

**Jersey: Financial Sector Assessment Program Update—Detailed Assessment of  
Observance of the Basel Core Principles for Effective Banking Supervision**

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision Report on **Jersey** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May 2009. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Jersey or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19th Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623 7430 • Telefax: (202) 623 7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

Price: \$18.00 a copy

**International Monetary Fund  
Washington, D.C.**

FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

**JERSEY**

BASEL CORE PRINCIPLES

**DETAILED ASSESSMENT OF  
OBSERVANCE**

MAY 2009

INTERNATIONAL MONETARY FUND  
MONETARY AND CAPITAL MARKETS DEPARTMENT



| Contents   | Page |
|--|------|
| Glossary .....   | 4    |
| I. Summary, Key Findings, and Recommendations .....                                  | 5    |
| II. Detailed Assessment .....  | 12   |
| <br>Tables   |      |
| 1. Summary of Compliance with the Basel Core Principles—Detailed Assessments.....    | 9    |
| 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles..... | 10   |
| 3. Detailed Assessment of Compliance with the Basel Core Principles.....             | 13   |

**GLOSSARY**

|                 |   |
|-----------------|---|
| Basel Committee | Basel Committee on Banking Supervision                  |
| BB (J) L        | Banking Business (Jersey) Law 1991                      |
| BCP             | Basel Core Principles for Effective Banking Supervision |
| Board           | Board of commissions                                    |
| CP              | Core principles   |
| EU              | European Union  |
| FSAP            | Financial Sector Assessment Program                     |
| FSC (J) L       | Financial Services Commission (Jersey) Law 1998         |
| GNI             | Gross national income                                   |
| GPO             | General Provisions (Jersey) Order 2002                  |
| GVA             | Gross value added                                       |
| JAC             | Jersey Appointments Commission                          |
| JFSC            | Jersey Financial Services Commission                    |
| MOU             | Memorandum of understanding                             |
| NBFI            | Nonbank financial institution                           |
| OFC             | Offshore financial center                               |
| SARs            | Suspicious activity reports                             |
| The States      | Parliament of Jersey                                    |
| UK              | United Kingdom  |

## I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

### Introduction

1. **This assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCPs) was undertaken as part of an IMF Financial Sector Assessment Program (FSAP) Update for Jersey in 2008, and in particular was prepared during an IMF mission that visited Jersey in November 2008.** This assessment follows-up on an earlier BCP assessment performed in the context of the 2002/2003 IMF Offshore Financial Center (OFC) assessment of Jersey. The assessors were Jürgen Dreymann (BaFin) and Keith Bell (banking supervision consultant).

### Information and methodology used for assessment

2. **The assessment of compliance with the BCPs was made on the basis of a study of the legal and regulatory framework, a self-assessment prepared by the authorities, and detailed discussions with relevant authorities and stakeholders.** Discussions were held with government representatives, the Jersey Financial Services Commission (JFSC), the Jersey Bankers Association, and senior management of banks and auditing firms. The team would like to express its appreciation to the JFSC and the representatives of banks and other institutions for their cooperation with the mission.

3. **The assessment team enjoyed very good cooperation from Jersey's authorities.** This included the comprehensive provision of all the documentation requested and extensive supplementary information and explanations delivered orally during meetings with members of the JFSC's Supervision Division. The JFSC also made available to the assessors its own updated assessment of compliance with the BCPs.

4. **This assessment was conducted in accordance with the Basel Committee on Banking Supervision's (Basel Committee) revised Core Principles Methodology (October 2006) and involved a qualitative assessment of compliance with each Core Principle (CP).** The methodology makes a distinction between "essential" and "additional" criteria. However, in accordance with the usual standards applied in the case of assessments which are conducted as part of an FSAP, the ratings take into account the essential criteria only.

5. **An assessment of compliance with the BCPs is not, and is not intended to be, an exact science.** Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are rapidly changing around the world, and theories, policies and practices of supervision are evolving swiftly. Nevertheless, it is internationally acknowledged that the CPs are seen as minimum standards.

## **Institutional and macroeconomic setting and market structure—overview**

6. **Jersey is one the three British Crown Dependencies, the others being Guernsey and the Isle of Man.**<sup>1</sup> As such it is not part of the United Kingdom (UK) and has its own parliament (the States of Jersey (States)), legal and regulatory system, and tax regime. In December 2005, a system of ministerial government was established. The council of ministers is made up of a chief minister and nine other ministers chosen by the States. The chief minister's department coordinates strategic planning across the public service.

7. **The Jersey economy has performed satisfactorily over the last decade, but some slowdown is currently expected in the context of the global financial turmoil and the slowing of the British economy.** In general the economy is highly oriented toward that of the UK and uses the pound Sterling as its currency. Jersey is also in a customs union with the European Union (EU) for trade in goods. Annual real gross value added (GVA) growth averaged 3.8 percent over 2003-07.<sup>2</sup> The trend growth rate has been satisfactory, but real GVA has fluctuated considerably over the past decade because of variations in financial institutions' net value added, which depends on global financial market conditions. Current strains in global financial markets and especially lower interest rates, combined with slower growth in the UK economy generally, is expected to slow growth in the coming year. However, the nonfinancial economy tends to be quite stable. Unemployment is negligible, in part because of immigration restrictions put in place to limit population density. Retail price inflation has been broadly in line with that of the UK in recent years, and has thus accelerated in the last year to 5.6 percent in the twelve months to June 2008. House prices were stable for much of the last decade but rose by over 40 percent between end-2005 and mid-2008.

8. **The basis of the economy is the financial sector.** The main activities are banking, fund management, and fiduciary services. The combined financial services sector contributes over half of GVA, and total assets under management are a large multiple of GVA. The island is among the larger OFCs in the banking sector. There has been some decline in the number of financial institutions on the island, in large part due to consolidation and shifts in business models, but the volume of assets rose fairly steadily at least through mid-2008.

9. **Banking is the dominant component of the financial sector.** Most major British banks have operations on the island. There are branches and subsidiaries from other EU countries, North America, and some other countries. Banks' principal business is the collection of retail deposits from overseas (e.g., from British expatriates or non-domiciled

---

<sup>1</sup> The Isle of Man FSAP Update mission was conducted in September 2008.

<sup>2</sup> GVA in 2007 is estimated at GBP 4.1 billion (GVA equals GDP less net taxes on products). Gross national income (GNI), which measures income of Jersey residents and companies, is estimated at GBP 3.7 billion. With a population slightly over 90,000, GNI per head is about GBP 41,000 (44 percent more than in the UK).

expatriates in the UK). A growing share of deposits stems from corporates and the trusts that are managed on the island. These funds are mainly placed with parent banks. Many banking groups have licenses to perform other financial services, such as fiduciary services, that are ancillary to the wealth management services provided to their clients. Non-interbank lending is mainly to individuals, property companies, and some nonbank financial institutions (NBFIs); the total is over 700 percent of GVA. Banks have relatively little real estate exposure and most do not operate trading books or independent treasury functions.

10. **Banks enjoy high asset quality, profitability, and capitalization, but leverage is also high.** The banking sector as a whole exhibits ample liquidity given that claims on groups are mostly very short term. Recent global financial turmoil has had some limited impact on banks.

#### **Preconditions for effective banking supervision**

11. **Jersey's macroeconomic performance is generally satisfactory.** Unemployment is low, and the trend growth rate and inflation have been satisfactory.

12. **The legal system, which is broadly based on common law with French and Norman elements, is highly developed.** The courts are well versed in financial matters, and reportedly are able to act quickly if needed. A full range of high-quality accountancy, audit, legal, and ancillary financial services are available on the island.

13. **Jersey is not a member state of the EU or the wider European Economic Area.** Consequently, Jersey has not been obliged to implement European directives on the regulation of financial services. Instead, it has voluntarily followed a policy of adopting wider international standards such as those of the Basel Committee. Furthermore, Jersey has introduced a system of information exchange and withholding tax on financial income in accordance with the EU Savings Directive.

14. **The authorities have substantially adequate powers to direct, intervene in, and close a troubled financial institution.** There is no depositor compensation or insurance scheme in place. No bank has failed in recent decades.

#### **Main findings**

15. **The BCP assessment confirms the high standard of prudential regulation and supervision described in the 2003 assessment, and found that the issues identified at that time have largely been addressed.** Most importantly, the JFSC now conducts a large program of on-site supervision, supported by off-site analysis. The JFSC follows up on on-site supervision visits with detailed recommendations. In addition, a framework of minimum prudential standards is provided by the Banking Business (Jersey) Law 1991, the Banking Business (General Provisions) (Jersey) Order 2002, and the Codes of Practice for Deposit-taking Business (Banking Codes).

16. **The JFSC, as the integrated regulator, has as its main responsibility the**



**supervision and development of financial services provided on the island.** By law, it should have regard to the reduction of risk to the public due to financial unsoundness or mis-management in a financial institution, protection and enhancement of the island's reputation, the best economic interests of Jersey, and the need to counter financial crime. The JFSC also operates the Companies Registry, and has certain related other functions, such as advising the government on financial sector matters.

17. **The JFSC enjoys considerable independence, and is subject to suitable accountability provisions.** A memorandum of understanding (MOU) between the JFSC and the responsible minister has clarified that the latter would exercise the statutory power to give the JFSC a "direction" only in exceptional circumstances where it is believed that the wellbeing of the island is at stake, and with respect to general policy, not individual cases. The minister has never exercised this power.

18. **The JFSC has numerous and effective powers.** The JFSC can request information, issue binding directions, publish warnings and advice, appoint managers or co-signatories, revoke licenses, or even request that a court start bankruptcy or winding-up proceedings. Fines can be imposed mostly for administrative matters, such as late submission of supervisory returns. The JFSC is adequately resourced.

19. **The authorities cooperate with the home supervisors of institutions active on the island.** Numerous MOUs with supervisors abroad have been signed to address both on-going supervision and information exchange. Information is in fact exchanged, and regular visits to and from the home supervisors are undertaken, including for the purpose of on-site supervision.

20. **Three broad areas for further work have been identified:**

- The authorities have exempted banks' exposures to their parents from limits on connected lending and large exposures, even though these exposures represent the major risk to the system. A permanent and blanket exemption from single counterparty limits is inconsistent with the BCP. It is recommended that the authorities make the exemptions less automatic by requiring that the JFSC on a regular basis has to confirm that the parent company still has the will and capacity to support its subsidiary, and try to ensure that local banks develop more autonomous risk management capacity.
- The authorities rely largely on banks' internal controls and auditors to ensure adequate loan classification and provisioning. More attention should be paid to this risk factor, especially in the current environment.
- The JFSC should develop more capacity to assess overall financial sector stability and banks' risk models. At present, attention seems to focus on individual banks. In this connection, the JFSC should consider publishing more statistics on banks and other financial institutions, such as aggregate balance sheets and the mean and distribution of financial soundness indicators.

21. Principle-by-principle compliance with the BCP is summarized in Table 1, below.

**Table 1. Summary of Compliance with the Basel Core Principles—Detailed Assessments**

| Core Principle   | Grading | Comments   |
|--|---------|--|
| 1. Objectives, independence, powers, transparency, and cooperation   | C       |  |
| 1.1 Responsibilities and objectives  | LC      |  |
| 1.2 Independence, accountability and transparency  | C       |  |
| 1.3 Legal framework  | C       |  |
| 1.4 Legal powers   | C       |  |
| 1.5 Legal protection   | C       |  |
| 1.6 Cooperation  | C       |  |
| 2. Permissible activities  | C       |  |
| 3. Licensing criteria  | C       |  |
| 4. Transfer of significant ownership   | C       |  |
| 5. Major acquisitions  | C       |  |
| 6. Capital adequacy  | C       |  |
| 7. Risk management process   | C       |  |
| 8. Credit risk   | C       |  |
| 9. Problem assets, provisions, and reserves  | LC      | Review policies and procedures for provisioning and write-offs |
| 10. Large exposure limits  | LC      | Replace general exemption for large inter-bank exposures       |
| 11. Exposure to related parties  | LC      | Replace general exemption for large inter-bank exposures       |
| 12. Country and transfer risks   | C       |  |
| 13. Market risks   | C       |  |
| 14. Liquidity risk   | C       |  |
| 15. Operational risk   | C       |  |
| 16. Interest rate risk in the banking book   | C       |  |
| 17. Internal control and audit   | C       |  |
| 18. Abuse of financial services  | C       |  |
| 19. Supervisory approach   | C       |  |
| 20. Supervisory techniques   | C       |  |
| 21. Supervisory reporting  | C       |  |
| 22. Accounting and disclosure  | LC      |  |
| 23. Corrective and remedial powers of supervisors  | C       |  |
| 24. Consolidated supervision   | C       |  |
| 25. Home-host relationships  | C       |  |
| <i>Aggregate:</i> Compliant (C) – 26, Largely compliant (LC) – 5, Materially noncompliant (MNC) – 0, Noncompliant (NC) – 0, Not applicable (N/A) – 0 |         |  |

