards.

The current approach by the Commission is limited to financial accounts, it does not include information on other key metrics which are relevant to the prudential regulation of banks, and access is through specific requests made in person at a local branch of the bank, which does not make information easily accessible.

[6] Existing guidelines may be found here:
Guidelines to Banks and their Auditors issued under s1(a) of the Banking Supervision (Accounts) Rules 1994;
Guidelines to Banks and their auditors issued under s1(b) (ii) of the Banking Supervision (Accounts) Rules 1994.
[7] Principle 28 of the Basel Core Principles (see s01.33): BCP01 - The core principles (bis.org)

The way in which the majority of people engage with financial institutions and access the information they need to make informed decisions about finances and investment has changed substantially since 1994. Customers and depositors expect to be better informed, better protected and better able to access information in a way which is convenient to them. This generally means that information should be made available online, on the bank's website. Limiting access to information to those who are able to visit a specific office in person is unduly restrictive. There are those for whom this simply would not be a practical option – for reasons of accessibility, for example – or because of other restrictions as highlighted by the corona virus pandemic, and it is important that such parties should have access to the same information as other depositors or potential depositors.

The Commission considers that information should be made available by licensed institutions in order to ensure that their customers and prospective customers are able to make well informed decisions about the security of their deposits with Licensed Institutions. In addition to the accounts and auditor's report, this should include key metrics relating to bank stability and liquidity.

The Commission recognises that the parent groups of local bank branches fall within the oversight of their home jurisdictions and these banks already publish accounts and key information at a group level.

Proposal

The Commission proposes that licensed institutions incorporated in the Bailiwick (subsidiary banks) should make available their audited annual accounts (an already long-standing requirement in the Bailiwick) together with information on key metrics for liquidity and financial stability. Such information including the key ratios is already routinely published at the group/parent level. This information should be made available in a way that is accessible and reflects the way in which most customers and their advisors would choose to access information.

The Commission proposes to update its rules on disclosure so that:

- information is published online on the licensed institution's own website;
- information is made available in a form that is accessible and reflects the substantial changes to technology since the original rules were made in 1994; and
- the disclosure requirements include information on key metrics in addition to the financial accounts and auditor's report.

It is proposed that the key metrics should comprise the following additional information:

- the Common Equity Tier 1 Capital Asset Ratio (CET1 CAR) calculated as the ratio of CET1 capital to total risk weighted assets;

- the Liquidity Coverage Ratio ("LCR"), or Liquidity Mismatch Ratio ("LMR") as appropriate[8];
- the Net Stable Funding Ratio ("NSFR"); and
- the Leverage Ratio.

This information is already reported to the Commission by licensed institutions in their regulatory returns on a monthly or quarterly basis. It is proposed that the information is published annually at the same time as the relevant set of financial accounts.

The figures disclosed should be the figures reported to the Commission at the accounting year-end of the bank, and that information should be published on the licensed institution's website. If the licensed institution does not have a website of its own, it may publish the information on the group website.

Therefore *The Banking Supervision (Accounts) Rules, 1994*, shall be replaced with the *Banking Supervision (Accounts, Disclosure & Reporting) Rules, 2021*, as set out in Annex A, which clarify the requirement for disclosure; specify the information that should be made available and in what form.

Consultation questions

Respondents are asked to comment on:
3. Do you agree that the information to be disclosed is appropriate? Have we identified the correct key metrics?
4. How should information on the key metrics be reported? Should it be limited to the headline ratios (as proposed) or should it include underlying information used to calculate the key metrics?

[8] The ratios are specified here: Guidance on Liquidity Risk Management

Part 2 – Large Exposures and Upstreaming

This section of the Consultation paper is relevant to Licensed Institutions incorporated in the Bailiwick (subsidiary banks).

2.1 Large Exposures

Strategic direction

In the past, there have been a number of bank failures due to significant, concentrated exposures to individual counterparties. Some of the issues leading to the 2008 Financial Crisis were, in part, caused by this. As a hypothetical example, consider a bank that makes a loan to a client that is worth more than 100% of its capital base. If that client were to default on that loan, the bank would become insolvent, leading to potentially significant losses for its depositors.

Over time large exposures rules and regulations have been developed as a means to limit the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency, and by extension, its depositors. One of the main ways this is achieved is through placing limits on the maximum size of an exposure that a bank can have to a particular counterparty, as a percentage of the bank's capital base.

Another significant contributor to the 2008 Financial Crisis was the level of interconnectedness between financial institutions and the fact that connections were not readily apparent. There are two other important parts to a large exposure framework that are intended to help address this issue. The first is the requirement that banks aggregate all exposures to counterparties that are connected when measuring large exposures and applying exposure limits. For example, when lending to two entities with the same beneficial owner, banks would need to aggregate those loans. The second element is the requirement to look through to any underlying security. Banks will often take a charge over the assets of a client or receive a guarantee from a separate party in order to reduce the credit risk of a loan. When they do so for large exposure purposes, they also need to recognize an exposure to that security. Taken together, these elements are intended to make sure the banks are fully identifying all the parties they have exposures to, how those parties are related and connected and how risk could be transferred through those connections.

This is important given how interconnected the financial system is and how complex certain structures can be, particularly within the wealth management and trust sectors.

The Commission is proposing a number of changes to its Large Exposure Policy to bring it in line with the updated Basel Framework and address some of the issues highlighted by the 2008 financial crisis that drove those updates. It is the policy of the Commission to adopt international standards that are proportionate to the scale and nature of the Bailiwick's industry.

However, there are some elements of the Basel Framework that we are not proposing to implement or where our proposals diverge slightly. This is for a number of different reasons.

The Basel Framework focuses on the supervision of large international banks at a group level and some elements are not relevant to local banks. The Basel Framework is also complex and inter-connected. In some areas we have sought to simplify the requirements or make proportional allowances given the nature and characteristics of the local banking sector.

An example of an element that is not relevant to local banks would be the trading book requirements. The Commission understands that licensed institutions incorporated in the Bailiwick do not engage in significant trading book activities for their own account. As such the Commission does not propose to implement the trading book elements of the Basel Large Exposure Framework.

While making these changes the Commission has re-stated the Large Exposure Policy as a set of rules and guidance. This should improve the clarity of the requirements and make them easier to reference. However, as a consequence, it is not practical to provide a black-lined version showing the changes between the new and old documents as the transition to rules has resulted in significant changes to the structure of the document and the language used. Other than the specific changes noted in this paper, much of the content of the current Large Exposure Policy has been retained in the proposed Rules and Guidance. Footnotes have been included in each section with page or section numbers for the Commission's current Large Exposure Policy, the proposed Draft Rules and the Basel Framework in order to make it easier to reference the changes and see where the proposals align or diverge from Basel.

There are a number of blue text boxes in this section of the Consultation Paper. They are used for more technical discussions of why and how the Commission's draft Rules represent a proportional local market specific implementation of the Basel Framework or to provide a more detailed definition of some terms and concepts.

For example:

> Exposures:
>
> The total amount at risk from all of a bank's assets, should the counterparties to those assets default.
>
> Large Exposure:
>
> An exposure to a counterparty or group of connected counterparties that is greater than or equal to 10% of the bank's net capital base.

Related party exposures[9]

The current Large Exposure Policy (and the proposed large Exposure Rules) include requirements for the treatment of related party exposures. These state that any exposures to entities and persons related to the bank must be carried out on an arm's length basis.

In line with other rules and the Basel Core Principles the definition of a related party has been expanded to cover the directors, controllers and key staff of related companies and their associates.

Exposure limits

Under the Commission's current policy large exposure limits are defined in relation to total regulatory capital. In alignment with the Basel Framework, it is proposed that large exposure limits will be defined in relation to Tier 1 Capital only in the draft new Rules[10]. A number of licensed institutions hold Tier 2 capital, so this change will involve an adjustment for those entities.

Tier 1 and Tier 2 Capital

Tier 1 Capital is high quality capital. It is mainly made up of share capital, retained earnings and other reserves, with the addition of some regulatory adjustments and deductions. It is the most permanent form of capital and the most readily available to absorb losses.

Tier 2 Capital is viewed as lower quality than Tier 1. It mainly consists of debt instruments issued by the bank that are subject to convertibility or written-down provisions. It is less permanent than Tier 1 and less readily available to absorb losses.

For these reasons, it is appropriate to set large exposure limits in relation to Tier 1 capital.

Client Exposure Limits[11]

Currently exposures to any individual client or group of connected clients are subject to a limit of 25% of capital. The Commission is not proposing to change this, other than the change from total capital to Tier 1 Capital. This is in line with the Basel Framework.

Interbank Exposure Limits[12]

With regard to interbank exposures, there are a number of issues to consider. The Basel Framework does not distinguish between interbank large exposures and exposures to other types of entity and sets an exposure limit of 25% of Tier 1 Capital for all large exposures. A direct application, therefore, would entail a significant reduction from the current limit of 100%

[9] Large Exposure Policy - 2014 – pg.7, Draft Large Exposure Rules 2021 – 2.3.3, Basel Core Principles – Principle 20
[10] Large Exposure Policy - 2014 – pg.4, Draft Large Exposure Rules 2021 – 2.2, Basel Framework – LEX10.8
[11] Large Exposure Policy - 2014 – pg.13, Draft Large Exposure Rules 2021 – 5.2(1), Basel Framework – LEX20.1
[12] Large Exposure Policy - 2014 – pg. 10, Draft Large Exposure Rules 2021 – 5.2(2), Basel Framework – LEX20.1

of total capital to 25% of Tier 1 Capital. This would likely result in licensed institutions needing to substantially increase their number of interbank counterparties or collateralise more of their interbank lending. Given the relatively small size of many local banks they may also struggle to find counterparties in the inter-bank market that are prepared to accept placements at the reduced limit. For this reason, internationally it is commonly accepted practice to make allowances for smaller banks when setting interbank large exposure limits.