## Recommended action plan and authorities' response

### *Recommended action plan*

| <b>Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles<sup>3</sup></b> |  |
|--|--|
| CP1(1)   | <p>The JFSC should publish statistics and a commentary on the performance of the Jersey banking system as a whole.</p> <p>The JFSC should place greater emphasis on registered persons having available for access by the public either summarized or audited financial statements.</p>  |
| CP1(2)   | <p>Schedule 1 of the Financial Services Commission (Jersey) Law 1998 (FSC(J)L) should provide an explicit requirement that the reasons for the dismissal from office of a Commissioner be made public.</p>   |
| CP6  | <p>With regard to public disclosure, it would be constructive for the JFSC to require any registered person to display prominently in its premises and in applicable promotional documentation a uniform notice informing the reader of the status of their deposits in Jersey-registered banks in so far as any guarantees, compensation or an insurance scheme apply</p>   |
| CP7  | <p>The JFSC should consider establishing a more formal process to observe developments at parent company or the head office level and within the home jurisdiction of the group.</p> <p>The JFSC should consider inserting a provision into Principle 3 of the Banking Codes under paragraph 3.1.4.5 according to which any exceptions to established policies, processes and limits should be reported and should receive the prompt attention of senior management and the board of a bank, where necessary.</p> <p>The JFSC should consider the explicit inclusion of minimum requirements on new product approval processes and procedures in Appendix I of the Banking Codes.</p> |
| CP9  | <p>The JFSC should on a regular basis form its own view with regard to the necessary assessment of the adequacy of a bank's provisioning policies and processes, and should also approach banks, parent institutions and the respective home supervisors in order to confirm so far as possible the adequacy of the provisioning policy.</p>   |
| CP10   | <p>The JFSC should consider having only one single definition of the term "exposure" in the large exposure and concentration risk context.</p> <p>The general exemption of inter-bank loans or placements, certificates of deposit or similar instruments issued by a bank with a maturity of one year or less from concentration risk regulation should be reconsidered. The JFSC should decide on a regular basis whether or not an exemption for large exposures granted should be renewed.</p>   |
| CP11   | <p>The regulation of exposures entered into in the inter-bank market and, as it is predominantly the case in this jurisdiction, to connected parties, should be</p>  |

<sup>3</sup> Note that several recommendations are included under CPs that are assessed as fully compliant.

| <b>Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles<sup>3</sup></b> |   |
|--|---|
|  | <p>reconsidered. Also, the JFSC should review these requirements such that that they cover all transactions with related parties, i.e., all kinds of investments, placement of deposits, capitalization, etc.</p> <p>The JFSC should enlarge the scope, and increase the frequency of its regular review of the status and financial condition of parent companies of local subsidiaries, including through an explicit need for the JFSC to consider whether the exemption of group related exposures from the concentration risk requirements applicable could be renewed.</p> <p>In the case of banks that are subsidiaries, the JFSC may wish to consider requiring receipt of a letter of comfort from parent companies more frequently than every five years (perhaps annually).</p> <p>The JFSC should consider including in Appendix I, paragraph 1.5, of the Banking Codes an explicit provision according to which policies and procedures ensure that all material concentrations should be reviewed and reported periodically to the board.</p>   |
| CP12   | The JFSC could incorporate explicit questions with regard to transfer and country risk in its "route planners" and introduce it also as a separate topic for the "Annual Review Meeting."   |
| CP13   | The JFSC should consider introducing key requirements for the management of market risk into Appendix I of the Banking Codes, e.g., requirements related to foreign currency and interest rate risks.   |
| CP14   | <p>The Banking Codes should include appropriate policies and procedures to limit liquidity risk and foresee the conduct of a regular analysis of funding requirements under alternative scenarios/stress tests. Specifically, the Banking Codes should include appropriate policies and procedures to limit liquidity risk and foresee the conduct of a regular analysis of funding requirements under alternative scenarios/stress tests. Furthermore, liquidity risk provisions of Appendix I of the Banking Codes should take into account the degree of diversification of funding sources and the necessary review of concentration limits (which were yet to be established at the time of the assessment; see CP 10 and 11). Standardized questions with regard to those topics should also be formulated and integrated into the route planner.</p> <p>The JFSC should also consider incorporating the maximum mismatch limits from the Liquidity Management and Reporting Guidance Notes into Appendix I of the Banking Codes.</p> <p>Given the recent market turmoil, the JFSC should review its liquidity regulations and guidance delivered to banks with a view of taking into account the new paper on liquidity management and supervision published in September 2008 by the Basel Committee.</p> |
| CP15   | The JFSC should consider including the standard definition of operational risk explicitly under paragraph 4.1 of Appendix I of the Banking Codes.   |
| CP16   | The JFSC should introduce into the route planner a separate section of specific questions dealing with interest rate risk generally and interest rates in the banking book, and should also take into due regard such questions as the price sensitivity of banking book items and their respective volumes, etc.   |
| CP19   | The JFSC should devote more effort to assessing risks affecting the financial system as a whole, including through the undertaking of aggregate stress testing and the  |

| <b>Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles<sup>3</sup></b> |   |
|--|---|
|  | examination of the distribution of financial soundness indicators.  |
| CP22   | <p>The JFSC should publish statistics and a commentary on the performance of the Jersey banking system as a whole.</p> <p>The JFSC should place greater emphasis on registered persons having available for access by the public either summarized or audited financial statements.</p> <p>Bilateral discussions with external auditors should be held more regularly.</p>  |
| CP25   | <p>Depositors should be made aware of the status of deposits in Jersey banks in so far as depositor-insurance schemes are concerned.</p> <p>The JFSC should strive to obtain regularly from home supervisors a written statement indicating whether they have any knowledge of any significant problems of which the JFSC should be aware.</p> <p>The JFSC should strive to obtain from home supervisors a commitment to communicate promptly and on their initiative information that is critical to the stability of the Jersey financial system.</p> |

*Authorities' response to the assessment*

22. **The Commission acknowledges with gratitude all aspects of this assessment and is committed to fully considering recommendations made.**

## II. DETAILED ASSESSMENT

23. **The Methodology provides that supervision of an individual principle is considered compliant when all essential criteria are generally met without any significant deficiencies.** A principle is considered **largely compliant** when only minor shortcomings are observed, which do not raise any concerns about the authority's ability and intent to achieve full compliance with the principle within a prescribed period of time. A principle is considered **materially noncompliant** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is considered **noncompliant** when no substantive progress toward compliance has been achieved. A principle is considered **not applicable** whenever, in the view of the assessors, the principle does not apply given the structural, legal, and institutional features of a country.

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
| <b>Principle 1.</b>  | <b>Objectives, autonomy, powers, and resources.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.  |
| Description  | See descriptions and comments below.   |
| Compliant  |  |
| Comments   |  |
| <b>Principle 1(1).</b>   | <b>Responsibilities and objectives.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.  |
| Description  | <p>Responsibilities of the JFSC are established in the FSC(J)L and related statutes (as amended), namely:</p> <ul style="list-style-type: none"> <li>• The Banking Business (Jersey) Law 1991 (BB(J)L);</li> <li>• The Collective Investment Funds (Jersey) Law 1988;</li> <li>• The Insurance Business (Jersey) Law 1996; and</li> <li>• The Financial Services (Jersey) Law 1998.</li> </ul> <p>The JFSC's functions (the FSC(J)L (Article 5)) are:</p> <ul style="list-style-type: none"> <li>• the supervision and development of financial services provided in or from within Jersey;</li> <li>• providing the States, any minister or any other public body with reports, advice, assistance and information in relation to any matter connected with financial services;</li> <li>• preparing and submitting to the minister recommendations for the introduction, amendment or replacement of legislation appertaining to financial services, companies and other forms of business structure (the FSC(J)L (Article 1) defines "the Minister" to be the Minister for Economic Development); and</li> <li>• such functions in relation to financial services or such incidental or ancillary matters as are required or authorized by or under any enactment, or as the States may, by Regulations, transfer.</li> </ul> <p>The BB(J)L regulates deposit-taking business in Jersey. The JFSC is solely responsible for the supervision of persons registered for deposit-taking activities using the powers conferred by that statute (BB(J)L; Article 6).</p> <p>The FSC(J)L does not provide for the JFSC to have any involvement in the promotion of Jersey's financial services industry.</p> <p>A framework of minimum prudential standards is provided by the BB(J)L, the Banking Business (General Provisions) (Jersey) Order 2002 (GPO) and the Banking Codes that banks must meet. The Banking Codes in particular set certain key prudential standards (detailed later in this assessment).</p> <p>The BB(J)L has been amended fourteen times, most recently in April 2008.</p> <p>Banking Codes were introduced in August 2006, becoming effective from February 2007. They were further amended in 2007, effective from 1 February 2008, to reflect revisions to the BCP in October 2006 and updated again in July 2008. Their stated objective is to establish sound,</p> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>high level principles for the operation of deposit-taking business as defined in the BB(J)L. They span control, corporate governance, financial resources and the effective risk management of all activities conducted by a deposit-taker and its subsidiaries. (See <u>Introduction to Banking Codes</u>).</p> <p>There is limited publicly available information on the financial strength and performance of the banking industry in Jersey taken as a whole. An annual Financial Institutions Survey is published by the Island's government, but it does not address financial strength or most aspects of performance.</p> <p>On a single entity basis, the GPO (Article 11(5)) requires that each "registered person (that) is a subsidiary of an organization" must have available for access by the public, either; "(a) summarized accounts of the registered person in a form determined by the Commission, or (b) "true and fair" audited accounts." There is a similar requirement in the BB(J)L (Article 32) for "registered persons" operating as branches. The assessors gained the impression that, in practice, this information is readily available from many but not all banks.</p> <p>The JFSC uses a 'regulatory package' to help determine its off-site and on-site supervisory programs for each bank, with high risk or high impact banks being afforded a higher level of supervisory resources and oversight. This will be reflected in a variety of supervisory actions.</p>   |
| Assessment   | Largely Compliant   |
| Comments   | <p>In order to be consistent with Essential Criterion 4, the JFSC should publish statistics and a commentary on the performance of the Jersey banking system.</p> <p>On a single entity basis, the JFSC should place greater emphasis on registered persons having available for access by the public either summarized or audited financial statements.</p>  |
| <b>Principle 1(2).</b>   | <b>Independence, accountability and transparency.</b> Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.  |
| Description  | <p>The FSC(J)L (Article 2(4)) provides that, except as provided therein, the JFSC shall be independent of the Minister for Economic Development (Minister) and of the States (see below).</p> <p>The States, from persons nominated by the minister, formally appoints all commissioners (FSC(J)L; Article 3). A nominations committee, comprising members of the Board of Commissioners (Board), proposes individuals for the positions of chairman and deputy chairman of the Board. The States formally appoints the chairman (nominated by the minister), whilst the minister appoints the deputy chairman. There are established procedures for appointment and terms of appointment (including removal) of Board members (FSC(J)L Articles 3 and 4 and Schedule 1). By convention, members of the States are not considered for appointment as members of the Board.</p> <p>All Commissioners act in a non-executive capacity, with the exception of the director general who is appointed as a commissioner by virtue of office (a matter of practice rather than law). Additionally, the deputy director general is invited to attend all Board meetings but is not a member of the Board for the purposes of voting and being quorate.</p> <p>Commissioners are appointed for a period not exceeding three years and are eligible for re-appointment (FSC(J)L Schedule 1). Commissioners generally serve for two periods and in exceptional circumstances this may be extended to three.</p> <p>The application and appointments procedures that are followed are in accordance with those recommended by the Jersey Appointments Commission (JAC) for senior public appointments and a member of the JAC normally sits on the selection panel.</p> <p>The FSC(J)L (Schedule 1) allows the minister to dismiss a commissioner only if he is satisfied that the Commissioner:</p> <ul style="list-style-type: none"> <li>• has been absent from meetings of the JFSC for a period longer than six consecutive months without the permission of the JFSC;</li> </ul> |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>• has become bankrupt;</li> <li>• is incapacitated by physical or mental illness; or</li> <li>• is otherwise unable or unfit to discharge the functions of a commissioner.</li> </ul> <p>There is no explicit requirement that the reasons for the dismissal from office of a commissioner be made public. However, by convention, removal from office of public officials is always publicized.</p> <p>The FSC(J)L (Article 12) states that the minister may, after first consulting with the JFSC and where he/she considers it to be in the public interest to do so, give guidance or give in writing general directions to the JFSC in respect of the policies to be followed by it in relation to the supervision and development of financial services in Jersey and the manner in which any of its functions is to be carried out. To date, no guidance or directions have been given to the JFSC.</p> <p>The JFSC has entered into a MOU with the Minister in respect of Article 12. <i>Inter alia</i>, the MOU (Section 4) sets out that: "The (Minister) notes that ... (he/she) may only exercise (his or her) power to give to the Commission guidance or direction where it is in the public interest ... (and) confirms that any guidance as well as any direction given ... will be general in nature and will not be used so as to influence particular cases, e.g. to require the Commission to grant (or refuse) a regulatory consent in relation to a particular person."</p> <p>The JFSC is accountable to the States for its overall performance. This accountability on the use of its powers and resources, takes the form of the annual report and financial statements presented to the States by the minister (FSC(J)L; Article 21). Periodically, the director general and/or Board chairman meet with either the chief minister or the minister to discuss JFSC matters. To date, these meetings have been at the JFSC's request but either party can call them. Additionally, the whole Board meets annually with States' representatives.</p> <p>The JFSC publishes an annual report for public consumption, which includes its audited financial statements and a report on the JFSC's operations of the past year. Separately the JFSC publishes its annual business plan. Both documents are published in the first quarter of the calendar year and generally the annual report includes:</p> <ul style="list-style-type: none"> <li>• details of achievements of the past year;</li> <li>• priorities for the coming year; and</li> <li>• summary financial data. The financial data highlights the latest year actual income and expenditure results against the budget for the same period along with actual results for the previous year and the budget for the coming year.</li> </ul> <p>The JFSC's independent status, accountability and governance structure is publicly disclosed on its website and in its annual report.</p> <p>The FSC(J)L (Article 3(3)) provides that the Commissioners shall include:</p> <ul style="list-style-type: none"> <li>• persons with experience of the type of financial services supervised by the JFSC;</li> <li>• regular users on their own account or on behalf of others, or representatives of those users, of financial services of any kind supervised by the JFSC; and</li> <li>• individuals representing the public interest.</li> </ul> <p>Consequently, the Board includes individuals with local commercial and sectoral interests. (However, the FSC(J)L (Schedule 1) requires Commissioners to disclose when they have any direct or indirect interest in an outcome of the deliberations of the JFSC and to withdraw from such deliberations.)</p> <p><u>The Board:</u></p> <p>Currently the Board comprises ten individuals. The Commissioners appointed to date have been individuals with expertise and experience, and have included several from abroad and several who have played prominent roles in relevant international fora.</p> |
|--|--|