The Commission's preferred approach therefore would be to set an interbank exposure limit of 50% of Tier 1 Capital. This would allow a licensed institution to weather the failure of at least one interbank counterparty. All entities would be operating to the same limit and it would not require adjustment in the future, unlike a limit defined in relation to a specific amount of capital.

One aspect of the Basel Framework that the Commission is proposing to implement in a proportionate Bailiwick specific fashion is the exclusion of intraday interbank exposures from the large exposure framework. This is for a number of reasons, set out below[13].

Intraday interbank exposures.

The aim of excluding these types of exposures in the Basel Framework is to avoid disturbing the ordinary payment and settlement processes.

The Commission achieves this aim by specifically excluding exposures due to settlement and payment activities in both the current policy and the proposed new Rules[14].

Directly applying the intraday exclusion has the potential to result in there effectively being no interbank exposure limit as a bank could choose to deposit all its excess funds overnight.

This would not meet the Commission's aim of to limit the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency, and by extension, its depositors.

While short term exposures carry less risk of default, they are not completely without risk as, historically, some bank failures have occurred very quickly.

This restriction on interbank exposures may still cause some licensed institutions difficulties in making overnight placements of funds. This may be due to, for example, large, unexpected flows of funds while interbank exposures are close to the limit with longer term placements. To aid licensed institutions in their handling of this practical challenge, the Commission proposes to allow the interbank limit to be exceeded on a temporary basis subject to the excess being cleared within 2-3 working days and the Commission being notified post-event[15]. This would then not be considered a breach of the Rules, although the Commission would not expect to see this happen regularly.

[13] Basel Framework – LEX30.36
[14] Large Exposure Policy - 2014 – pg. 6, Draft Large Exposure Rules 2021 – 3.2
[15] Draft Large Exposure Rules 2021 – 6.4

However, under the proposed new rules, the Commission will retain the ability to vary the interbank exposure limit (and other exposure limits) or exclude some exposures in individual cases if appropriate and prudent to do so.

Sovereign Exposure Limits[16]

In line with the Basel Framework, it is proposed that under the draft new Rules exposures to sovereigns and multilateral development banks will no longer be subject to a large exposure limit. Sovereigns include the governments of Guernsey, Jersey and the Isle of Man. The Commission expects licensed institutions to continue to manage their exposures to governmental counterparties prudently.

Sovereigns

Sovereign exposures include both direct exposures to a government, such as through the holding of UK government Gilts, or exposures to government agencies that have the full faith and credit of the government. Exposures to agencies and public bodies that do not have such an unconditional guarantee are not eligible for treatment as a sovereign exposure.

Covered Bonds[17]

The Basel Framework includes provisions for the valuing of covered bonds for large exposure purposes that are not included in the Commission's current Policy so we are proposing to include them in the draft new Rules.

Covered bonds that meet specific criteria around the quality of the assets backing the bond can be assigned an exposure value of 20% of the nominal or face value of the bond for large exposure purposes.

Covered Bonds

Covered bonds are bonds issued by a bank or mortgage institution collateralized against a pool of assets, often mortgages, that can be used to cover claims. They are subject by law to special public supervision designed to protect bond holders.

Covered bonds stay on the balance sheet of the issuer, unlike asset-backed securities, so the investor has recourse to both the issuer and the pool of assets.

They are commonly issued in a number of European countries, with Denmark, Germany and France being amongst the largest issuers.

[16] Large Exposure Policy - 2014 – pg. 11, Draft Large Exposure Rules 2021 – 5.3, Basel Framework – LEX30.32
[17] Draft Large Exposure Rules 2021 – 3.1(7), Basel Framework – LEX30.38

Exposures to Central Counterparties[18]

The Commission's current large exposure policy does not specifically address exposures to central counterparties. However, the Basel Framework excludes from the aggregation of large exposures, exposures to qualifying central counterparties that are related to clearing activities. So in the draft new Rules the Commission is proposing to do the same.

Central Counterparties

Central counterparties, sometimes referred to as central clearing counterparties, are institutions that provide clearing and settlement services for trades in derivatives, foreign exchange, options and securities. They take on the counterparty credit risk between the two parties to a transaction.

A qualifying central counterparty is an entity that is licensed and regulated to operate as a central counterparty.

An example of a central counterparty is LCH.Clearnet.

Financial collateral and other Credit Risk Mitigation techniques

Currently licensed institutions are able to use financial collateral (limited to cash and government bonds), guarantees and participation agreements to reduce the net value of a large exposure below the relevant limit. These are sometimes referred to as *credit risk mitigation techniques*. The Commission is proposing to adopt the Basel Framework approach to credit risk mitigation. This will expand the types of eligible collateral while also more clearly defining the criteria they must meet. This approach will apply to all types of large exposure and upstreaming regardless of the counterparty.

Under the Basel Framework[19], credit risk mitigation for large exposures follows the same rules and conditions as credit risk mitigation for capital requirement purposes, under the Standardised Approach to Credit Risk. The Commission is not proposing to replicate elements of our capital requirement framework in the draft new Rules, instead the Rules will simply refer to the Standardised Approach, as published by the Commission.

The Standardised Approach to Credit Risk[20]

The Standardised Approach to Credit Risk defines how banks are required to calculate the amount of capital they need to maintain to back the loans they've made and other assets they hold. This is done by weighting each of the bank's assets based on how risky the asset is. The level of risk is based on the likelihood that the counterparty to the loan or asset will default and not be able to pay back the bank. These weighting are defined by the Commission. Capital requirements are then based on the weighted asset values.

[18] Draft Large Exposure Rules 2021 – 3.2(1)(e) and (f), Basel Framework – LEX30.55
[19] Basel Framework – LEX30.7
[20] Standardised Approach to Credit Risk

For example, exposures to governments with a high credit rating have a 0% weighting. This means that banks would not have to hold any capital to back an exposure to such a government.

Banks can use credit risk mitigation techniques to reduce the value of an exposure that the weighting is applied to. Under the Standardised Approach banks can use the either the Simple or Comprehensive approach to credit risk mitigation.

The Simple approach operates on the basis of the substitution of risk weights. For example, if a bank made a loan to a counterparty, they would use the risk weight appropriate to that counterparty. If that counterparty provided the bank with a guarantee from a third party or some corporate bonds as collateral, the bank could then use the risk weighting of that third party or corporate instead.

Under the Comprehensive approach, before the weighting is applied the value of the exposure is reduced by the value of the collateral. However, the value of the collateral is first reduced by the application of various haircuts. The haircuts banks must use are defined by the Commission.

Under the proposed new Rules, the types of financial collateral[21] licensed institutions will be able to use to mitigate large exposures will be expanded to include the following:

- Cash on deposit with the licensee and certificates of deposit;
- Gold;
- Sovereign-issued debt securities externally rated BB- or better (S&P or equivalent);
- Other debt securities externally rated BBB- or better (S&P or equivalent);
- Unrated bank debt securities;
- Main index equities or equities listed on a recognised exchange; and
- Collective investment schemes.

In line with the Basel Framework, the Commission is also proposing that licensed institutions will be required to use the same credit risk mitigation techniques for large exposures and capital requirement purposes. For example, if a licensed institution used corporate bonds to mitigate a large exposure, they would have to do the same when calculating their capital requirement due to that exposure.

If an exposure, or portion of an exposure, is mitigated by a credit risk mitigation technique the licensed institution must recognise an exposure to the provider of that credit mitigation which must then be aggregated with other exposures to that counterparty as normal[22].

The exception to the approach set out above is unfunded credit protection which is provided by a licensed institution's Group or parent. These guarantees and/or credit derivatives will not count towards the bank's upstreaming limit. This is discussed in more detail in the "Upstreaming" section of this Consultation Paper.[23]

[21] Large Exposure Policy - 2014 – Pg.13, Draft Large Exposure Rules – 3.3, Basel Framework – LEX30.7
[22] Draft Large Exposure Rules 2021 – 3.3(3), Basel Framework – LEX30.14
[23] Draft Large Exposure Rules 2021 – 5.1(6)

On Balance Sheet Netting[24]

In line with the Basel Framework, the Commission is proposing to allow netting of banking book loans and deposits with the same counterparty for the purpose of determining the level of exposure to that counterparty. A licensed institution may net banking book loan exposures with deposits only where it:

- Has a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt;
- Is able at all times to identify the relevant assets and liabilities;
- Monitors and controls its roll-off risks; and
- Monitors and controls the relevant exposures on a net basis.

It would not be permitted to net on-balance sheet items with off-balance sheet items. In addition, this approach would not be permitted for group exposures.

Reporting of Large Exposures

Prior notification of client large exposures over 25% of capital will still be required under the proposed new Rules[25].

The Commission is also proposing to update its BSL/2 Return forms such that large exposures are reported both gross and net of any acceptable collateral. This is so the Commission can more easily monitor licensed institution's portfolios of large exposures. We will also update the relevant sections of the BSL/2 guidance at the same time.

Consultation questions

Respondents are asked to comment on:
5. Do you anticipate that the following changes will pose difficulties for your bank in complying with the Large Exposure Rules: a. The calculation of large exposure reporting thresholds and limits as a % of Tier 1 Capital (in alignment with the Basel Framework) rather than Total Capital? b. The changing of the inter-bank exposure limit to 50% of Tier 1 Capital?
6. Are the proposed Large Exposure Rules sufficiently clear? Are there any areas that require further clarification or guidance?
7. Does your bank have any exposures that would qualify as "trading book" exposures under the Basel Framework?

The Commission is aware that the amendments to the Upstreaming Framework will also have an impact on these points – however, there is a separate list of questions relating to upstreaming, and we request that banks give feedback on intragroup exposure matters with reference to that section of the Consultation Paper.

[24] Draft Large Exposure rules 2021 – 5.2(7), Basel Framework LEX30.12
[25] Large Exposure Policy - 2014 – pg. 14, Draft Large Exposure Rules 2021 – 6.1

2.2 Upstreaming

Strategic direction

Upstreaming refers to the practice whereby a bank lends or deposits excess funds with its parent bank.

For several jurisdictions including Guernsey, upstreaming is a challenge to bank regulators. The basic problem arises from banks having more liabilities than can be absorbed locally. This forces local banks to enter larger markets where their balance sheet is too small to compete. The end result is that banks invest in investment grade bonds or cash; neither of which helps long-term viability and is not financial intermediation. The historic alternative is simply to upstream. This approach, as demonstrated during the 2008 Financial Crisis, in turn creates a potentially fatal exposure to one counterparty.

The risk of cross-border upstreaming has also increased as bank resolution frameworks have been implemented. Foreign resolution authorities are now empowered via bail-in legislation to write-down exposures to institutional creditors (including creditors within the same Group) in order to meet the claims of their "own" legal entities' retail depositors.

In addition, the Commission's current approach of setting bespoke upstreaming limits for individual licensed institutions is not transparent and could lead to the perception, by a bank's senior management or parent, of unfairness or favouritism in the Commission's treatment of the institution or its competitors.

In this section of the Consultation Paper, we attempt to find a compromise that on the one hand limits group exposure whilst on the other allows Guernsey banks to successfully engage in financial intermediation.

Other regulators have adopted a range of approaches to upstreaming. There is no single international approach. However, the Commission wants to move away so far as possible from its current bespoke approach and set a specific cap on upstreaming. However, under the proposed new rules, the Commission will retain the ability to vary the upstreaming limit or exclude some exposures in individual cases if appropriate and prudent to do so.

Group exposure limit[26]

For the reasons set out above, the Commission is proposing a upstreaming limit of 100% of Guernsey-established entities' Tier 1 Capital; i.e. aggregate exposures to all Group entities should not exceed 100% of Tier 1 Capital.

Under the current approach there are separate limits for on-balance sheet upstreaming and off-balance sheet upstreaming. Under the proposed new Rules there will be a single aggregate limit that includes both on and off balance sheet exposures.

[26] Large Exposure Policy - 2014 – pg. 8, Draft Large Exposure Rules 2021 – 5.1

All exposures to Group must mature in 6 months or less, so that the exposure can be managed down if either the licensed institution or the Commission develops serious misgivings about the financial soundness of the Group counterparty. The exception for short term limit excesses discussed earlier also applies to exposures to group banks.

For the purposes of the upstreaming limit, the Commission is concerned only with the naked direct exposure to the Group. Collateralised exposures, where the collateral meets the requirements governing credit risk mitigation outlined in the large exposure section of this paper, will not be counted towards the upstreaming limit. For example, a loan to a parent bank that is collateralised by say government bonds will not count towards the upstreaming limit.

Parental Guarantees[27]

In addition, under the current Large Exposure Policy, one of the ways licensed institutions can mitigate client large exposures and bring them below the 25% of capital exposure limit is to receive a guarantee from their parent bank for the portion of the exposure that is above 25% of capital. At present this guarantee would then be included in the licensed institution's upstreaming limit.

Under the proposed new rules, such guarantees would not be included within the upstreaming limit, provided the guarantee is from a licensed bank, and not some other entity with the group. The purpose of this is to allow a Guernsey bank – which may have a small capital base - to engage in financial intermediation and make commercially viable loans to third parties subject to a guarantee from the group. However, the Commission will closely monitor licensed institution's exposure to group entities from such guarantees and may intervene if the exposure become excessive. In addition, the licensed institution's large exposure policy should set out its appetite for such exposures and ensure that they are subject to specific aggregate limits.

As is currently the case, all client large exposures would be subject to maximum, gross limit of 100% of net capital, regardless of the use of collateral.

The overall effect of this approach is to apply cap of 100% of net capital to upstreaming but to take a liberal approach as to what constitutes upstreaming.

Credit Risk Mitigation

The same credit risk mitigation rules that apply to third party exposures will also apply to group exposures under the proposed new rules[28].

In addition, the Commission is proposing that where a licensed institution lends to a Group entity and there is a cut-through clause to the Group entity's commercial or retail mortgage book, this may be treated as an eligible credit risk mitigation technique, as mortgages generally

[27] Large Exposure Policy - 2014 – Pg. 9, Draft Large Exposure Rules 2021 – 5.1(6)
[28] Large Exposure Policy - 2014 – Pg.9, Draft Large Exposure Rules – 3.3, Basel Framework – LEX30.7

are less risky than most other types of private loans. This is to allow Guernsey banks to have exposure to the UK property market rather than simply upstreaming to the group[29].

For the purposes of the Large Exposure Framework, the licensed institution will still not be permitted to treat property as acceptable collateral for its own direct-to-third-party mortgage book.

Consultation questions

Respondents are asked to comment on:
8. Do you agree with the Commission's proposed approach? If not, please explain and provide specific examples.
9. What alternative approach would you suggest that achieves the Commission's goal of reducing concentration and resolution risks? Please provide details.
10. Will the removal of a separate off-balance sheet upstreaming limit cause significant difficulties for your bank? Please provide details

[29] Draft Large Exposure Rules 2021 – 5.1(7)

2.3 Implementation Timeline

In order to give banks sufficient time to make any required adjustments to their business model, the Commission is proposing a 12month implementation period, from the date on which the finalised *Large Exposure Rules* are published.

Respondents are asked to comment on:
11. Will the proposed implementation period of 12 months give you sufficient time to make the changes required to comply with the proposed new rules? If not, what period would be sufficient? Would a shorter implementation period be possible?

Part 3 – Regulatory Reporting

Certification of Information

This section applies to all Licensed Institutions.

The Commission is concerned to ensure that information reported by licensed institutions in their Regulatory Returns is accurate and reliable, and therefore intends to update the certification requirements for specific regulatory returns.

This will be updated in the individual returns and the revised wording will require the signatory to certify that:

(i) *the return presents an accurate view of the bank's position as at the above reporting date;*
(ii) *they understand the basis of the information reported and the way in which figures have been prepared;*
(iii) *the bank has in place appropriate and robust reporting systems and processes to provide the Data for this return; and*
(iv) *figures reported are correct and any other information provided is accurate.*

In accordance with The Law (Section 55 – Verification of Information and Execution of Documents), signatories will be required to be the chief executive officer and chief financial officer of the Licensed Institution, who hold supervised roles, in accordance with section 12 of the Law. For licensed institutions which are incorporated outside the bailiwick (bank branches) the Commission recognises that the appropriate level of signatory to provide certification of returns may not be the CEO/CFO but the appropriate senior managers within the branch, who hold supervised roles (eg, branch manager, senior financial manager).

As you are aware the Commission takes a number of matters into account when determining if a person is fit and proper to undertake a supervised role. The provision of materially inaccurate or misleading information to the Commission is certainly a matter which the Commission would have regard to in determining if a person remains fit and proper.

Annexes

Annex A provides a draft copy of the new *Banking Supervision (Accounts, Disclosure and Reporting) Rules 2021* for respondents' information. These rules contain the new measures relating to Parts 1 (Accounting Information and Disclosure) & 3 (Regulatory Reporting) of this Consultation Paper. The new rules will replace the existing *Banking Supervision (Accounts) Rules, 1994*.

Annex B provides a draft copy of the new *Large Exposure Rules 2021* for respondents' information. These rules contain the new measures relating to Part 2 (Large Exposures and Upstreaming) of this Consultation Paper. The new rules will supersede the existing *Large Exposure Policy, 2014.*

Both sets of new Rules will be issued under the *Banking Supervision (Bailiwick of Guernsey) Law, 2020*, which is intended to replace the *Banking Supervision (Bailiwick of Guernsey) Law 1994*.

BANKING SUPERVISION (LARGE EXPOSURE) RULES AND GUIDANCE, 2021

The Large Exposure Rules, made in accordance with the Banking Supervision (Bailiwick of Guernsey) Law, 2020 ("the Law"), are set out in this document. Guidance, provided by the Guernsey Financial Services Commission ("the Commission") can be found in blue boxes.

Contents

PART 1 – INTRODUCTION

1.1. Application

(1) These Rules replace –

(a) The Large Exposure Policy, 2014;

(2) The Commission may in its absolute discretion, by written notice to a licensee, exclude or modify the application of any provision of these Rules.

(3) The provisions of these Rules do not affect any conditions that may be imposed, in respect to a banking licence, under the Law.