**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p><u>JFSC staff:</u></p> <p>Staff has previous experience in both public and private sectors, in Jersey and other parts of the British Isles; financial regulation, within the UK and Europe, other Crown Dependencies and other offshore financial centers; and the academic world. Attainment of professional qualifications and continuance with professional studies is actively encouraged and the current staff complement includes a number of qualified accountants, lawyers and chartered secretaries (equivalent to US Corporate Secretary) along with individuals who are currently studying for a professional qualification.</p> <p>The JFSC and its staff displayed expertise and professionalism during the mission, an impression confirmed by industry representatives.</p> <p><u>JFSC funding:</u></p> <p>The JFSC is funded through fees and charges levied on regulated financial services businesses. In addition, the FSC(J)L provides for the States, if necessary, to pay a grant to the JFSC (Article 16) or for the latter to borrow money in its own right (Article 17). To date, neither event has occurred.</p> <p>The JFSC has the ability to set its own fees (previously the government had a role in setting fees). The FSC(J)L (Article 15(2)) provides that:</p> <p>“The fees mentioned in paragraph (1) [of Article 15] are to be retained by the Commission and must, together with any other income..., be such as are necessary –</p> <ul style="list-style-type: none"> <li>• to raise sufficient income to meet (its) liabilities;</li> <li>• to cover (its) expenses; and</li> <li>• to provide a reserve for (it) of such amount as it considers necessary.”</li> </ul> <p>The JFSC’s objective, when setting the level of fees for each aspect of financial services regulation, is that the fees from a particular financial sector should cover the costs of regulating that sector plus a share of JFSC overheads. The level of fee income received per sector is monitored against the expense of regulating that sector via monthly management accounts.</p> <p>The level of fees received is directly related to the number of entities that fall within the JFSC’s regulatory scope. For each sector of the financial services industry which the JFSC regulates (e.g. banking; insurance; investment funds; trust and company service providers) there is a separate basis for calculating the level of fees to be paid by any single entity in that sector. The separate charging methodologies are set out on the JFSC’s website.</p> <p>FSC(J)L (Article 15(3) (c)) requires the JFSC to publish a report that provides details of the duty or power for which the fee is to be determined, the amount of the proposed fee, a request for comments on the proposal and a closing date for those comments which must allow at least 28 days. Actual reports on proposed fees meet these criteria, and in addition provide a justification of fee levels relating fees to actual and projected costs. Article 15(4) deals with circumstances where the Commission is unable to agree with a body representative of the interests of those who would be required to pay the fee, and states that the Commission must request the Bailiff to appoint 3 Jurats to consider if the fee proposed by the Commission is unreasonable having regard to all the circumstances of the case and, in particular, the requirement of Article 15(2). There has yet to be any need for recourse to this arbitration mechanism, and the JFSC reports no significant difficulty in setting proposed fees for any supervised sector.</p> <p>For the past two complete years the JFSC has recorded a surplus of income over expenses, mainly from the funds industry and company registry, but also as a result of incurring fewer litigation costs than budgeted.</p> <p>From 2009, the JFSC will no longer pay to government a fixed amount of its revenue from the operation of the Companies Registry. Instead, it will collect and remit to government a tax</p> |
|--|--|