PART 2 – ADMINISTRATION

2.1 Application

(1) This rule applies to licensed entities incorporated within the Bailiwick.

2.2 Definition of a large exposure

(1) A large exposure is defined as an exposure to an individual counterparty or a group of connected counterparties that is greater than or equal to 10% of the reporting licensee's net capital base.

Net capital base, in this context, is the Tier 1 capital figure reported in the quarterly BSL/2 prudential return.

2.3 Inclusion in concentration risk policies and procedures

2.3.1 General

(1) All licensed entities must have policies and procedures in place which provide a comprehensive view of significant sources of concentration risk. This includes, but is not limited to, credit concentration through exposure to –

(a) single counterparties and groups of connected counterparties, both direct and indirect;

(b) counterparties in the same industry, economic sector or geographic region;

(c) counterparties in the same group or ownership structure;

(d) counterparties whose financial performance is dependent on the same activity or commodity;

(e) off-balance sheet exposures, including guarantees and other commitments; and

(f) market risk and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

(2) Risk policies and procedures must –

(a) establish thresholds for acceptable concentrations of risk;

(b) properly reflect risk appetite, profile and capital strength; and

(c) be regularly communicated to, and understood by, relevant staff.

(3) Material concentrations must be regularly reviewed and reported to the Board.

Exposure via an indirect counterparty would include exposure to collateral or to credit protection provided by a single counterparty.

The Commission expects licensees to particularly closely monitor exposures to collateral or credit protection provided by group entities.

Licensees' information systems should be able to identify and aggregate on a timely basis and facilitate active management of exposures creating risk concentrations and large exposures to single counterparties, or groups of connected counterparties.

2.3.2 Large exposure policy

(1) Within the concentration risk policies there must be specific reference to large exposures.

(2) The large exposure policy must –

(a) specify the control systems which give effect to the policy;

(b) detail the method used to monitor the size of the net capital base used to calculate the limits set within the policy; and

(c) detail how the policy is monitored by the Board.

(3) The large exposure policy must be formally accepted by the Board.

(4) Material changes to the large exposure policy must not be implemented without prior discussion with the Commission.

Each licensee may be required to justify to the Commission its policy on exposures to individual counterparties, including the maximum size of an exposure contemplated. Relevant factors which the Commission will expect a licensee to have taken into account when setting its policy and considering the acceptability of particular exposures include, but are not limited to -

- the standing of the counterparty;
- the nature and extent of security taken against the exposure;
- the maturity of the exposure; and
- the licensee's expertise in the particular type of transaction.

2.3.3 Related parties

(1) Exposures to companies or persons related to a lending licensee, its managers, directors or controllers are exposures to related parties. Related parties include, but are not limited to –

(a) entities within the same group as the licensee, where 'group' is defined in section 66(1) of the Law;

(b) associated companies as recognised within the accounting standards approved for use by licensees in the Bailiwick;

(c) any other party including subsidiaries, affiliates, or special purpose entities that the licensee exerts control over or that exerts control over the licensee;

(d) holders of supervised roles, within the licensee's structure, their associates and close family members. This does not apply to auditors;

(e) the holders of supervised roles at those companies identified in (a), (b) and (c), their associates and close family members. This does not apply to auditors;

(f) companies with which the persons identified in (d) and (e) are associated;

(g) an employee of the lending licensee who is not a director but who is appointed by the lending licensee to be a director of another company.

(2) Policies and procedures must be in place to –

(a) identify related party exposures;

(b) monitor related party exposures;

(c) report on related party exposures, thorough an independent credit review or audit process; and

(d) ensure reporting, of exceptions to the policies and procedures either to senior management or to the Board, as appropriate.

(3) Exposures to related parties –

(a) must be approved by the Board;

(b) must be entered into on an arms' length basis; and

(c) must not be undertaken on more favourable terms than corresponding exposures to non-related counterparties.

If the Commission becomes aware of exposures to companies or persons related to a lending licensee that are of a nature of a capital investment or are made on particularly concessionary terms, it may consider deducting them from the licensee's capital base.

PART 3 – MEASUREMENT

3.1 Inclusions

(1) The gross value of all exposures to a counterparty or groups of connected counterparties must be aggregated for the measurement of a large exposure.

(2) The gross exposure value, prior to the application of any credit risk mitigation or other netting, must be used for the initial identification of a large exposure.

(3) The value of balance sheet exposures must be the accounting value of the exposure.

(4) For the purpose of these Rules, the accounting value of the exposure must include the full value of an advised facility, both drawn and undrawn, whether conditional or unconditional, revocable or irrevocable.

(5) The value of off balance sheet exposures must be the credit equivalent amount calculated as set out in the standardised approach to credit risk as set out in rules or guidance issued by the Commission .

(6) The value of –

(a) interest rate contracts including, but not limited to –

(i) cross currency swaps;

(ii) forward rate agreements; and

(iii) interest rate options purchased;

(b) foreign exchange rate contracts including, but not limited to –

(i) cross currency swaps;

(ii) forward foreign exchange rate contracts; and

(iii) foreign exchange options purchased; and

(c) other derivative contracts including, but not limited to, commodity and equity derivatives

must be calculated as set out in the standardised approach to credit risk, as set out in rules and guidance issued by the Commission.

(7) The value of covered bond exposures must be 20% of the nominal bond and –

(a) the pool of underlying assets assigned to the bond must consist of claims-

(i) on, or guaranteed by, sovereigns, their central banks, public sector entities or multilateral banks;

(ii) secured by mortgages on residential real estate that have a loan-to –value ratio of 80% or lower; and

(iii) secured by commercial real estate with a loan-to-value ratio of 60% or lower; and

(b) the nominal value of the pool of assets assigned to the covered bond instrument by its issuer must exceed its nominal outstanding value by at least 10%. The portion above 100% of the bond's nominal outstanding value may include –

(i) cash;

(ii) short term liquid assets; and

(iii) derivatives entered into for the purpose of hedging the risks arising in the covered bond,

in addition to those conditions set out at (a).

(8) The measure of exposure, in relation to security underwriting activities –

(a) must not be the nominal amount; and

(b) must be measured and controlled using an approach agreed by the Commission prior to entering into the exposure.

An exposure is the amount at risk arising from all of a reporting licensee's assets and off-balance sheet items.

Covered bonds are bonds issued by a bank or mortgage institution and are subject to specific legal protection and public supervision designed to protect bond holders. Proceeds deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of the validity of the bonds, are capable of covering claims attached to the bonds and which, in the event of the failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.

In most circumstances, the Commission would expect licensees to measure securities underwriting exposures using the jump-to-default method. However, as stated in this rule, this would be agreed on a case by case basis.

3.2 Exclusions

(1) Measurement of exposure must not include –

(a) items deducted from capital base, unless the exposure is 1250% risk weighted;

(b) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;

(c) in the case of transactions for the purchase or sale of securities –

(i) exposures incurred in the ordinary course of settlement, during five working days following payment or delivery of the securities, whichever is earlier; or

(ii) where neither counterparty has settled there will be no reportable exposure until 21 days after the due settlement date, after which the replacement cost of the transaction will be considered to be an exposure;

(d) in the case of the provision of money transmission –

(i) the execution of payment services;

(ii) clearing and settlement in any currency;

(iii) correspondent banking and financial instruments clearing;

(iv) settlement and custody services to clients;

(v) delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;

(e) segregated margin posted with a Central Counterparty; or

(f) exposures to Qualifying Central Counterparties related to clearing activities, including –

(i) trade exposures; and

(ii) both segregated and non-segregated margin.

For example, an exposure relating to a foreign exchange transaction might occur in the following way: the reporting entity has paid its side of the transaction but has not received the counter value. Following the two working days such claims would constitute an exposure.

An exposure relating to transactions for the purchase or sale of securities might occur in the following way: payment has been made or securities delivered but the counter value has not yet been received.

Note that a licensee's exposure arising from securities trading operations should be calculated as its net long position in a particular security; a short position in another security should not be used to offset this long position.

Central Counterparties, sometimes referred to as central clearing counterparties, are institutions that provide clearing and settlement services for trades in derivatives, foreign exchange, options and securities. They take on the counterparty credit risk between the two parties to a transaction.

An examples of a central counterparty is LCH.Clearnet.

A qualifying central counterparty is an entity that is licenced and regulated to operate as a central counterparty. The jurisdiction in which it is licenced must regulate it in line with the Committee on Payment and Financial Infrastructure and International Organisation of Securities Commissions' Principles for Financial Market Infrastructures. The Commission must agree, in writing, that the central counterparty meets the above criteria.

Segregated margin are funds or other assets posted as collateral with a central counterparty as part of a derivatives trade or other transaction. It is separated from the central counterparty's own accounts in such way that makes it bankruptcy remote from the central counterparty. This means that it cannot be lost by the bank if the central counterparty were to default. This might include margin that is held by a third-party custodian.

3.3 Eligible credit risk mitigation techniques

(1) The gross value of a large exposure may be reduced, resulting in a net exposure, through the use of the credit risk mitigation techniques set out in this rule.

(2) Eligible credit risk mitigation techniques implemented must meet all criteria, under the standardised approach to credit risk, as set out in rules and guidance issued by the Commission in addition to those set out in these Rules.

(3) Where a licensed entity uses a credit risk mitigation technique to reduce the value of a large exposure it must use the same technique for that exposure when applying the standardised approach to credit risk.

(4) When using the simple approach to credit risk mitigation, the amount by which the gross value of a large exposure is reduced by must be the value of credit protection as defined under the standardised approach to credit risk.

(5) When using the comprehensive approach to credit risk mitigation, the amount by which the gross value of a large exposure is reduced by must be the value of the collateral after the application of the standard statutory haircuts required under the standardised approach to credit risk.

(6) Only collateral that has been assigned a standard supervisory haircut under the comprehensive approach to credit risk mitigation may be used

for large exposure purposes, regardless of whether the licensed entity uses the simple or comprehensive approach.

(7) If an exposure, or portion of an exposure, is mitigated by an eligible credit risk mitigation technique, the licensee must recognize an exposure to the provider of that credit risk mitigation which should be aggregated with other exposures to that counterparty as normal for large exposure purposes and the value of the exposure to the credit risk mitigation provider must be the amount by which the value of the initial exposure is reduced.

Rule 3.3(3) means that if a licensed entity uses government bonds to reduce the value of a large exposure they must also apply the same bonds when calculating the risk weighted value of that exposure under the standardised approach to credit risk.

3.3.1 Eligible credit risk mitigation techniques - Funded sub-participation agreements

(1) For a funded sub-participation agreement to be eligible, as a method for the reduction of the net value of the exposure, there must be no possibility of the participated portion of the exposure returning to the balance sheet.

Other methods of reducing the value of an exposure are permitted for exposures to specific types of counterparty. These methods are set out in the relevant sections.

PART 4 – IDENTIFICATION OF A COUNTERPARTY

4.1 Transactions relating to persons

(1) For the purposes of this rule, a transaction relates to a person if it is a transaction under which –

(a) that person incurs an obligation to the licensee or, as a result of which, may incur such an obligation;

(b) the licensee will incur, or as a result of which it may incur, an obligation in the event of that person defaulting on an obligation to a third party; or

(c) the licensee acquires, or incurs an obligation to acquire, an asset the value of which depends wholly or mainly on that person performing their obligations, or otherwise on their financial soundness;

and where the risk of loss attributable to the transaction is the risk of the person concerned defaulting on the obligation.

The identity of a counterparty will normally be the borrower, the person on whose behalf a guarantee has been issued by the licensee, the issuer of a security in the case of a security held, or the party with whom a contract was made in the case of a derivatives contract.

4.2 Exposures to groups of connected counterparties

(1) Exposures to groups of connected counterparties must be aggregated for large exposure purposes.

(2) A single exposure limit will apply to the aggregated exposure to a group of connected counterparties.

Groups of connected counterparties are those counterparties that are connected in such a way that the financial soundness of any of them affects the financial soundness of the other, or the same factors may affect the financial soundness of them all.

For example, if a bank has an exposure to Client A, and a separate exposure to Client B, where Client A and B are connected counterparties, the relevant exposure limit will apply to the sum of the exposures.

For the purposes of the Large Exposure Rules, the Commission considers that the following types of connection would lead to the financial soundness of one counterparty affecting the financial soundness of another –

- Control relationship – one of the counterparties, directly or indirectly, is able to exercise control over the others;
- Economic interdependence – if one of the counterparties were to experience financial difficulties then the other counterparties, as a result, would be likely to experience financial difficulties.

Schedule 3 sets out further guidance on how licensees should assess control and economic interdependence.

4.3 Exposures to collective investment schemes, securitisation vehicles and other structures

(1) Where the exposure is to structures such as collective investment schemes and securitisation vehicles, the licensed entity must look through the structure and recognise exposures to the underlying assets. This does not apply where the licensed entity can be demonstrate that exposure to each underlying asset is less than 0.25% of net capital base.

PART 5 – EXPOSURE LIMITS

5.1 Exposures to group entities

(1) A licensee must not incur net exposures to group entities which, in aggregate, exceed 100% of net capital base.

(2) A licensee may enter into exposures with group entities without further notification to the Commission provided that the aggregate exposure is within the exposure limit.

(3) All exposures to group entities must have a maximum maturity of no more than six months.

(4) The exposure limit includes all types of exposure, both off and on balance sheet, to another entity within the licensee's group.

(5) A licensee may use eligible credit risk mitigation techniques, in accordance with rule 3.3, to reduce the net value of an exposure for the purposes of the exposure limit.

(6) Where a bank within the same group as the licensee provides a guarantee, funded sub-participation agreement or unfunded risk participation agreement, in support of a client loan, the value of the guarantee or participation agreement should not be included in the exposure limit.

(7) A licensee may treat a security interest in another group entity's mortgage book as acceptable financial collateral, in accordance with rule 3.3.1, provided they meet the 'Requirements for recognition of collateral' at Schedule 1.

The Commission has set an exposure limit in respect of the aggregate exposures to the parent bank and other entities within the parental group ('the upstreaming limit').

The Commission would expect licensees to closely monitor their exposures to group entities created by guarantees provided to support client lending under subsection (5). Should the concentration risk created by these exposures exceed a

prudent level, the Commission may consider taking measures to reduce or prevent further increases in risk.

The Commission may consider exceptions to the upstreaming limit but only with the approval of the Commission and only in exceptional circumstances.

For example, the Commission may consider excluding a particular exposure, a particular type of exposure or exposures to a particular counterparty from the upstreaming limit if the counterparty's asset base is sufficiently high quality.

Rule 5.1(7) is intended to enable licensees to fund another group entity's mortgage lending, provided it has a direct claim on the underlying security.

The Commission would not expect licensees to take as security mortgages that would not meet their own internal credit quality requirements.

The Commission reserves the right to reduce the upstreaming limit at any point if it appears that this would be desirable for the protection of the reporting licensee's net capital base.

5.2 Exposures to third parties

(1) A licensee must not incur net exposures to a third party client or groups of connected third party clients which, in aggregate, exceed 25% of net capital base.

(2) A licensee must not incur net exposures to a third party bank or groups of connected third party banks which, in aggregate, exceed 50% of net capital base.

(3) A licensee must not incur exposures which exceed 10% of net capital base to clients or groups of connected clients which in aggregate exceed 800% of the net capital base without the prior agreement of the Commission.

(4) The large exposure limit, in relation to exposures to third parties, includes all types of exposure both on and off balance sheet.

(5) A licensee may use eligible credit risk mitigation techniques, under rule 3.3, to reduce the net value of an exposure to a third party.

(6) The gross value of all exposures to a non-bank third party, client or group of connected third party clients must not exceed 100% of net capital base, regardless of the use of eligible credit risk mitigation techniques.

(7) Licensees may net banking book exposures and deposits from third parties when calculating the net value of an exposure for large exposure purposes only when –

(a) there is a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction, regardless of whether the counterparty is insolvent or bankrupt;

(b) the relevant assets and liabilities are, at all times, identifiable;

(c) roll-off risks are monitored and controlled; and

(d) relevant exposures, on a net basis, are monitored and controlled.

(8) Licensees are not permitted to net on-balance sheet items with off-balance sheet items.

Third parties includes banks, individual clients and groups of connected counterparties. It excludes sovereigns and entities within the same group as the licensee.

In rule 5.2(1), (3) and (^), client refers to a third party that is not a bank.

The Commission may, in exceptional circumstances, consider granting an exemption from the large exposure limit or an adjusted limit for a particular exposure.

5.3 Exposures to sovereigns

(1) Exposures to the following will not be subject to any limit –

(a) the States of Guernsey;

(b) the Governments of Jersey and the Isle of Man;

(c) multilateral development banks as listed in the Commission's Guidance Notes for completion of the BSL/2 return; and

(d) all other sovereigns.

'Sovereign' includes sovereign governments, central banks, rated supranational authorities (e.g. the European Bank for Reconstruction and Development) and those government agencies that have an unconditional guarantee from a sovereign government (e.g. GNMA or 'Ginnie Mae').

The Commission may also be willing to consider, as sovereign exposures, some exposures to sovereign government sponsored enterprises. These enterprises do not have the 'full faith and credit' of the underlying government however and they will not be subject to the exposure limits set out in this rule. Instead the Commission will discuss exposures to government sponsored entities on a case by case basis and in advance of any exposure being entered into. Such enterprises include FHLMC ('Freddie Mac'), FNMA ('Fannie Mae') and SLMC ('Sallie Mae').

PART 6 – LARGE EXPOSURE REPORTING REGIME

6.1 Prior notification

(1) Prior notification of large exposures must be made to the Commission in cases where, either alone or together with other existing exposures to the same counterparty or group of connected counterparties, an exposure exceeds 25% of net capital base before the application of eligible credit risk management techniques.

(2) Increases in an exposure, which are beyond that which the Commission already has notice of, must be notified to the Commission, in writing, prior to entering into the increase.

(3) The Commission must be notified when an exposure, which has been previously notified to the Commission, is repaid in full.

(4) This rule does not apply to large exposures made to –

(a) group entities;

(b) third party banks; or

(c) sovereigns.

Where a proposed transaction with one of the excluded counterparties (group entities, third party banks or sovereigns) will result in an exposure which represents a significant departure from the licensee's statement of policy on its large exposures, as submitted to the Commission, the Commission will expect the proposed transaction to be discussed with it in advance of the licensee entering into the exposure.

All notifications to the Commission, under this rule, should be made by letter and submitted on the Commission's Online Submissions Portal. Guidance on the detail to be included can be found at Schedule 2.