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|                        |  |
|------------------------|--|
|                        | <p>which is to be applied by the States on annual returns that must be made by companies.</p> <p><u>Salary scales:</u></p> <p>To monitor that its pay structure remains competitive, the JFSC has access to local surveys of salaries in the finance industry. An annual review is conducted with the objective that both the job hierarchies and pay bands remain up to date. Senior management indicates that there is no evidence that prospective employees have rejected the JFSC based on pay offered and, likewise, leavers do not cite pay levels as a primary reason for leaving.</p> <p>The JFSC does experience certain labor constraints locally, namely losing trained staff to the local finance industry. As Jersey's sole regulator, the JFSC's staff is seen as extremely valuable.</p> <p><u>Staff levels:</u></p> <p>The JFSC has an authorized headcount of 118. The Banking and Insurance Division is headed by a Director, and is assisted in respect of banking supervision by a Deputy, a Senior Manager, and three portfolio managers. An analyst works full-time on Basel II and Liquidity Management issues. There is two support staff. Resources are considered adequate for the current size and activities of the industry.</p> <p><u>Outside experts:</u></p> <p>The JFSC makes use of secondees that have expertise in particular areas. In addition, it is able to hire or consult with outside experts as needed.</p> <p>Under the BB(J)L (Article 28), the JFSC may, and does, appoint one or more competent persons to investigate and produce a report for submission to it. Those appointed, typically lawyers and accountants, are given wide powers to collect information on the institution or individual subject to investigation.</p> <p><u>Training:</u></p> <p>The JFSC actively encourages its staff to obtain relevant professional qualifications and looks to second individuals to other relevant positions, wherever possible, either by placement with an entity in the finance sector in Jersey, to enable them to gain relevant experience, or to entities outside Jersey. Staff regularly attends conferences and seminars and attendees are required to share knowledge obtained with other relevant members of staff. The JFSC is looking to appoint a Learning and Development Manager to fill a vacancy. All staff have annual personal development reviews.</p> <p><u>Computer and other equipment budget:</u></p> <p>The budget for computers and other such equipment is adequate.</p> <p><u>Travel Costs:</u></p> <p>The JFSC has a sufficient travel budget to enable attendance at all appropriate international regulatory gatherings and to conduct on-site visits to banks with branches in overseas jurisdictions, including the Middle East.</p> |
| Assessment             | Compliant  |
| Comments               | In order to be strictly consistent with Essential Criterion 1, Schedule 1 (FSC(J)L) should provide an explicit requirement that the reasons for the dismissal from office of a Commissioner be made public, although in practice the dismissal would be made public.   |
| <b>Principle 1(3).</b> | <b>Legal framework.</b> A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.  |
| Description            | The BB(J)L (Articles 9 and 10) sets out the JFSC's exclusive power to grant and withdraw deposit-taking registrations.   |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>The JFSC is authorized (BB(J)L; Article 19A) to issue Codes of Practice that set out sound principles for the conduct of deposit-taking business, which include prudential requirements.</p> <p>Amendments to primary laws, secondary laws (“Regulations” and “Orders”) and Codes are subject to appropriate industry consultation before being implemented. A documented consultation policy is in place that provides the framework for proposing changes and seeking industry opinions.</p> <p>The FSC(J)L (Article 8) empowers the JFSC to require an entity to supply information in a format and at times specified and to provide answers to questions. The BB(J)L (Article 26) allows the JFSC to require a registered person to provide any information (by formal notice) that it reasonably requires in performance of its statutory functions. The JFSC can issue directions that are binding (BB(J)L; Article 21(7)).</p>   |
| Assessment   | Compliant   |
| Comments   | While the States can make Regulations and a Minister can - on the recommendation of the JFSC- make an Order, both of which are secondary legislation, the JFSC can issue only Codes of Practice and guidance, which strictly speaking do not have the force of law, though they set requirements that are enforceable by the JFSC.  |
| <b>Principle 1(4).</b>   | <b>Legal powers.</b> A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.   |
| Description  | <p>The FSC(J)L (Article 8) sets out the JFSC’s powers in general and more specifically:</p> <p>“(2) That power includes the power, as part of (its) routine examination of a supervised entity –</p> <p style="padding-left: 40px;">(a) to require the entity to supply information in a format and at times specified by (it);</p> <p style="padding-left: 40px;">(b) to require the entity to provide answers to questions; and</p> <p style="padding-left: 40px;">(c) to require the entity to allow (its) officers or agents to enter the entity’s premises.”</p> <p>The BB(J)L (Article 6) states that: “the Commission shall have the powers conferred on it by this Law and the duty generally to supervise the persons registered by it in the exercise of those powers”. The JFSC exercises its duty to address compliance with the Law and Orders through the application of prudential standards/criteria (in Codes of Practice) and the application of disciplinary sanctions as provided by the BB(J)L.</p> <p>The JFSC applies qualitative judgment in safeguarding the safety and soundness of the banks in Jersey through a combination of on- and off-site supervisory techniques.</p> <p>The FSC(J)L (Article 8) and the BB(J)L (Article 26) provide the JFSC with a legal right of access to a bank’s board, management, staff and records. As noted in the Description for CP 1(3), above, the BB(J)L (Article 26) allows the JFSC to require a registered person to provide <u>any</u> information (by formal notice) that it reasonably requires in performance of its statutory functions.</p> <p>The JFSC may take (or may require banks to take) a number of remedial actions, depending on the nature of the non-compliance, through:</p> <ul style="list-style-type: none"> <li>• revocation of registration (BB(J)L; Article 10);</li> <li>• the issue of a condition on the bank’s registration (BB(J)L; Article 11);</li> <li>• the removal of an existing shareholder controller (BB(J)L; Article 15);</li> <li>• a restriction on the sale of shares (BB(J)L; Article 17);</li> <li>• the issue of a direction (BB(J)L; Article 21);</li> </ul> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>the appointment of inspectors (BB(J)L; Article 28); and</li> <li>the ability to make public statements (BB(J)L; Article 48).</li> </ul> <p>Additionally, the BB(J)L (Article 37A) provides that the Minister may, on the JFSC's recommendation, by Order, prescribe circumstances in which it may appoint a manager to the registered person.</p>   |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 1(5).</b>   | <b>Legal protection.</b> A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.   |
| Description  | <p>The FSC(J)L (Article 9) provides limitation of liability as follows:</p> <p>"1. No person or body to whom this Article applies shall be liable in damages for anything done or omitted in the discharge or purported discharge of any function under, or authorized by or under, this Law or any other enactment unless it is shown that the act or omission was in bad faith.</p> <p>2. This Article applies to –</p> <p>(a) the Commission, any Commissioner or any person who is, or is acting as, an officer, servant or agent of the Commission or who is performing any duty or exercising any power on behalf of the Commission; and</p> <p>(b) the States or any Minister in respect of any delegation of functions to the Commission."</p> <p>The JFSC has adequate insurance arrangements to cover the cost of defending any actions (except for acting in bad faith) that have occurred during the discharge of its duties.</p>                                      |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 1(6).</b>   | <b>Cooperation.</b> Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.  |
| Description  | <p>The JFSC is Jersey's sole financial services regulator.</p> <p>The BB(J)L (Articles 43, 44 and 45) provides statutory gateways for disclosure of restricted information, <i>inter alia</i>, to:</p> <ul style="list-style-type: none"> <li>the Viscount who handles matters such as bankruptcy; and</li> <li>the Attorney General or to a police officer of information obtained by virtue of Articles 26, 28, 29, or 30 (BB(J)L) for the purposes of an investigation into a suspected offence or a prosecution.</li> </ul> <p>The BB(J)L (Article 47) provides the JFSC with powers to assist a "relevant supervisory authority" in the areas of:</p> <ul style="list-style-type: none"> <li>refusal or revocation of a registration;</li> <li>imposition, revocation or variation of a condition on a bank registration;</li> <li>usage of the JFSC's powers of intervention (BB(J)L; Article 19);</li> <li>requiring the provision of information and documents;</li> </ul> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>• investigation; and</li> <li>• powers of entry and search of premises (through application to Jersey’s Bailiff [Chief Judge]).</li> </ul> <p>In this connection, the BB(J)L (Article 1 Interpretation) provides that: “Relevant supervisory authority in relation to a country or territory outside Jersey means the authority discharging in that country or territory any function that is the same as, or similar to, a function of the Commission.”</p> <p>Additionally, it may communicate information which is in its possession to a relevant supervisory authority, whether or not it is the result of an exercise of one of the powers listed above. However, under Article 47, it may only share information that is in its possession if it is satisfied that the information will be treated with appropriate confidentiality.</p> <p>The BB(J)L (Article 47) also provides factors that may be taken into account by the JFSC in deciding whether to exercise its powers to co-operate:</p> <ul style="list-style-type: none"> <li>• whether corresponding assistance would be given in that country or territory to the JFSC;</li> <li>• whether the case concerns the possible breach of a law, or other requirement, which has no close parallel in Jersey or involves the assertion of a jurisdiction not recognized by Jersey;</li> <li>• the seriousness of the case and its importance in Jersey and whether the assistance could be obtained by other means; and</li> <li>• whether it is otherwise appropriate in the public interest to give the assistance sought.</li> </ul> <p>The JFSC has a significant number of MOU agreements to assist in information sharing between jurisdictions (details are available on its website).</p> <p>The BB(J)L (Article 42) sets out adequate restrictions on the disclosure of restricted information. The penalty for failing to comply is imprisonment for a term not exceeding two years, or a fine, or both.</p> |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 2.</b>  | <b>Permissible activities.</b> The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word “bank” in names should be controlled as far as possible.   |
| Description  | <p>The term “bank” is not clearly defined in the BB(J) L, the FSC(J)L or any orders made there under. Instead, the activity of concern which brings an entity within the scope of the BB(J)L (and, in effect, acts as a substitute for the definition of a bank) is “deposit-taking business”. This is defined in the BB(J)L (Article 3). The meaning of “deposit” is provided by the BB(J)L (Article 2), and includes a definition of those items to be excluded from the statute’s meaning of “deposit” (see below).</p> <p>An applicant’s intended activities are considered by the JFSC as part of the registration process. Subsequent to registration, the GPO (Article 11(1)(a)) requires any “registered person” wishing to undertake a new activity that has, or may have, a significant effect on its business or profitability in Jersey to obtain the JFSC’s prior consent . The Banking Codes (paragraph 6.8) require any bank to notify the JFSC, prior to commencement, of a new activity that is likely to have a material effect on the business.</p> <p>The BB(J)L (Articles 38 to 41) set out the detailed restrictions on the use of certain names and descriptions. Any terms which indicate – or may be reasonably understood to indicate – that a person is a “bank” or “banker” or is “carrying on a banking business” may only be used by a</p>   |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>“registered person”, unless expressly authorized by the JFSC (BB(J)L; Articles 39).</p> <p>The BB(J)L (Article 8) reserves the taking of proper deposits from the public to appropriately licensed institutions. BB(J)L (Article 35) contains provisions for the repayment of unauthorized deposits. The GPO (Articles 3 to 7) provides for exempt transactions to which the prohibition in the BB(J)L (Article 8) does not apply. These exempt transactions include those occurring in respect of charities, solicitors and trustees. The BB(J)L (Article 3) permits a business to fall outside the definition of “a deposit taking business” - and therefore not require registration - if in the normal course of business it does not hold itself out to accept deposits on a daily basis and only accepts deposits on particular occasions.</p> <p>The JFSC publishes an up to date list of all registered deposit-takers (including branches) on its website.</p>  |
| Assessment   | Compliant   |
| Comments   |   |
| <b>Principle 3.</b>  | <p><b>Licensing criteria.</b> The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>  |
| Description  | <p>The JFSC is responsible for both licensing and supervising banks.</p> <p>The BB(J)L (Article 10) sets out minimum criteria for licensing deposit-takers. The JFSC has published a policy statement that sets out its licensing criteria for new banks in accordance with the BB(J)L. This policy, which has been long established and updated from time to time, is published on the JFSC’s website.</p> <p>In addition, the JFSC has published a policy on dominant shareholders applicable to Jersey deposit-takers.</p> <p>The criteria used for both registering banks and ongoing supervision are consistent as the same principles are applied to both, although additional requirements, such as reporting obligations, are required as part of ongoing supervision. If a bank no longer fulfilled the required criteria, action would be taken to bring it into compliance or revoke its registration.</p> <p>The BB(J)L (Article 10) sets out grounds for refusal to grant registration and provides full opportunity for the JFSC to reject an application. Failure to provide information is a reason for refusing registration. Where an application is refused, written confirmation is given to the applicant (BB(J)L; Article 17A).</p> <p>In determining whether a registration should be granted, the JFSC considers both the applicant’s structure and that of the wider group. The JFSC’s licensing policy requires, <i>inter alia</i>, that an applicant bank be a member of “a group of stature” (i.e. one ranked in the top 500 by Tier 1 capital), systemically important in its “home” jurisdiction, that the government of the latter has indicated its willingness to provide support to such systemically important banks when warranted, and that consolidated supervision of a standard judged to be of international standard by the JFSC is applied to the group by its primary regulator. The latter aspect is aimed at ensuring that there is a second, top down, level of supervisory assessment of group structure. The JFSC’s policy on dominant shareholders also establishes an approach that guards against harmful ownership structures.</p> <p>Furthermore, the JFSC has detailed its position with regard to dominant shareholder controllers within a policy statement. This policy statement requires that any bank making an application for a registration under the BB(J)L must notify the JFSC of the identity of its shareholder controllers (i.e. those holding 15 percent or more of the shares or who have equivalent voting power, as defined in the BB(J)L (Article 1)). Such shareholder controllers must complete a ‘Personal Questionnaire’ (PQ) which is used by the JFSC to assess fitness and propriety.</p> |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <p>The Banking Codes (paragraph 5.1) stipulate a minimum of £5,000,000 Tier 1 capital.</p> <p>One registered person currently has a capitalization below this figure, as its registration was granted before the requirement came into effect. However, its capital ratio exceeds the minimum risk asset ratio (10 percent) requirement.</p> <p>The JFSC requires all directors, controllers, managers and “key persons” (as defined) to complete a PQ at the time of the original application (or on subsequently being proposed for such positions) for assessment against “fit and proper” criteria. Completion of PQs requires provision of comprehensive information by an individual, including qualifications and experience, whether the individual has been subject to any criminal or regulatory action and any conflicts of interest. It also authorizes the JFSC to perform police and bank checks.</p> <p>The JFSC bank licensing policy states that: “Registration may be refused if it appears to the Commission Board that the applicant is not fit and proper to be registered by reason of any Director, Controller or Manager employed by the applicant having been convicted for acting fraudulently or dishonestly, or by reason of any other circumstances whatsoever which are either likely to lead to improper conduct of business by the applicant, or reflect discredit on its methods of conducting business.” The power to refuse registration in these circumstances is provided by the BB(J)L (Article 10(3)).</p> <p>The guidance notes for deposit-taking applicants requires submission of: a detailed business plan for the first three years of operation, including pro-forma financial statements, sources and types of business and staffing levels; the applicant’s latest audited financial statements of the parent bank and (if applicable) of the ultimate parent organization; details of external funding; and a completed application form. Control of the institution, risk management procedures and assumptions underlying business projections must also be stated. Where the information supplied is insufficient to make an adequate assessment of business plans, governance and controls, further information is requested.</p> <p>For a branch, the JFSC also requires that a PQ be completed by a senior officer located outside Jersey who acts as its external point of contact.</p> <p>In addition, the JFSC conducts meetings with representatives of the applicant to establish that operational policies, procedures, internal controls and oversight will be adequate and reflect the nature of the proposed activities. The information requirements and other actions to be taken by the JFSC are documented in a checklist. Where appropriate, the JFSC can impose conditions on the bank’s registration (BB(J)L; Article 11) such as restricting the undertaking of specific activities.</p> <p>In the case of an applicant for a deposit-taking registration, as provided in the guidance note for deposit-taking applicants, the JFSC obtains written consent from the home supervisor to the proposal and confirmation that it will exercise consolidated supervision and that, further, there are no significant regulatory issues, and that the applicant has a satisfactory record in its “home” jurisdiction. The JFSC also confirms that the home supervisor adheres to international standards.</p> <p>The BB(J)L (Article 22) states that “any person who knowingly or recklessly provides the Commission or any other person with (specified) information which is false or misleading in a material particular shall be guilty of an offence”. The JFSC may revoke a registration where false or misleading information has been provided (BB(J)L; Article 10).</p> <p>The JFSC assesses the competence of directors via review of individual PQs and, if appropriate, by face-to-face meetings, and would not permit a bank to pursue activity in an area of business where it considers that board members do not have sound knowledge. This could be achieved by issue of a direction (BB(J)L; Article 21) or imposition of a condition of registration (BB(J)L; Article 11).</p> <p>The JFSC’s policy of registering only members of the world’s top 500 banking groups as measured by Tier 1 capital has the implicit expectation that shareholders have the ability to supply additional financial support if needed. In addition, each registered person that is a Jersey-incorporated company must obtain a letter of comfort from its parent stating that the parent will provide support and assistance to ensure maintenance of adequate capital and</p> |
|--|---|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>liquidity levels.</p> <p>The JFSC closely monitors new entrants to ascertain that they are meeting their goals, managing risks and are compliant with regulatory laws, Orders and Codes (and also with the Money Laundering (Jersey) Order 2008). This involves regular meetings with the bank and an on-site examination once a measurable degree of business has been built up.</p>   |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 4.</b>  | <b>Transfer of significant ownership.</b> The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.   |
| Description  | <p>The BB(J)L (Article 25(1)) defines a “significant shareholder” as a person who, either alone or with an associate or associates, is entitled to exercise between 3 percent or more but less than 15 percent of the voting power at any general meeting of a registered person incorporated in Jersey.</p> <p>As regards proprietary interests of an “institution” (which includes a body corporate incorporated in Jersey or elsewhere) the BB(J)L (Article 1) introduces the definition of a “shareholder controller”. The latter is someone who alone or with any associate holds not less than 15 percent of the voting power of an institution or any of its holding companies. Shareholder controllers are sub-categorized as:</p> <ul style="list-style-type: none"> <li>• minority shareholder controller – 15 percent to 50 percent voting power;</li> <li>• majority shareholder controller – 51 percent to 75 percent voting power; and</li> <li>• principal shareholder controller – above 76 percent voting power.</li> </ul> <p><u>Subsidiaries incorporated in Jersey:</u></p> <p>Confirmation of no objection from the JFSC is required pursuant to the BB(J)L (Article 14(1)), which states that : “No person shall become a minority, majority or principal shareholder controller or an indirect controller of a registered person which is incorporated in Jersey unless the person has notified the Commission in writing of the person’s intention to become such a controller and the Commission has notified the person in writing that there is no objection to his or her becoming such a controller.” (An “indirect controller” is a person on whose instructions the directors of an institution (see above) are accustomed to act (BB(J)L; Article 1).)</p> <p>The BB(J)L (Article 25(1)) requires that persons who become “significant shareholders” (see above) in relation to a Jersey-incorporated bank shall so notify the JFSC within 14 days.</p> <p><u>Branches:</u></p> <p>Confirmation of no objection is required pursuant to the BB(J)L (Article 24(1)), which states that “A person shall not become a director, controller, key person of any class or manager of a registered person unless (a) he or she has notified the Commission in writing...(b) the Commission has notified the person in writing that there is no objection...” (The definition of “controller” in relation to an institution – or any of its holding companies - includes that of a “managing director” or “chief executive officer”).</p> <p><u>Branches and Subsidiaries:</u></p> <p>The above requirements for both subsidiaries and branches are supported by the JFSC’s policy statement with respect to controllers which states that in respect of all controllers a PQ will be required covering probity; competence; soundness of judgment; and diligence.</p> <p>All “controllers” must provide the JFSC with a PQ, which is used to assess their fitness and propriety. Should the JFSC conclude that the proposed change in ownership did not meet its fit and proper criteria then it could object to the proposal. Should the JFSC’s objection be ignored, the BB(J)L (Article 24(9), (11) and (12)) provides for legal action to be taken that can lead to</p> |



| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>imprisonment and/or a fine for the individuals concerned.</p> <p>For Jersey-incorporated subsidiaries, the BB(J)L (Article 25(3)) requires that significant changes in control (above 3 percent of the voting power) be notified to the JFSC. Both Jersey-incorporated subsidiaries and branches must obtain confirmation of no objection from the JFSC for changes resulting in a shareholding of 15 percent and more.</p> <p>Additionally, due to the JFSC's 'Top 500 policy' and the fact that Jersey banks are generally branches or 100 percent-owned subsidiaries of existing overseas banking groups, it will be clear who the shareholders and controllers are.</p> <p>The JFSC requires that banks have transparent ownership structures, which are assessed on initial application. Subsequent changes in this structure would require the JFSC's confirmation of no objection and would be assessed under the same transparency requirements.</p> <p>For Jersey-incorporated subsidiaries, the BB(J)L (Article 17(2)) provides the JFSC with the power to restrict the rights of shares transferred without necessary notification and approval. These powers include voiding transfers of shares, suspending shares' voting rights, preventing further share issues and stopping dividend payments.</p> <p>For branches, the JFSC cannot restrict the rights of shares as they are issued outside of Jersey. However, as noted above, it is a criminal offence not to notify the JFSC or to become a controller in the absence of its confirmation of no objection (BB(J)L; Article 24(9), (11) and (12)).</p> <p>For existing shareholder controllers, the Banking Codes (paragraph 6.1) states that "A registered person must advise the JFSC promptly of any matter that might reasonably be expected to effect its registration or be in the interests of its customers to disclose. This principle extends to the provision of information and the notification of events concerning non-regulated activities and other members of the corporate group..."</p> |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 5.</b>  | <b>Major acquisitions.</b> The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.  |
| Description  | <p>The GPO (Article 11) requires a "registered person" (bank) to obtain the JFSC's prior consent to undertake any new activity in Jersey with significant effect on its business or profitability. Furthermore, "if a registered person is a subsidiary of an organization" it must not establish or acquire a representative office, branch or subsidiary outside Jersey or participate in joint ventures involving deposit-taking, banking or investment business without the JFSC's approval.</p> <p>The Banking Codes (paragraph 6.8) states "A registered person must notify the Commission in writing of any decision to commence a new activity, prior to commencement, which is likely to have a material effect on the business or its profitability." The following definitions are applicable:</p> <ul style="list-style-type: none"> <li>• "New Activity" – includes new acquisitions or investments made by the bank; and</li> <li>• "Material" – defined as an amount in excess of 5 percent of a bank's agreed capital base for acquisitions or investments, or 5 percent of total income for other new activities.</li> </ul> <p>Should the JFSC believe that the activity would be detrimental to customers, creditors, other registered persons, the reputation or economic interests of Jersey, then a direction could be issued preventing the activity from occurring (BB(J)L; Article 21).</p> <p>The JFSC looks to prevent new acquisitions from exposing the bank to undue risks or hinder effective supervision. It also considers the requirements of the Banking Codes, in particular risk management, internal controls, financial resources and organization resources, when assessing new acquisitions or investments. The JFSC assesses the host jurisdiction, including</p>  |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>the regulations applied, as part of a proposed acquisition/investment review.</p> <p>The JFSC would consider financial and organizational resources when assessing new acquisitions and investments. Certain investments and acquisitions made by a bank (e.g. (a) investments in subsidiary and associated companies; (b) holdings of equity and capital investments in other banks, bank holding companies, or financing vehicles within banking groups; (c) lending of a capital nature to associated companies) are deducted from the bank's capital in the required quarterly prudential return (see also CP11). Such investments, therefore, impact on the bank's risk asset ratio and should be considered by the bank before the acquisition or investment is made.</p> <p>The Banking Codes (paragraph 6.10) states "A registered person must give written notice within seven days to the Commission (subject to any general or specific waiver from the Commission) of the formation, disposal or dissolution of a subsidiary company or acquisition of a holding of more than half in nominal value of the share capital of a company, specifying the name of the company and its principal business."</p> <p>The JFSC would consider the risks faced by a banking group when assessing new acquisitions and investments, especially when the proposed activities are outside normal banking activities. Moreover, if appropriate, this would be part of the ongoing process carried out by the JFSC in its monitoring of a bank via both on-site and off-site supervision.</p> <p>Should the risks faced by the bank be considered to be significant, the JFSC can issue directions on the bank under the BB(J)L (Article 21) to mitigate the risks by requiring the bank to take or not take specified action.</p> <p>Should a bank wish to acquire a significant holding in an institution in another jurisdiction, the JFSC will identify whether the relevant supervisor follows expected supervision practices. The JFSC is aware of the need to maintain sufficient home-host communication in such circumstances.</p> |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 6.</b>  | <b>Capital adequacy.</b> Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.   |
| Description  | <p>The Banking Codes (paragraph 5.2.1) prescribe maintenance of a minimum risk asset ratio of at least 10 percent (versus the Basel minimum of 8 percent) for all Jersey-incorporated "registered persons", calculated quarterly by the methods established in the Basel II Capital Accord. (The JFSC does not impose capital requirements on branches registered in Jersey.)</p> <p>The JFSC has assessed each such Jersey-incorporated bank's Internal Capital Adequacy Assessment Process (ICAAP) according to Pillar 2 methodology and, where it judged it appropriate, has increased the minimum risk asset ratio to take account of additional unmitigated risks identified. These individual risk asset ratios have been established by attaching a condition (under the BB(J)L (Article 11)) on the registration of the banks in question.</p> <p>Components of capital are defined, in accordance with Basel II definitions, in the published instructions for completion of the quarterly prudential returns. The instructions and returns are available on the JFSC's website. (It should be noted that the quarterly prudential return that coincides with a bank's year end is assessed and confirmed as materially correct by the bank's external auditor.)</p> <p>The quarterly prudential returns instructions provide Jersey-incorporated banks with a list of assets for which the JFSC requires a specific capital charge. These instructions follow relevant Basel guidance. In addition, the JFSC has—on occasion—instructed a bank to apply a specific capital treatment to particular assets. This instruction could be enforced by use of a direction (BB(J)L; Article 21), but this has not proved necessary.</p> <p>The Banking Codes (paragraph 5.4.5), plus prudential reporting instructions, require that</p>  |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>significant credit concentration risk exposures that exceed 10 percent of a bank's agreed capital base be notified to the JFSC. The GPO (Article 11(3)(c)) (and the Banking Codes (paragraph 5.4.1)) requires that a bank obtains the JFSC's prior approval for all credit exposures in excess of 25 percent of its agreed capital base, subject to defined "exemptions" (see CP. 11).</p> <p>The JFSC can also limit - by direction (BB(J)L; Article 21) - material risk exposures in both Jersey-incorporated registered persons as well as banks' registered branches if, in its opinion, the risk they pose is too great.</p> <p>Both on-balance sheet and off-balance sheet risks are included in risk assessments, and included in risk asset weightings for the calculation of a bank's risk asset ratio.</p> <p>If a bank were to fall below its minimum ratio, the JFSC has a range of actions it could take (see above).</p> <p>The JFSC permits deposit-takers to use advanced models – subject to:</p> <ul style="list-style-type: none"> <li>• the availability of ongoing model validation and support from the home supervisor;</li> <li>• the process adequately reflecting the entity's local risk profile; and</li> <li>• the outputs being adequate for the JFSC's assessment purposes.</li> </ul> <p>Permission is granted by application of a condition to the bank's registration (BB(J)L; Article 11). Only two registered persons have sought such permission.</p> <p>As noted above, the JFSC has assessed each Jersey-incorporated bank's ICAAP document, according to Pillar 2 methodology, and considered whether each bank has adopted a forward-looking approach to capital management. Thereafter, a number of banks were instructed by the JFSC to increase the length of financial projections in order to assess adequately their future capital requirements. This is supported by the Banking Codes (paragraph 5.2) requirements that a bank maintain adequate capital and, moreover, procedures and controls to monitor its capital adequacy requirements on an ongoing basis.</p> <p>Each Jersey-incorporated bank is required to maintain adequate capital based on minimum capital requirements and the risks faced by the bank, both as a consolidated group and on a solo basis. The JFSC also imposes solvency requirements on non-banking financial services subsidiaries that it regulates (trust company business, fund services business, investment business, insurance business, and general insurance mediation business).</p> |
| Assessment   | Compliant   |
| Comments   | <p>While CP 6 has been assessed as Compliant, in respect of the future implementation of Pillar 3 requirements regarding market discipline and detailing minimum levels of public disclosure, reference is made to the comments provided at CP 1(1), above.</p> <p>Further, in regard to public disclosure, it would be constructive for the JFSC to require any registered person to display prominently in its premises and in applicable promotional documentation a uniform notice informing the reader of the status of their deposits in Jersey-registered banks in so far as any guarantees, compensation or an insurance scheme apply.</p>  |
| <b>Principle 7</b>   | <p><b>Risk management process.</b> Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.</p>  |
| Description  | <p>Principle 3 of the Banking Codes establishes various requirements for adequate corporate governance and span of control. Paragraph 3.1.4.5 of the Banking Codes requires in general that there is appropriate oversight by the board (or senior management for branches) of all relevant areas of risk management.</p>   |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <p>Paragraph 3.1.4.3 of the Banking Codes requires that registered persons must put in place risk management strategies which must be ratified at board level (or by the senior officer in the case of branches). In addition to that, banks are obliged to ensure that risk management strategies and procedures are documented, regularly reviewed, communicated and adhered to in practice.</p> <p>Principle 3 of the Banking Codes also sets out the expected minimum standards that banks are to follow with regard to risk management systems. These standards cover the following subjects:</p> <ul style="list-style-type: none"> <li>• Corporate governance;</li> <li>• Internal control systems;</li> <li>• Internal audit;</li> <li>• Appointment of a Compliance Officer, Money Laundering Reporting Officer and Money Laundering Compliance Officer;</li> <li>• Record keeping and reporting;</li> <li>• Complaints;</li> <li>• Integrity and competence; and</li> <li>• Continuing professional development.</li> </ul> <p>By way of a note to the '3.1 Corporate governance' provisions, the JFSC explicitly addresses the challenges posed to local corporate governance by so called matrix organization of group organizations, i.e. the management and control of the group's operations on a business line basis. In order to prevent gaps in responsibility and accountability it has to be ensured that the decisions taken are consistent with the proper fulfillment of local corporate governance responsibilities.</p> <p>Paragraph 2.2 and paragraph 3.7.3 of the Banking Codes require that banks have a policy for dealing with conflicts of interests, by the registered person or by directors/employees. In addition, paragraph 3.1.4 obliges banks to have in place a separation of critical functions in the business.</p> <p>Paragraph 3.1.4.4 of the Banking Codes requires that there is appropriate oversight by the board (or senior management for branches) of all relevant areas of risk management, including:</p> <ul style="list-style-type: none"> <li>• risk assessment;</li> <li>• measurement, monitoring and controlling of risks;</li> <li>• exposure limits;</li> <li>• effective communication;</li> <li>• individual authority levels;</li> <li>• management information; and</li> <li>• documented system of internal control.</li> </ul> <p>Paragraph 3.1.4.4 of the Banking Codes furthermore determines that an assessment of resource requirements is carried out to ensure an appropriate risk management system exists, with a specific requirement that large and complex banks have an independent risk management unit.</p> <p>Paragraphs 3.2.1.5 and 3.2.1.6 of the Banking Codes place requirements on the management of the bank to identify and regularly assess all relevant risks, and to monitor the adequacy of capital in relation to the dynamics of the business operation, including risk profiles. Paragraph 3.1.4.4 requires that procedures exist that ensure that accurate and reliable management information and reporting systems are in place.</p> <p>Appendix I to the Banking Codes establishes minimum control requirements for a number of key risks and cross-refers to Basel Committee papers on the following risk topics:</p> <ul style="list-style-type: none"> <li>• credit risk;</li> <li>• country and transfer risks;</li> </ul> |
|--|---|

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <ul style="list-style-type: none"> <li>• market risk;</li> <li>• operational risk;</li> <li>• interest rate risk;</li> <li>• liquidity risk; and</li> <li>• customer due diligence.</li> </ul> <p>More comprehensive guidance has been separately issued in respect of:</p> <ul style="list-style-type: none"> <li>• liquidity management; and</li> <li>• the trading book.</li> </ul> <p>Appendix I of the Banking Codes also requires regular reviews of limits and underlying assumptions, including independent reviews.</p> <p>In addition, the JFSC issues industry guidance by way of summarized findings resulting from themed examination programs. These, to date, have spanned credit risk; treasury risk; outsourcing; information technology; and liquidity risk. Anti-money laundering/countering the financing of terrorism compliance assessments are to be completed soon, but interim findings have been published.</p> <p>Paragraph 3.3 of the Banking Codes requires banks to have an internal audit function, which has appropriate status to ensure that directors react to and determine whether to act upon its recommendations. The Banking Codes also require that:</p> <ul style="list-style-type: none"> <li>• the internal audit function has appropriate independence and assesses whether existing risk practices remain sufficient and appropriate (paragraph 3.3.1); and</li> <li>• larger and more complex banks have an independent risk management unit for evaluation, monitoring and control of risk (paragraph 3.1.4).</li> </ul> <p>Both internal audit and the compliance officer function are required under paragraphs 3.3 and 3.4 of the Banking Codes and must have appropriate independence, which would necessitate that they are separated from the risk taking functions of the bank.</p> <p>Paragraph 3.1.4.4 of the Banking Codes requires that an assessment on resource requirements is carried out to ensure an appropriate risk management system exists, with a specific requirement that large and complex banks have an independent risk management unit. Paragraph 3.3.2 of the Banking Codes states that the internal audit function is responsible for assessing risk management practices and reviewing whether these practices remain sufficient and appropriate.</p> <p>Given the nature and size of some of the banks in Jersey, the Banking Codes allow for the internal audit function to be provided from elsewhere within a group (i.e. by part of the group outside Jersey). The JFSC has an established expectation to meet with a visiting internal audit team when audits are performed, so that the scope of the audit work can be assessed as sufficient and any findings noted (paragraph 3.3, Note 2).</p> <p>The JFSC obtains reasonable assurance that exceptions to policies, processes and limits are promptly corrected by the bank through reviews of external and internal audit reports and meetings with the entities (particularly the annual review meetings) and by monitoring the resolution of findings from JFSC on-site examinations. In addition, this serves as a tool to confirm that the board and senior management understand the content of risk management information they receive.</p> <p>Appendix I of the Banking Codes also requires that an adequate assessment of risk relating to new products is accomplished prior to their launch. Banking Codes paragraph 3.1.4.3 requires that major risk management initiatives are ratified at board level.</p> <p>The JFSC has not placed a requirement on its regulated banks to have an approval process at board level (or committee of the board) specifically for new products but expects this to be generally covered by the requirements for board/senior management oversight of risk management and assessment procedures. Also, the Banking Codes require an adequate</p> |
|--|---|