For some exposures the Commission may request further information. This may include, but is not limited to –

- signed extracts from Group Credit and/or Risk Committees;
- copies of agreements supporting credit risk mitigation techniques; and
- evidence that any credit risk mitigation techniques used are legally enforceable.

The Commission will acknowledge the exposure and provide a unique 'large exposure number' which must be used to report the exposure on the subsequent BSL/2 returns.

Please note that this is a notification regime and not an approval regime. The decision to enter into any exposure, large or small, is a matter for the commercial judgment of the management of the licensee.

Acknowledgement of notification, from the Commission, should not be regarded as permission or approval.

6.2 Quarterly notification of exposures – licensed entities incorporated in the Bailiwick

(1) Entities incorporated in the Bailiwick must report on large exposures on a quarterly basis.

(2) In the case of parent and group entities all exposures, regardless of size, must be reported. In all other cases all exposures of 10% and over must be reported.

(3) Where an exposure is excluded from an exposure limit it must still be included in the quarterly report.

Separate spreadsheets within the BSL/2 are available for the reporting of –

- exposures to group entities;
- exposures to third party banks;
- exposures to sovereigns; and
- exposures to clients or groups of connected clients.

6.3 Quarterly notification of exposures – licensed entities incorporated outside the Bailiwick

(1) Branches must report on the –

(a) ten largest market loans; and

(b) ten largest credit exposures

on a quarterly basis.

Market Loans – may be to a parent or group entity or to a third party bank.

Returns will be made using BSL/2.

6.4 Breaches of limits

(1) Any breach in large exposure limits must be reported, in writing, to the Commission immediately after the entity becomes aware of the breach.

(2) Where a licensee exceeds a bank large exposure limit, it shall not be regarded as a breach of these Rules, subject to the following conditions –

(a) any excess above the large exposure limit is cleared within three working days;

(b) the licensee notifies the Commission within one week of the limit excess occurring; and

(c) the excess occurs due to exceptional circumstances.

A breach will be deemed to have occurred if there was a –

- breach of an exposure limits;
- breach of an exposure limit caused by the change in value of the collateral used for credit risk mitigation purposes;

- failure to conform to the credit risk mitigation requirements for exposures in excess of 25% of net capital base;
- failure to notify the Commission, in advance, of an exposure to a client or group connected clients in excess of 25% of net capital base;
- failure to notify the Commission, within seven days, of becoming aware the licensee had entered into an exposure to a client or group connected clients in excess of 25% of net capital base.

In rule 6.2(4) "bank" refers to both third party banks and group banks.

In rule 6.4(2)(c) "exceptional circumstances" may, for example, include funds received late in the day that cannot be placed with another counterparty.

When notifying the Commission under rule 6.4(2)(b) licensees would be expected to include, as a minimum –

- the reason for the excess;
- the scale of the excess, both in absolute terms and as a percentage of net capital;
- the duration of the excess and how it was remediated; and
- if relevant, any changes to processes, procedures or controls that the licensee has made to avoid re-occurrence.

Licensees are asked to pay particular attention to the effect of any proposed reduction in net capital base, such as the proposed payment of a dividend, in order to ensure that exposure limits are not inadvertently breached by such a reduction.

Further guidance on the Commission's powers

The Commission may require any relevant subsidiary to make such arrangements that may appear to be desirable for the protection of the licensee's net capital base. This power flows from section 26(6) of the Law and would normally be used in cases where the Commission considers a licensee to be exposed to particular concentration of risk.

The arrangements will differ depending on the circumstances.

For example, the Commission –

- may require a locally incorporated entity to maintain higher capital ratios than would otherwise be the case;
- may impose a lower upstreaming limit;
- and would have regard to –
    - the acceptability of the exposures, when considered in the context of the licensee's large exposures policy;

- the particular characteristics of the individual licensee, including the nature of the business and the experience of its management; and
- the number of such exposures, their individual size, and nature.

PART 7 – GENERAL PROVISION

8.1. 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 -

"central counterparties" are financial institutions that provide clearing and settlement services for trades in financial instruments;

"control relationship" indicates the counterparty who, directly or indirectly, is able to exercise control over the others;

"economic interdependence" means the situation where, if one of the counterparties were to experience financial difficulties then the other counterparties would be likely to suffer consequential financial difficulties;

"groups of connected counterparties" are those counterparties connected through control relationships and/or economic interdependence;

"net capital" means the Tier 1 capital figure reported in the quarterly BSL/2 prudential return;

"qualifying central counterparties" are central counterparties that the Commission has agreed, in writing, meet the following criteria –

(a) they are licensed and regulated to act as a central counterparty; and

(b) they are regulated in line with the Committee on Payment and Financial Infrastructure and International Organisation of Securities Commissions' Principles for Financial Market Infrastructures;

"segregated margin" refers to funds or other assets posted as collateral with a central counterparty as part of a derivatives trade or other transaction. It is separated from the central counterparty's own accounts in such a way that it cannot be lost by the licensed entity if the central counterparty defaults.

(3) The Interpretation and Standard Provisions (Bailiwick of Guernsey) Law, 2016[1] applies to the interpretation of these rules.

(4) A reference in these rules to an enactment should be taken to include any amendments, re-enactments (with or without modification), extensions and applications.

[1] Order in Council No. V of 2018, as amended.

PART 8 – CITATION AND COMMENCEMENT

8.1. Citation and commencement

(1) These rules made shall come into operation on ****** and may be cited as the Large Exposure Rules 2021.

SCHEDULE 1

REQUIREMENTS FOR RECOGNITION OF COLLATERAL

General requirements of legal certainty

(1) In order for banks to obtain the benefit from any use of CRM techniques the following, minimum, standard for legal documentation must be met –

(a) all documentation used in collateral transactions, and for documenting balance sheet netting, guarantees and credit derivatives, must be binding on all parties and legally enforceable in all relevant jurisdictions; and

(b) banks must have conducted sufficient legal review to verify this, have a well-founded legal basis to reach this conclusion and undertake such further review as necessary to ensure continuing enforceability.

(2) In addition to the general requirement for legal certainty set out above, the legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of –

(a) the default;

(b) insolvency;

(c) bankruptcy; or

(d) one or more otherwise defined credit events set out in the transaction documentation, of the counterparty and, where applicable, of the custodian holding the collateral.

Furthermore, banks must take all steps necessary to fulfil those requirements under the law applicable to the bank's interest in the collateral to obtain and maintain an enforceable security interest.

Steps taken could include registering the interest with a registrar, or exercising a right to net or set-off.

(3) In order for collateral to provide protection, the credit quality of the counterparty and the value of the collateral must not have a material positive correlation.

> For example, securities issued by the counterparty – or by any related group entity – would provide little protection and so would be ineligible.

(4) Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed, and that collateral can be liquidated promptly.

(5) Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

SCHEDULE 2

NEW CLIENT LARGE EXPOSURE NOTIFICATION

When a bank proposes to enter into an exposure which, either alone or together with other existing exposures to the same client or group of connected clients, exceeds 25% of net capital base, details must be notified to the Commission before the bank becomes committed to the exposure.

A notification letter from the bank, to the Commission must contain, as much of the following details as applicable.

Basic details

Client name	The name of the client counterparty.
Amount of new facility	The maximum amount that may be drawn under the new facility and the currency of the facility. If the loan is to be made available in tranches, provide details. If the loan is to be subject to a sub-participation agreement, please report the gross amount of the facility to the client (i.e. ignoring the effect of any sub-participation).
Type of facility	For example, mortgage, overdraft, temporary loan, etc.
Term of facility	State the term of the facility and the maturity date for the exposure. If the facility is a rolling facility or a revolving credit facility, provide details.
Date of anticipated drawdown	The earliest date on which the client is expected to draw down some or all of the facility.
Purpose of facility	Provide as much detail as possible on the purpose of the facility.
Valuation (property only)	Where the exposure involves property give the date and the amount of the most recent professional valuation of the property.
Loan to Value	Give the loan to value of the asset, where applicable.
Credit Risk Mitigation	Give the type and value of the credit risk mitigation, its currency and its location. If the collateral is encumbered in any way, provide details.
Details of any sub-participation agreement	If the loan is subject to a sub-participation agreement provide details of the participating entities, the nature of the agreement, the amount that will be sub-participated, and the exposure

	remaining on the balance sheet of the bank net of a sub-participated amount. Provide an explanation of how the Board has satisfied itself that there is no possibility of the credit risk covered, by the sub-participation agreement, returning to the balance sheet of the bank.
Net capital base in GBP	Unless the capital has changed, give the net capital base of the bank as reported in the most recent BSL/2 quarterly prudential report.
% of net capital base this new facility represents	State the % of net capital base that this new facility represents.

Examples of collateral entries include –

- Cash to the value of GBP 1,500,000 held in custody by the bank;
- US Treasury Bills to the value of USD 500,000 pledged to the bank under a security interest agreement, and cash to the value of USD 250,000 held in custody at the bank;
- Parental guarantee to the value of GBP 5,000,000.

Other exposures to the client/group of clients

If there are multiple exposures that are already held in a separate spreadsheet, supply a copy of this sheet. The information must include the following –

Details of existing exposure to this client	Provide details of all other exposures to this client, including – • LE number (where applicable); • Amount of facility; • Term of facility; • Collateral held; • Purpose of facility.
Aggregate value of all exposures to this client	Provide the aggregate value of all exposures to this client, to include all existing exposures, however small, and the new facility which is the subject of this notification.
% of net capital base this aggregate exposure represents	Please state the % of net capital base that this aggregate exposure, including the new facility, represents.
Connected party details	If this client is connected to other parties to which the bank already has an exposure, provide details of – • The parties; • The nature of the connection; and

	• The exposure to those clients, including the amount, term, and type of the exposure and the associated collateral.

Risk Assessment

Identify the highest level at which the exposure has been sanctioned.

Examples include - individual lending officer, Guernsey Credit Committee, Group Credit Committee, Group Risk Committee, Group Chief Risk Officer, etc.

SCHEDULE 3

GROUPS OF CONNECTED COUNTERPARTIES

"Control"

(1) Interpretation of "control" in the definition of a group of connected counterparties -

(a) Control refers to the relationship between a parent undertaking and a subsidiary, or a similar relationship between any natural or legal person and an undertaking.

(b) Control will be presumed to exist when the counterparty owns directly, or indirectly through subsidiaries, more than half of the capital or voting power of an entity, unless in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.

(c) A counterparty owning 50% of the shares/voting power of another counterparty may be able to exercise one or more of the powers mentioned below. This can also occur where two equal partners/owners share the power and govern the entity jointly.

(d) Control can also exist when the counterparty owns less than half of the voting power or does not hold any participating interest in the entity at all. In those cases the institution should refer to indicators of control that can be seen when the counterparty is able to exercise one or more of these powers.

(e) In respect of control, the Commission would expect that, where any of the examples at (2) exist, in order NOT to consider the counterparties to be connected counterparties, the bank should be able to document that what seems to be a control relationship truly is not. It is not relevant whether the counterparty does or does not exercise control; it is the ability to do so that is the key. Voluntary self-imposed limitations by a counterparty, on the exercise of control, such as legal ring-fencing or statements of a similar nature, would not suffice as valid documentation.

(2) Powers which are indicators of control

The power to -

(a) direct the activities of the undertaking so as to obtain benefits from its activities;

(b) decide on crucial transactions;

(c) govern the financial or operating policies of the undertaking;

(d) appoint or remove the majority of directors, the supervisory board, members of the board of directors or equivalent governing body of the undertaking, where control is exercised by that board or body;

(e) cast the majority of votes at meetings of boards of directors, general assembly or other governing body of the undertaking, where control is exercised by that board or body; and

(f) co-ordinate the management of an undertaking with that of other undertakings in pursuit of a common objective, i.e. where the same natural persons are involved in the management or board of two or more undertakings.

(3) Calculating the exposure

(a) In calculating the exposure to a group of connected counterparties the entire exposure to a connected counterparty must be included in the calculation. The exposure should not be limited to, or be proportional to, the formal percentage of ownership.

Economic "interconnectedness"

(4) Interpretation of economic "interconnectedness" in a group of connected counterparties -

(a) Two or more natural or legal persons between whom there is no relationship of control but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.

(b) If a bank can evidence that one counterparty would be able to experience funding or repayment difficulties without the other counterparty also facing funding or repayment difficulties, then there is no requirement to consider such counterparties to be interconnected.

Sharing the same trustee or investment manager does not automatically correct two counterparties.

Examples of economic dependencies that a counterparty may not be able to overcome without experiencing repayment difficulties can include –

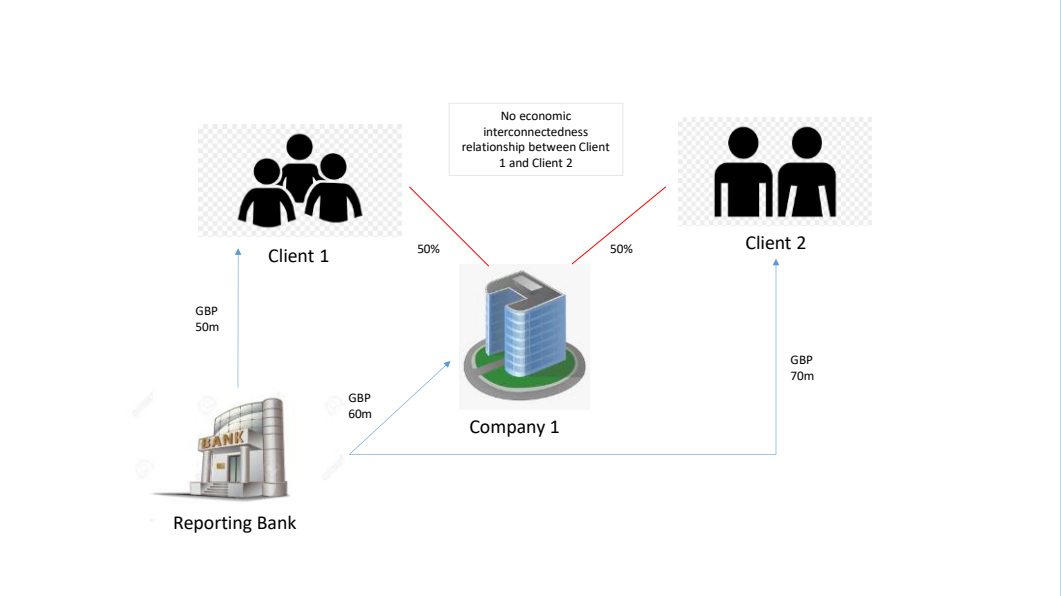
- Where one counterparty has guaranteed fully or partly the exposure of the other or is liable by other means;
- Where 50%, or more, of one counterparty; gross expenditures (on an annual basis) is derived from transactions with the other counterparty;
- Where the bank has committed itself to provide credit facilities to more than one conduit or SPV under similar conditions, and where it is likely that those commitments may materialise into exposures at the same time because they are dependent on the same funder;
- Where the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source, which may be the Bailiwick bank itself;
- Where counterparties rely on the Guernsey bank for their main funding source, for example through explicit or implicit liquidity support or credit support;
- Where the insolvency or default of one of them is likely to be associated with the insolvency or default of the other;
- Where the bank is exposed to the owner of a commercial/residential property and to the tenant who pays the rent;
- Where the bank is exposed to the sole producer of a product and the only buyer of the product.

Reporting exposures with connected counterparties

(5) In respect of reporting an exposure to an entity that has multiple beneficial owners, the reporting depends of whether the exposure is to the entity alone, in which case it is a single exposure to that company, or whether there are other exposures to the beneficial owners of that company.

These two examples deal with exposures to a company and to one or more of its beneficial owners.

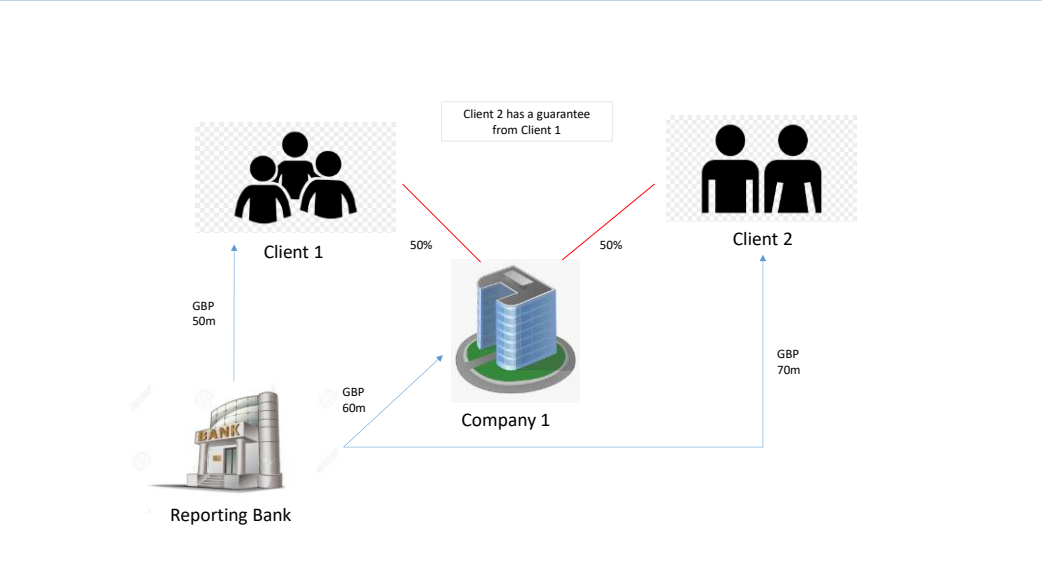
Figure 1



Using the figure above, consider the following example –

- The bank is asked to loan £60m to Company 1. This is Loan 01.
- Two months later one of the shareholders, Client 1 who has a 50% shareholding in Company 1, asks for a loan for £50m for personal use. Since there is a control relationship between Client 1 and Company 1, these clients are connected. Loan 01 increases to £110m. Note that although Client 1 owns only half of Company 1, prudence dictates that the whole amount of the loan to Company 1 should be included in Loan 01.
- Six months later, the other shareholder, Client 2 asks the bank for a loan of £70m, also for personal use. He is unconnected to Client 1, other than through ownership of Company 1, and there is no economic dependence between them.
- The control relationship between Client 2 and Company 1 makes them connected clients, but the lack of any other link to Client 1 means that this connection can be treated separately. This is Loan 02 with a value of £130m.
- This logic can be applied to multiple shareholders, provided that there is no economic dependence between them (i.e. the only link between the individuals is that they have shares in the same company).