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <p>assessment of risk relating to new products prior to their launch (Appendix I), and pre-notification to the JFSC of any new activities that will have a material effect on the business or profitability (paragraph 6.8). New products and initiatives are also covered in the annual review meeting held with registered persons.</p> <p>Paragraph 3.5.2 of the Banking Codes requires that accounting and other records must:</p> <ul style="list-style-type: none"> <li>• capture and record every transaction and commitment;</li> <li>• be maintained in such a manner that information can be extracted promptly to enable directors and senior management to adequately monitor all relevant exposures;</li> <li>• contain details of exposure limits; and</li> <li>• provide information that can be summarized in such a way as to enable actual exposures to be readily, accurately and regularly measured against such limits.</li> </ul> <p>The JFSC's "route planners" used for on-site examinations (see below) require JFSC staff to assess whether reports on the bank's exposures are provided on a timely basis to the board/senior management and adequately reflect the bank's risk profile and capital needs. The route planners require JFSC staff to assess whether models used to measure components of risk are adequately validated. The route planners are comprehensive in scope and specifically address the whole range of risks to be covered. Standardized questions tailored to specific risk categories are laid down in the route planner and serve as a guide for JFSC staff during on-site examinations.</p> <p>In 2007 the JFSC performed themed examinations on a selection of banks to assess their compliance with the Banking Codes, with particular focus on risk management. The summarized results from these examinations were published on the JFSC's website.</p> <p>The quarterly prudential returns submitted by banks are reviewed by the JFSC and provide a good indication of the quality of information systems and output of banks. Returns also provide regular and comprehensive information for the JFSC's staff on the business development of banks and of risks associated therewith.</p> <p>The JFSC also makes off-site requests for information, including reviewing the information passed to the board and the conclusions reached by the board.</p> <p>As already mentioned, the JFSC performs on-site examinations which utilize formalized 'route planners' to assess the risk management processes in place at banks. Findings from these examinations are fed back to banks as recommendations and the banks' implementation of the recommendations is monitored (through the use of a diary system). Should a bank fail to implement changes to improve the risk management processes in a reasonable timeframe, the JFSC can issue a direction under Article 21 of the BB(J)L to require this.</p> <p>The JFSC has assessed Jersey-incorporated banks' ICAAP documentation, and has concluded on whether the methodology used in its production was appropriate given the size and complexity of the bank. It is a requirement that each bank keeps its ICAAP up to date, and at least annually the JFSC will perform a review of the assessment. The ICAAP specifically requires that the senior management of the bank understands and documents the nature and levels of risk being taken by the bank and how this risk relates to adequate capital levels.</p> <p>Consistent with the Pillar 2 methodology, and where appropriate, the JFSC has increased the minimum risk asset ratio to take account of additional risks identified. Paragraph 5.2.1 of the Banking Codes requires that banks maintain a level of capital commensurate with the nature and scale of their business and risk profile.</p> <p>The "Basel II in Jersey: Quarterly Reporting and Pillar 2" guidance paper brought to the attention of Jersey incorporated subsidiaries the importance of stress testing, including forward looking stress testing, as part of the ICAAP process. For instance, in the concentration risk section of the guidance note, the JFSC requires that "bank's management should conduct periodic stress tests of its major risk concentrations and review the results of those tests to</p> |
|--|---|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>identify and respond to potential changes in market conditions that could adversely impact the bank's performance".</p> <p>The JFSC has the power, under Article 26 of the BB(J)L and Article 8 of the FSC(J)L, to obtain information it requires to perform its statutory duties. It can also use a direction on the bank to obtain such information.</p>  |
| Assessment   | Compliant  |
| Comments   | <p>The JFSC has put in place a thorough licensing process which takes into account the financial standing of the applicant and its parent company. Furthermore, the status of the home supervisor and its jurisdiction is considered with great care. On several occasions the JFSC has turned away applications which did not meet its high standards and which were not deemed appropriate in stature, risk profile or because of the home jurisdiction.</p> <p>However, given the utmost importance the parent company or group and the home jurisdiction might have on the operations of local entities, the JFSC should consider establishing a more formal process to observe developments at parent company or head office level and within the home jurisdiction of the group. This formal process could well entail a regular assessment of published accounting information, rating developments and outlooks, share price developments, coverage in selected newspapers etc. and, so far as possible, intensified and regular contact with home country supervisors.</p> <p>Such a process would increase the JFSC's capacity to assess the development of capital adequacy, risk management powers etc. in time to take supervisory measures at an early stage in order to protect the integrity and reputation of the local (financial) economy, should a parent company get into difficulties. The need to implement such a formal process is reinforced by the fact that local banking operations are predominantly set up to serve the funding needs of group entities and handle large amounts of liquid assets (see also comments to CP No 10 and 11).</p> <p>Furthermore, the JFSC should consider inserting a provision into Principle 3 of the Banking Codes under paragraph 3.1.4.5 according to which any exceptions to established policies, processes and limits should be reported and receive the prompt attention of senior management and the board, where necessary.</p> <p>Although there is an elaborate and explicit section in the "route planner" (see below) asking questions with regard to new product approval processes and procedures, no minimum requirements concerning risk management controls are set out in the Banking Codes (or in Appendix I to the Banking Codes). The JFSC should consider the explicit coverage of those processes and procedures in Appendix I of the Banking Codes in order to increase the formal relevance of those procedures given their importance.</p> <p>With regard to the issuance of specific risk management standards please see the descriptions and comments to CPs 8 – 16.</p> |
| <b>Principle 8.</b>  | <p><b>Credit risk.</b> Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>   |
| Description  | <p>The JFSC in general requires, through the Banking Codes, standards of corporate governance that require that the management of a bank assesses and manages all its principal risks. Paragraph 3.1.4.3 of the Banking Codes requires that all risk management strategies must be ratified at board level (or by the senior officer in the case of branches).</p> <p>Principle 3 and Appendix I of the Banking Codes require above all the following credit risk policies and procedures:</p> <ul style="list-style-type: none"> <li>● a sound and well documented credit granting and investment process;</li> <li>● documentation of the factors considered, analysis undertaken, and the authorization and</li> </ul>  |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>rejection of each loan, advance, or other credit exposure;</p> <ul style="list-style-type: none"> <li>● maintenance of appropriate credit administration, monitoring, reporting and asset grading processes which enable credit risk to be measured on all on- and off-balance sheet facilities provided, including stress testing;</li> <li>● a system for early remedial action on deteriorating credits, appropriate provisioning policy and impairment policy;</li> <li>● maximum repayment periods for different types of lending and preferred covenanting arrangements; and</li> <li>● the setting of exposure limits, which must include recording the basis of decisions for individual limits.</li> </ul> <p>In addition, Appendix I to the Banking Codes states that credit officers are to make credit decisions free of conflicting interests, on an arm's length basis and free from inappropriate pressures from outside parties. Furthermore, Paragraph 3.1.4.5 and Appendix I of the Banking Codes require that authority levels are set for relevant risk areas, including credit risk, to provide appropriate oversight by the board or senior management.</p> <p>Article 8 of the FSC(J)L gives the JFSC the power to require the bank to supply information, provide answers to questions and to allow officers of the JFSC to enter the bank's premises. Moreover, Article 26 of the BB(J)L gives the JFSC the power to obtain any information and documentation it requires for the discharge of its duties. This article also requires that any person who is or was employed by the bank shall provide an explanation of the documents in question.</p> <p>The JFSC's route planners require that credit risk is considered carefully during on-site examinations. Specifically, the JFSC considers whether the credit management strategy has been approved by the board and how it has been implemented by senior management. The on-site route planner covers a wide range of standardized questions, e.g. questions on whether authority, responsibility and accountability are defined clearly so that decisions are taken by appropriate employees and conflicts of interest are avoided. In planning the scope of examinations to be undertaken, the JFSC selects appropriate sections of the route planner based on the principles of risk based supervision (see also CP20).</p> <p>The on-site examinations undertaken are informed by external audit reports, internal audit reports, and quarterly prudential returns delivering specific information on the credit risk exposure of the local entity.</p> <p>In 2004, the JFSC undertook a themed examination program on credit risk. This themed examination included the credit decision making process in its scope. In 2007, the Banking Codes themed examination program included the assessment of the conflicts of interest policies at a selection of registered persons.</p> |
| <b>Assessment</b>  | Compliant  |
| <b>Comments</b>  |  |
| <b>Principle 9.</b>  | <b>Problem assets, provisions and reserves.</b> Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.   |
| <b>Description</b>   | <p>The Banking Codes require management to be able to monitor the quality of assets and, where necessary, to make provisions for credit risks. The Banking Codes provide in paragraph 3.5.2.3 that appropriate information can always be extracted promptly to enable directors and senior management to adequately monitor all relevant exposures.</p> <p>Paragraph 3.2 and Appendix I of the Banking Codes oblige banks to regularly assess credit risk and have a policy in place to deal with problematic credits. Furthermore, a bank's management has to ensure that it is able to make appropriate provisions for bad and doubtful debts and for any other exposure, both on- and off-balance sheet.</p> <p>Appendix I to the Banking Codes requires specifically with regard to risk management controls that a bank's policy to deal with problematic credits should, as a minimum:</p>   |