Figure 2



In this example, there is economic interconnectedness between the shareholders. The reporting would be as follows –

- The bank is asked to loan £60m to Company 1. This is Loan 01.
- Two months later one of the shareholders, Client 1 asks for a loan for £50m for personal use. Since there is a control relationship between Client 1 and Company 1, these clients are connected. Loan 01 increases to £110m. Note that although Client 1 owns only half of Company 1, prudence dictates that the whole amount of the loan to Company 1 should be included in Loan 01.
- Six months later, the other shareholder, Client 2 asks the bank for a loan of £70m, also for personal use. As collateral for the loan, he presents a guarantee from Client 1.
- The guarantee establishes an economic dependence; Client 1 and Client 2 are not connected not only indirectly from their ownership of Company 1, but also directly by the guarantee. It is now prudent to consider the loan to Company 1 and the two exposures to Client 1 and Client 2 to be connected. Hiving off Client 2 and his ownership of Company 1 into a separate exposure is no longer appropriate.
- Loan 01 becomes £180m.

Assume that there is third shareholder who now comes along and asks for a loan of £25m for personal use. If this person has an economic dependency with either Client 1 or Client 2, then the amount of his exposure will also need to be included in Loan 01, which would now make it £205m. If, however, his only connection to Client 1 and Client 2 is through ownership of Company 1, then he can be hived off into a separate exposure, which would have a value of £85m.

THE BANKING SUPERVISION (ACCOUNTS, DISCLOSURE AND REPORTING) RULES AND GUIDANCE, 2021

The Banking Supervision (Accounts, Disclosure and Reporting) Rules are set out in this document with guidance provided by the Guernsey Financial Services Commission. Guidance is set out in blue boxes

Contents

PART 1 **INTRODUCTION**

1.1 Application

(1) These Rules replace –

(a) The Banking Supervision (Accounts) Rules, 1994;

(2) The Commission may in its absolute discretion, by written notice to a licensee, exclude or modify the application of any provision of these Rules.

(3) The provisions of these Rules do not affect any conditions which may be imposed, in respect to a banking licence, under the Law.

PART 2 **ACCOUNTS**

2.1 Licensed Entities incorporated within the Bailiwick

2.1.1 Application of rule 2.1

(1) Rule 2.1 applies to licensed institutions incorporated within the Bailiwick.

This applies to subsidiary banks licensed in Guernsey and incorporated locally.

2.1.2 Approved accounting rules

(1) Entities licensed under the Law, and incorporated in the Bailiwick, must prepare annual accounts in accordance with an approved accounting standard. For the purposes of these Rules the following accounting standards are approved by the Commission –

(a) IFRS[1];

(b) UK GAAP[2]; or

(c) US GAAP[3].

(2) The Commission may approve the use of an alternative accounting standard, on the application of a licensee, or potential licensee, on a case by case basis. Approval must be sought prior to the use or implementation of an alternative approach or accounting standard.

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[1] International Financial Reporting Standards published by the IFRS foundation and International Accounting Standards Board and adopted by the UK and the EU.
[2] UK Generally Accepted Accounting Practice, including FRS 102, published by the UK Financial Reporting Council (or its successor bodies).
[3] US Generally Accepted Accounting Practice, adopted by the US Securities and Exchange Commission.

Bailiwick incorporated Licensed institutions must prepare accounts annually, in accordance with the Companies (Guernsey) Law, 2008 and in accordance with one of the accounting standards approved by the Commission; unless the Commission has given its prior, written approval for the use of an alternative approach.

2.1.3 Submission of accounts to the Commission

(1) The licensee must be submit to the Commission, no later than three months from the date of their completion, copies of –

(a) the audited accounts including the auditor's report; and

(b) any management letter prepared by the auditors.

(2) Any derogation from this rule can only be entered into with the written consent of the Commission.

2.1.4 Auditor's report

(1) The auditor's report must include statements on the following –

(a) the basis of the auditor's opinion;

(b) the auditor's opinion as to whether the accounts show a true and fair view and have been properly prepared in accordance with the provisions of the Law and the provisions of the Companies (Guernsey) Law, 2008[4]; and

(c) any additional comment as required under rule 2.3.

In addition to the report, licensed institutions should provide a copy of the auditor's management letter to the Commission.

[4] No. VIII of 2008.

2.2 Licensed Entities incorporated outside the Bailiwick

2.2.1 Application of rule 2.2

(1) Rule 2.2 applies to licensed entities incorporated outside the Bailiwick.

This applies to bank branches licensed in Guernsey and incorporated elsewhere.

2.2.2 Information required by the Commission

(1) Entities licensed under the Law, and incorporated outside the Bailiwick, must provide the Commission with a copy of the audited accounts of the main group, including the auditor's report, no later than one month following their publication.

2.3 Disclosure

2.3.1 Application

(1) This rule applies to licensed institutions incorporated within the Bailiwick.

This applies to subsidiary banks licensed in Guernsey and incorporated locally.

2.3.2 Information required

(1) The Licensee must make available on request and publish online, no later than one month following the submission of its accounts to the Commission, the following information –

(a) a copy of the audited accounts including the auditor's report; and

(b) additional information including but not limited to –

(i) the Common Equity Tier 1 ("CET 1") capital asset ratio ("CAR")[5], calculated as the ratio of common equity tier 1 capital to total risk weighted assets;

(ii) the Liquidity Coverage Ratio ("LCR")[6] or, where appropriate, the Liquidity Mismatch Ratio ("LMR")[7];

(iii) the Net Stable Funding Ratio ("NSFR")[8];

(iv) the Leverage Ratio[9].

DISCLOSURE AND PUBLICATION

If the licensed entity does not have its own website it may use a group website and should clearly indicate the subsidiary to which the information applies.

KEY METRICS

The key metrics, listed below, are defined in more detail in the relevant regulatory returns and associated guidance issued by the Commission. The full suite of guidance can be found on the Commission website (see www.gfsc.gg/industry-sectors/banking/returns) and in the specification of the relevant return form or spreadsheet, which are provided to banks as required.

CET Capital Asset Ratio (CAR)

This is the ratio of common equity tier 1 capital (CET1) to total risk weighted assets. The information required is set out in the BSL/2 quarterly return forms provided to the banks, and the relevant guidance on regulatory reporting on the Commission website, BSL/2 General Guidance and Individual Capital Guidance (Module 7).

Liquidity Coverage Ratio (LCR) or Liquidity Mismatch Ratio (LMR)

[5] See Commission website for General Guidance and Individual Capital Guidance (Module 7) for completion of BSL/2.
[6] Defined in Commission guidance on completing the LCR module or form LCR.
[7] Defined in Commission Guidance of completing the LMR module.
[8] See Commission website Guidance on completing the NSFR module of form LCR and LMR.
[9] See Commission Website, Guidance on completing the Leverage Ratio Module of BSL/2.

Licensees should disclose the figure for their LCR or LMR as appropriate and in accordance with the information reported to the Commission in the relevant regulatory return. Guidance on the definition and reporting for form LCR and form LMR is provided on the Commission website.

Net Stable Funding Ratio, NSFR

The figure disclosed should be the NSFR for the relevant period at the end of the financial year, as reported to the Commission on form LCR or LMR. Guidance on the definition and regulatory reporting can be found on the Commission website, NSFR Guidance.

Licensees may also wish to disclose the average CAR, LCR or other measures for the financial year in question, in which case they may include the information alongside those specified above and should disclose how they have calculated the average.

Leverage Ratio

The figure disclosed should be the ratio at the balance sheet date. Guidance can be found on the Commission website on BSL/2 (Module 11).

2.3.3 Reporting period

(1) The figures reported under this rule must be for the relevant date, which will be the date of the balance sheet used in preparing the accounts.

(2) The information reported under this rule must be consistent with the information reported to the Commission in the relevant regulatory returns.

Regulatory Returns & Reporting Periods

The relevant regulatory returns are BSL/2 and LCR/LMR as appropriate.

The relevant reporting period is the final submission for the financial year for which the accounts have been prepared.

The figures disclosed for key metrics should be the same as those reported to the Commission in the regulatory returns.

2.3.4 Auditor's comment

(1) The auditor's report must include statements on the following –

(a) the basis of the auditor's opinion; and

(b) the auditor's opinion as to whether the accounts, and in the case of group accounts submitted by a holding company the group accounts, show a true and fair view and have been properly prepared in accordance with the provisions of the Law and the provisions of the Companies (Guernsey) Law, 2008.

PART 3 **GENERAL PROVISION**

3.1 Interpretation

(1) In these Rules terms have their ordinary meaning unless specifically defined in the Law or in these Rules.

(2) The Interpretation and Standard Provisions (Bailiwick of Guernsey) Law, 2016[10] applies to the interpretation of these Rules.

(3) A reference in these Rules to an enactment should be taken to include any amendments, re-enactments (with or without modification), extensions and applications.

[10] Order in Council No. V of 2018, as amended.

PART 4 TRANSITIONAL ARRANGEMENTS, REVOCATIONS, AMENDMENTS, CITATION AND COMMENCEMENT

4.1 Transitional Arrangements

4.2 Revocations

4.2.1 Revocation of The Banking Supervision (Accounts) Rules, 1994

(1) The Banking Supervision (Accounts) Rules, 1994 are revoked.

4.3 Savings

4.4 Amendments

4.5 Citation and commencement

(1) These rules may be cited as the Accounts, Disclosure and Reporting Rules 2021.

(2) These rules come into force on ********.