**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <ul style="list-style-type: none"> <li>• have a system for early remedial action on deteriorating credits;</li> <li>• have a system for classifying loans into categories when payments are contractually a minimum number of days in arrears;</li> <li>• be treated as impaired when there is reason to believe that principal or interest will not be collected according to contractual terms; and</li> <li>• require appropriate provisioning policies.</li> </ul> <p>Credit risks are measured and reported in all on- and off-balance sheet facilities provided. Appendix I to the Banking Codes also requires that the bank has appropriate credit administration, monitoring, reporting and asset grading processes in place to enable credit risk to be measured, including stress testing exposures. Furthermore, a clearly documented policy over collateral valuations should be in place.</p> <p>With regard to the valuation, classification and provisioning of large exposures, a requirement to conduct this on an individual item basis has been implemented in paragraph 5.4.10 of the Banking Codes.</p> <p>Credits, assets and total provisions are reported in the quarterly prudential returns to the JFSC for its review. Credits are classified by sector and split between domestic and non-domestic exposure. An analysis is provided of security held against such credits. Assets are split by type: cash; market loans; certificates of deposits; investments; loans and advances; debtors; prepayments and fixed assets. They are also split by credit quality and by number of days past due.</p> <p>The prudential returns are delivered by the banks and reviewed by the JFSC each quarter, with individual banks' provisioning and write offs challenged in light of supervisory expectations. According to the JFSC, this process provides indirect confirmation of the adequacy of classification and provisioning policies. The bank's internal audit reports and the audited financial statements might also be reviewed by the JFSC and the JFSC places some reliance on this independent work.</p> <p>The JFSC has chosen not to be more specific than this as Jersey banks, all of which are branches or subsidiaries of major international banking groups, are required to adopt established group standards in this respect.</p> <p>However, the BB(J)L allows the JFSC to issue directions (Article 21) which could place requirements on a bank relating to credit risk and provisioning. Thus, the JFSC could require a bank to increase its level of provisions and reserves, or overall financial strength, where it is desirable in the interests of depositors or potential depositors.</p> <p>During on-site examinations, which may also include credit risk in their scope, the JFSC considers whether policies and procedures exist over classification, provisioning and write-off problem assets and the risk reports provided to the bank's board are assessed for appropriateness and timely submission. The route planner utilized during such examinations lists questions to be asked depending on scope.</p> <p>A themed examination on credit risk was undertaken in 2004. This involved all local banks completing a self assessment questionnaire and a number of follow-up examinations based on the questionnaires. In addition, the information provided to the board on credit risks was assessed during the Banking Codes themed visits undertaken in 2007. Key findings of the 2004 themed examinations on credit risk are to be found on the Commission's website; see also CP 20 Description: "On-site Inspections".</p> <p>The Basel II credit guidance notes issued by the JFSC provide rules for credit risk mitigation. These rules state that the value of a risk mitigant is proportionally reduced according to the period of re-assessment, therefore longer periods without assessment reduce the benefit of the risk mitigant.</p> |
|--|---|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
| Assessment   | Largely compliant  |
| Comments   | <p>The JFSC should take a more active approach with regard to the necessary assessment of the adequacy of a bank's provisioning policies and processes. Although it is understood that local subsidiaries of foreign banks predominantly have to follow provisioning policies either of their parent or of the parent's home supervisor, the JFSC should on a regular basis form its own view in this regard. It should also approach banks, parent institutions, respective home supervisors of the parent or relevant accountants in order to confirm so far as possible the adequacy of the provisioning and write-off policy and inform its understanding of the provisioning applied (see also comment to CP 12).</p> <p>The JFSC could make more explicit in its Banking Codes certain requirements that are mentioned in the essential criteria, in particular, that:</p> <ul style="list-style-type: none"> <li>• banks are required to perform <i>periodic</i> reviews of their problem assets, and of their asset classification, provisioning and write-offs;</li> <li>• the board receives timely and appropriate information thereon;</li> <li>• banks are required to have in place appropriate policies and procedures for collecting past due obligations; and</li> <li>• banks are required to have in place appropriate mechanisms for periodically assessing the value of risk mitigants, including guarantees and collateral.</li> </ul>   |
| <b>Principle 10.</b>   | <b>Large exposure limits.</b> Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.  |
| Description  | <p>A large exposure is defined in the Banking Codes (Appendix II) as "... an exposure to a counterparty or group of connected counterparties which is greater than or equal to 10 percent of a registered person's agreed capital base". An extensive definition of "exposure", i.e. the maximum gross loss, is also provided for in Appendix II of the Banking Codes in paragraph 2.1 and 2.2 and includes both, on- and off- balance sheet positions. However, in paragraph 5.4 of the Banking Codes a slightly different definition of an exposure is laid down.</p> <p>The Banking Codes define, in Note 1 to paragraph 5.4.3, the term connected counterparties as:</p> <p>"... counterparties that together may pose a single risk to the registered person. It includes persons linked by family tie or by common endeavor and companies linked financially or by common ownership, management or function (such as marketing)."</p> <p>Paragraph 5.4 of the Banking Codes requires that:</p> <ul style="list-style-type: none"> <li>• exposures over 10 percent of agreed capital base ("Large Exposures") are reported to the Commission on a quarterly basis in the prudential returns. In addition to that, the ten largest exposures are also reported quarterly; and</li> <li>• exposures over 25 percent of agreed capital base require prior approval from the Commission.</li> </ul> <p>The Banking Codes contain in paragraph 5.4.5 a provision according to which the JFSC may approve exemptions from these requirements, i.e. in cases where the exposure is adequately secured by cash deposits, Zone A government securities or certificates of deposit issued by the bank. The same holds true if there is an adequate and legally enforceable parental guarantee or a loan takeover agreement is provided.</p> <p>According to paragraph 5.4.8 of the Banking Codes the registered person must restrict the total value of all large exposures to a total of 800 percent of its agreed capital base. This does not hold true for large exposures supported by a legally enforceable parental guarantee or loan takeover agreement, and where the JFSC's prior approval has been obtained.</p> <p>Generally exempt from the concentration risk regulation are according to the Banking Codes, paragraph 5.4.7:</p> <ul style="list-style-type: none"> <li>• an inter-bank loan or placement, certificate of deposit or similar instrument issued by a bank</li> </ul> |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|            |   |
|------------|---|
|            | <p>with a maturity of one year or less;</p> <ul style="list-style-type: none"> <li>• an exposure to, or one that is guaranteed by, a central government or a central bank from Zone A country;</li> <li>• an exposure to, or one that is guaranteed by, a Zone B central government if it is denominated in the currency of that government's country and funded by liabilities in the same currency.</li> </ul> <p>Even though they are exempted from the need to be included in the calculations for concentration risk, those exposures have to be reported to the JFSC via the quarterly prudential reports.</p> <p>Paragraph 3.5.2.3 of the Banking Codes requires that appropriate information can be extracted promptly to enable directors and senior management to adequately monitor all relevant exposures. In addition, Appendix I to the Banking Codes sets out minimum control requirements over credit risk and country and transfer risk. These requirements include the identification of portfolio concentrations, and documentation of those sectors for which the bank has limited or no appetite. Furthermore, the general requirement of management being able to identify and regularly assess all relevant risk in the conduct of business, including credit risk, applies (see Banking Codes, paragraph 3.2.1.6).</p> <p>Information on sectoral and foreign currency exposures is obtained via quarterly prudential returns, enabling the JFSC to review concentrations. So far, information on geographic exposure is not obtained other than to establish the breakdown between domestic and non-domestic lending. Non-domestic lending is not a major activity for the majority of banks in Jersey and it is the exposure to the local market that most concerns the JFSC. Where a bank has significant geographical exposures, the JFSC explores the matter on an individual basis. This is also e.g. the case for one particular bank with exposures to Middle Eastern countries.</p> <p>The JFSC performed a credit risk themed examination during 2004 that involved all local banks completing a self assessment questionnaire followed, in addition to that, by a more specific examination of a sample of five banks. Material topics and findings were published to the industry and the general public. The examination included work on the adequacy of management information systems.</p> <p>During on-site examinations, which include credit risk in their scope, the JFSC examines how the bank identifies and aggregates exposures also to connected counterparties and considers whether policies and procedures exist with regard to exposure limits. The route planner utilized during such examinations lists questions to be asked in those cases.</p> <p>During 2008, the JFSC has assessed incorporated banks' ICAAPs, including the assessment of concentration risk where appropriate. This process included consideration of the documentation relating to the bank's process for controlling concentrations of credit risk.</p> |
| Assessment | Largely compliant   |
| Comments   | <p>The JFSC should consider having only one single definition of the term "exposure" in the large exposure and concentration risk context, which should include all claims and transactions, on-balance sheet as well as off-balance sheet. At present there seems to be certain degree of overlap and an unclear distinction between the respective definitions provided under paragraph 5.4.3 of the Banking Codes and under Appendix II of those Codes.</p> <p>Although it has to be recognized that CP 10 does not specify specific limits on large exposures to a single counterparty or group of connected counterparties, the setting of prudential limits by laws, regulations or the supervisor is, however, required under the second essential criterion.</p> <p>In this context, the general exemption of inter-bank loans or placements, certificates of deposit or similar instruments issued by a bank with a maturity of one year or less (see Banking Codes, paragraph 5.4.7.1) from concentration risk regulation should be reconsidered. Even short term lending to banks could provide for considerable losses as experiences e.g. from the failure of Bankhaus Herstatt in 1974 (i.e. the so called "Herstatt risk") or the recent market turmoil and losses connected therewith clearly show. It has also to be taken into account that these</p>   |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>exposures constitute the dominant vulnerability of Jersey as a financial center.</p> <p>Although there is an ongoing discussion e.g. within the EU on how to regulate large exposures and, closely connected with this, exposures to related parties, many countries chose to set more prudent rules than this jurisdiction. It could well be seen as an evolving international standard to require that the supervisor has to decide on a regular basis whether or not an exemption for large exposures granted should be renewed. Hence, the JFSC should decide on a regular basis whether or not an exemption for large exposures granted should be renewed.</p> <p>With regard to exposures to related parties, see comments under CP No 11.</p>  |
| <b>Principle 11.</b>   | <p><b>Exposures to related parties.</b> In order to prevent abuses arising from exposures (both on-balance sheet and off-balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.</p>  |
| Description  | <p>The Banking Codes define, in Appendix I, the term 'related parties' as follows:</p> <ul style="list-style-type: none"> <li>• "... includes the registered person's subsidiaries, affiliates and any person that the registered person exerts control over or that exerts control over the registered person. These may be the registered person's major shareholders, directors, senior management, key staff, their close family members and corresponding persons in affiliated companies."</li> </ul> <p>The JFSC retains the right to exercise discretion in applying definitions within the Banking Codes by granting variances in specific circumstances.</p> <p>Paragraph 1.5 of Appendix I to the Banking Codes sets out the requirement to have in place specific policies and procedures to deal with related parties. Those should, as a minimum, require that transactions with related parties and the write-off of such exposures exceeding specified amounts or otherwise posing unique risks are subject to prior approval at an appropriately senior level.</p> <p>Furthermore, it is laid down in paragraph 1.5 that policies and procedures provide for an adequate and appropriate assessment of the terms under which the transaction is to be granted when lending to related parties, including whether or not proposed terms are inappropriately favorable. It is also required that the monitoring and reporting of these exposures has to be done via an independent credit review process.</p> <p>There are no specific regulations to limit exposures to related parties other than for those relating to Large Exposures (see CP No 10). However, the JFSC's Core Financial Data Guide requires investments to certain related parties to be deducted from capital when assessing capital adequacy. The circumstances when exposures are deducted from capital are laid out in the Core Financial Data Guide. This includes investments in subsidiaries and associated companies and other capital connected lending. In addition to that, banks are required by the Core Financial Data Guide to aggregate and report some related party exposures to the JFSC on a quarterly basis.</p> <p>Banks are required to adhere to generally accepted accounting principles for their financial statements, which require them also to maintain adequate records which provide for the disclosure of all material related party transactions and balances (see CP 22: Accounting and disclosure). The JFSC reviews financial statements, to identify related party disclosures.</p> <p>The on-site examinations by the JFSC, the requirement to have an appropriate internal audit function (Banking Codes paragraph 3.3) and the annual external audit provide some level of assurance that policy and procedure exceptions and limit breaches are adequately reported.</p> <p>Where concern is raised and where co-operation was not forthcoming from the bank concerned, the JFSC, by issuing a direction under Article 21 of the BB(J)L, could set limits for exposures to related parties on a case-by-case basis; require such lending to be deducted from capital; and provide for the collateralization of such exposures.</p> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
| Assessment   | Largely compliant   |
| Comments   | <p>The regulation of exposures entered into in the inter-bank market and, as it is predominantly the case in this jurisdiction, to connected parties, should be reconsidered (see also comment to CP No 10). Also, the JFSC should review these requirements such that they cover all transactions with related parties, i.e., all kinds of investments, placement of deposits, capitalization, etc.</p> <p>It is recognized that the JFSC has a practice of reviewing group financial statements (including therein intermediate “holdco” financial statements). Nonetheless, given the specifics of the banking operations of subsidiaries of foreign banks in the jurisdiction, i.e., funding of parent or group companies being their, by far, most important task, the JFSC should consider the following:</p> <ul style="list-style-type: none"> <li>• review at least annually the exemption of group-related inter-bank exposures from the concentration risk requirements applicable;</li> <li>• refining, and increasing the frequency of its regular review of the status and financial condition of parent groups of local subsidiaries; and</li> <li>• press home regulators for a more frequent update on their view of the parent group’s financial condition.</li> </ul> <p>As a standard procedure, the JFSC writes a letter to the home supervisor on at least an annual basis. In this letter the home supervisor who is responsible for supervision on a consolidated basis could also be asked whether or not from his point of view any circumstances exist which would hinder the exemption being granted by the JFSC. Other evidence to be taken into account in this process could, e.g., be an assessment of share price developments of the parent company and of material other companies of the group, accounting information, and further relevant financial information from the financial markets.</p> <p>The aim would be to have a regular, distinct and transparent process in place according to which the JFSC takes a decision to renew the exemption of exposures to parent and group companies on a semi-annual or annual basis. In this context the JFSC should consider revision of the Banking Codes’ requirement for a “letter of comfort” from the parent company so as to provide for a regular (perhaps annual) submission of such letter (paragraph 5.3 of the Banking Codes).</p> <p>The JFSC should consider including in Appendix I, following paragraph 1.5, of the Banking Codes an explicit provision according to which policies and procedures ensure that all material concentrations should be reviewed and reported periodically to the board.</p> |
| <b>Principle 12.</b>   | Country and transfer risks. Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.  |
| Description  | <p>The JFSC requires, through the Banking Codes, that the management of a bank assesses and manages all its principal risks. Furthermore, Principle 3 of the Banking Codes requires banks to have adequate information systems, risk management systems and internal control systems in place.</p> <p>According to the Banking Codes, Appendix I, banks should have country limits in place, and should identify and monitor exposures on an individual country basis. Banks are also obliged to monitor and evaluate developments in country risk and transfer risk and apply appropriate countermeasures.</p> <p>As part of the licensing process and ongoing monitoring of banks, the JFSC considers any significant areas of country risk. Specific concerns of the JFSC arising from a bank’s exposure to country and transfer risk would be raised during on-site examinations or annual review meetings.</p> <p>Exposure is identified through different means, e.g. via the structured “route planner” which entails a set of standardized questions, “Themed Examination Programs”, the “Annual Review Meetings”, and via regular quarterly prudential reporting files. As previously noted (see CP 6) the quarterly prudential return that coincides with a bank’s year end is assessed and confirmed</p>   |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>as materially correct by the bank's external auditor.</p> <p>To date the JFSC has not set prescribed provisioning levels against country or transfer risk taken by banks. It considers that it is more appropriate for individual banks to set provisioning levels themselves, as they regularly will be required to follow the requirements of their group and sometimes also that of their group's home regulator. In addition to that, it is also the responsibility of the external auditor to assess the appropriateness of the level of provisions and reserves for the purpose of determining whether or not a bank's financial statements present a "true and fair" view.</p> <p>However, under Article 21 of the BB(J)L the JFSC could issue a direction to require a bank to set appropriate provisions if concerns were identified in this respect.</p>   |
| Assessment   | Compliant   |
| Comments   | As indicated in the Comments for CP 9, the JFSC should take a more active approach with regard to the necessary assessment of the adequacy of a bank's provisioning policies and processes, including, where applicable, those relating to country and transfer risk. To this end, the JFSC could incorporate explicit questions with regard to transfer and country risk in its "route planners" and introduce it also as a separate topic for the "Annual Review Meeting."  |
| <b>Principle 13.</b>   | Market risk. Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.   |
| Description  | <p>The JFSC requires, through the Banking Codes and in particular Principle 3, that the management of a bank assesses and manages all its principal risks. In addition to that, Appendix I to the Banking Codes provides for a number of minimum control requirements relating to market risk as follows:</p> <ul style="list-style-type: none"> <li>• appropriate limits for all significant risks incurred and regular reviews of these;</li> <li>• controls in place to ensure that all transactions are captured on a timely basis and that the bank's positions are re-valued on an appropriately regular basis, using reliable and appropriate market data (or in the absence of market prices the use of industry accepted models);</li> <li>• policies and processes in place to consider valuation adjustments for positions that cannot be otherwise prudently valued, including concentrated, less liquid and stale positions; and</li> <li>• performance of scenario analyses, stress testing and contingency planning, as appropriate, and periodic validation of measurement systems used.</li> </ul> <p>The JFSC's route planners used for specific on-site examinations in relevant areas require that market risk is carefully assessed by JFSC staff. In particular the JFSC reviews the policies and procedures for assessing, monitoring, and controlling market risks, under the guidance of standardized questions.</p> <p>In particular, the JFSC investigates the accuracy of data inputs, processing, and reporting outputs from the market risk system used by the bank. The route planner also requires that limits are considered carefully by JFSC staff to assess whether they are adhered to in practice and assesses board and senior manager oversight of the bank's policies and procedures.</p> <p>In February 2008 the JFSC published extensive and detailed guidance on additional rules and requirements that apply to deposit-takers that have a trading book. The guidance paper provides for a comprehensive coverage and addresses general trading book rules, foreign exchange, interest rate and equity risk. Commodity and settlement risks are covered likewise. Capital charges are in place for foreign exchange, interest rate and commodity risk.</p> <p>Basel II reporting was introduced in Jersey for the first quarter of 2008 with new reporting requirements for market risk, including interest rate risk in the banking book. Banks in Jersey need to report their market risk exposures depending on whether they are a Jersey incorporated subsidiary or a branch and whether they run trading books or have market risk in their banking</p> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | book.  |
| Assessment   | Compliant.   |
| Comments   | Although fully compliant, the JFSC should consider introducing key requirements for the management of market risk into Appendix I of the Banking Codes, e.g., requirements related to foreign currency and interest rate risks.  |
| <b>Principle 14.</b>   | Liquidity risk. Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.   |
| Description  | <p>Paragraph 3.1.4.3 of the Banking Codes requires that a clearly defined, documented and implemented risk management strategy for all significant risks is in place. The board has to ratify this risk management strategy. Additionally, paragraph 3.2.1.6 of the Banking Codes requires that all relevant risks, explicitly including liquidity risk, are regularly assessed.</p> <p>According to Appendix I of the Banking Codes banks have to measure and monitor net funding requirements, perform a regular review of underlying assumptions and provide for adequate contingency planning to cover possible disruptions. Those requirements also hold true for all material currency exposures.</p> <p>The Liquidity Management and Reporting Guidance Notes, issued May 2007, set out standards for the management of liquidity in Jersey registered persons. These include guidance and core requirements to:</p> <ul style="list-style-type: none"> <li>• produce a Liquidity Management Policy;</li> <li>• adhere to maximum mismatch limits set by the JFSC for reporting;</li> <li>• provide the JFSC with proposals for reports to be submitted on a behaviorally adjusted basis; and</li> <li>• produce a Liquidity Contingency Plan.</li> </ul> <p>For reporting the JFSC has set out maximum mismatch limits that apply to all registered persons in Jersey, and therefore does not take into consideration individual bank's stress testing results in setting mismatches.</p> <p>The Liquidity Reporting Guide, issued September 2007, requires consideration of undrawn commitments and other off-balance sheet liabilities and establishes a standard format for regular reporting of a bank's liquidity profile, including foreign currency exposures, to the JFSC which analyses assets and liabilities by type and residual maturity.</p> <p>During on-site examinations, which include liquidity risk in their scope, the JFSC considers whether policies and procedures exist to monitor, control and limit liquidity risk. The route planner utilized during such examinations lists questions to be asked depending on the scope of the respective examination.</p> |
| Assessment   | Compliant  |
| Comments   | <p>Given the predominating business model in the jurisdiction, it would be appropriate to convert the current guidance note into a separate section of the Banking Codes. Specifically, the Banking Codes should include appropriate policies and procedures to limit liquidity risk and foresee the conduct of a regular analysis of funding requirements under alternative scenarios/stress tests. Furthermore, liquidity risk provisions of Appendix I of the Banking Codes should take into account the degree of diversification of funding sources and the necessary review of concentration limits (which were yet to be established at the time of the assessment; see CP 10 and 11). Standardized questions with regard to those topics should also be formulated and integrated into the route planner.</p> <p>The JFSC should also consider incorporating the maximum mismatch limits from the Liquidity Management and Reporting Guidance Notes into Appendix I of the Banking Codes.</p>  |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | Moreover, taking into account recent turbulence, the JFSC should also review its liquidity regulations and guidance delivered to the banks with a view of taking into account the new paper on liquidity management and supervision published in September 2008 by the Basel Committee.   |
| <b>Principle 15.</b>   | <b>Operational risk.</b> Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.  |
| Description  | <p>Paragraph 3.1.4.3 of the Banking Codes requires banks to have a clearly defined, documented and implemented risk management strategy for all significant risks in place. It also requires that the board of Jersey incorporated banks ratify this risk management strategy. This section goes on to require that there are clearly defined procedures for appropriate oversight by the board of all relevant areas of risk management.</p> <p>Section 4 of Appendix I of the Banking Codes establish minimum operational risk management controls and requires appropriate policies, processes and procedures for managing operational risk in all material products, activities, processes and systems and explicitly addresses e.g. documentary and legal risk, internal and external fraud and physical damage. In addition to that, an adequate assessment of risk related to new products prior to launch and the existence of an adequate business continuity plan is seen as a minimum requirement. Within the risk management control subsection on operational risk, a cross-reference to the relevant Basel Committee guidance is also made. Furthermore, an obligation to establish a procedure for regular review of risk profiles is laid down.</p> <p>The risk management strategies and procedures over operational risk are assessed during specific on-site examinations by JFSC staff.</p> <p>The JFSC's route planner includes references to the operational risk area, for use when appropriate, during on-site examinations by JFSC staff. The JFSC has developed a set of 88 standardized questions covering all aspects of operational risk (definition of operational risk, enumeration of specific control objectives, categories of specific risks relevant and tackled as operational risk etc.). Specifically, the JFSC considers whether management is continually aware of, and adjusts to, bank's operational risks, including risks originating from people, processes and technology, as well as external events.</p> <p>A self assessment questionnaire on compliance with the Banking Codes was issued to all banks in 2007, which was followed by examinations by the JFSC on a sample basis. This themed examination program covered a review of compliance with the Banking Codes, focusing on corporate governance, risk management and internal control. In 2005 and 2006, the JFSC addressed within its themed examination program topics which have a close connection to operational risk: outsourcing and information technology, respectively.</p> <p>In October 2008, the JFSC updated its Policy Statement and Guidance Notes on Outsourcing. Within this paper core principles are defined such as the requirement to provide for a written agreement with the delegate specifying the terms of the engagement and the levels of services to be provided. The paper also provides that nothing should prevent the JFSC from exercising its statutory oversight responsibilities, especially from inspecting books and records.</p> <p>In May 2007, the JFSC published together with the Guernsey Financial Services Commission and Isle of Man Financial Supervision Commission the so called pan-island approach to Basel II – Operational risk. This paper takes due account of the operational risk definition employed by the Basel Committee in its papers and describes the different approaches to measuring operational risk and the respective supervisory requirements to be fulfilled prior to approval of the more advanced measurement approaches.</p> <p>The JFSC has assessed each of the incorporated banks' ICAAPs, according to Pillar 2 methodology, and where appropriate has increased the minimum risk asset ratio to take account of additional risks identified. The ICAAP process specifically requires that the senior management of the bank understands and documents the nature and levels of risk being taken by the bank, including operational risk.</p> |
| Assessment   | Compliant   |



| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
| Comments   | The JFSC should consider including the standard definition of operational risk explicitly under paragraph 4.1 of Appendix I of the Banking Codes.  |
| <b>Principle 16.</b>   | <b>Interest rate risk in the banking book.</b> Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk..  |
| Description  | <p>The JFSC requires, through Principle 3 of the Banking Codes, that the management of a bank assesses and manages all its principal risks. Paragraph 3.1.4.3 of the Banking Codes requires that a clearly defined and documented and implemented risk management strategy for all significant risks is in place, including interest rate risk. The board (or senior officer for branches) must ratify the risk management strategy.</p> <p>Appendix I of the Banking Codes set out the minimum control requirements required from each bank over certain risk areas. Under section 5 "Interest rate risk", Appendix I requires e.g. that established standards for valuing positions and measuring risk are employed, ongoing assessment of the effects of interest rate changes are conducted, and independent reviews and appropriate stress testing are performed.</p> <p>Prudential reporting requirements introduced in 2008 under Basel II include a section on interest rate risk, covering interest rate mismatch positions classified in specific bands according to their residual maturity. In addition to that, a 200 basis point shock test on the interest rate risk in the banking book likewise forms a section of the quarterly prudential returns of each bank. The JFSC obtains assurance that adequate measurement systems are in place in banks by reviewing the positions based on this reporting and challenging where appropriate.</p> <p>The on-site route planner includes questions on, inter alia, the comprehensiveness of a bank's measurement systems, validation of models and assumptions applied, and limits in place with regard to interest rate risk.</p> <p>The JFSC has assessed incorporated banks' ICAAP documents, according to Pillar 2 methodology, and where appropriate has increased the minimum risk asset ratio to take account of additional risks identified. The Pillar 2 process specifically requires that the senior management of the bank understands and documents the nature and levels of risk being taken by the bank, including interest rate risk.</p> <p>Stress testing forms a necessary part of the ICAAP, which is subsequently assessed by the JFSC. Stress testing of interest rate risk based on worst case scenarios would be required if interest rate risk were ever perceived to be a material risk to the bank. In such an instance, and were co-operation not forthcoming from the bank concerned, an appropriate direction could be issued under Article 21 of the BB(J)L.</p> |
| Assessment   | Compliant  |
| Comments   | The JFSC should consider introducing into the route planner a separate section of specific questions dealing with interest rate risk generally and interest rate in the banking book, and should also take into due regard such questions as the price sensitivity of banking book items and their respective volumes, etc.  |
| <b>Principle 17.</b>   | <b>Internal control and audit.</b> Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.   |
| Description  | <p>The Banking Codes (Principle 3) contain, <i>inter alia</i>, minimum requirements for corporate governance and internal controls and, in particular, require defined responsibilities for bank directors and senior managers (paragraph 3.1).</p> <p>The JFSC's requirements regarding banks' internal controls are set out in the Banking Codes (paragraphs 3.1 and 3.2) and incorporate:</p>   |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <ul style="list-style-type: none"> <li>● 3.1.4.2 - apportionment of responsibilities amongst senior managers and/or directors such that their individual responsibilities are clear and there is separation of critical functions;</li> <li>● 3.2.1.1 - business is planned and conducted properly and adequately;</li> <li>● 3.2.1.2 - transactions are entered into in accordance with documented authorities;</li> <li>● 3.2.1.3 - assets are safeguarded and liabilities controlled;</li> <li>● 3.2.1.4 - accounting and other records are complete, accurate and timely;</li> <li>● 3.2.1.5 - ability to assess and monitor adequacy of capital; and</li> <li>● 3.2.1.6 - ability to identify and assess all relevant risks.</li> </ul> <p>To determine the level of satisfaction of its requirements at “registered persons”, the JFSC’s “route planners” direct that the adequacy of internal controls be considered carefully during specific on-site inspections by JFSC staff and reports made thereon.</p> <p>The Banking Codes (paragraph 3.2) require that the registered person must ensure that the business is planned and conducted properly and adequately and in an orderly manner. It is made a duty of the board to ratify a clearly defined, documented and implemented risk management strategy (paragraph 3.1).</p> <p>The board composition must meet the JFSC’s corporate governance requirements (Banking Codes; paragraph 3.1). This includes a minimum number of directors, and requires an appropriate number of non-executive directors. The BB(J)L (Article 24) provides that no person shall become a director, controller, key person or manager without confirmation by the JFSC that it does not object. The experience and qualifications of such persons are important factors in the JFSC’s consideration of their ability to understand risks arising from business lines and products. The JFSC can require a bank to change the composition of its board and senior management due to prudential concerns via issue of a direction (BB(J)L; Article 21(2)(b) refers).</p> <p>The Banking Codes (paragraph 3.1.4) require that there is an adequate number of senior managers and/or directors and the apportionment of responsibilities so that their individual responsibilities are clear and there is separation of critical functions. Moreover, there must be an appropriate balance of skills and resources of back office functions relative to the front office.</p> <p>The on-site route planner includes questions on whether the bank has procedures in place to ensure that only fit and proper persons are employed and whether or not personnel are suitably experienced and qualified to undertake their duties.</p> <p>The Banking Codes (paragraph 3.4) require that an appropriately skilled compliance officer is appointed and:</p> <ul style="list-style-type: none"> <li>● has appropriate independence and direct access to the registered person’s Jersey board of directors or equivalent;</li> <li>● has unfettered access to all business lines and support departments;</li> <li>● be based in Jersey;</li> <li>● has appropriate status within the registered person to ensure that directors and senior management react to and determine whether to act upon his or her recommendations; and</li> <li>● has sufficient resources to properly discharge the responsibilities of the position.</li> </ul> <p>The JFSC maintains the details of each bank’s compliance officer in central records and can ensure through off-site monitoring that a compliance function is in place.</p> <p>As part of most on-site inspections performed and during most annual review meetings, the JFSC considers the structure of a bank’s compliance department, and its reporting lines. From this assessment the JFSC can determine whether the board exercises sufficient oversight of the management of the compliance function, without unduly affecting the independence of the bank compliance function.</p> <p>The Banking Codes (paragraph 3.3) require that a registered person has an appropriate</p> |
|--|---|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>internal audit function and that it:</p> <ul style="list-style-type: none"> <li>• has appropriate independence and reports directly to the board of directors or a group audit committee or equivalent function;</li> <li>• has unfettered access to all business lines and support departments;</li> <li>• has appropriate status within the registered person to ensure that directors and senior management react to and determine whether to act upon its recommendations;</li> <li>• has sufficient resources and staff that are adequately trained and have relevant auditing experience to understand and evaluate the business they are auditing; and</li> <li>• employs a methodology that identifies all significant risks run by a registered person and allocates resources accordingly.</li> </ul> <p>Given the nature and modest size of some of the banks in Jersey, allowance is made for the internal audit function to be provided from elsewhere within a group.</p> <p>The JFSC expects that the internal audit team of a registered person meet with the JFSC during visits at least annually. The on-site route planner includes questions on whether the internal audit function meets the requirements of the Banking Codes (paragraph 3.3). The assessment includes whether the approach adopted by the internal audit team includes auditing the design and implementation of policies and processes. Copies of internal audit reports are requested from bank management in order to supplement JFSC oversight.</p> <p>The Banking Codes (paragraph 3.1.2.2) require that, for a Jersey-incorporated company, there are an “appropriate number” of non-executive directors and that the internal audit function reports directly to the board of directors or a group audit committee or equivalent function (paragraph 3.3.1.1.).</p> <p>The Banking Codes (paragraph 6.9.10) require that any matter arising that the registered person considers as material to the requirements placed on it, or any of its employees, regarding fitness and propriety, should be notified to the JFSC immediately.</p> <p>Given that all registered Jersey-incorporated banks are subsidiaries of large banking groups from major, well-regulated jurisdictions, typically with well defined policies, the JFSC does not make mandatory that an audit committee include non-executive directors.</p> |
| Assessment   | Compliant   |
| Comments   |   |
| <b>Principle 18.</b>   | <b>Abuse of financial services.</b> Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.  |
| Description  | <p>The measures required by the 40 FATF recommendations and 9 special recommendations are implemented in Jersey through legislation and regulatory requirements, contained in the following:</p> <ul style="list-style-type: none"> <li>• the Proceeds of Crime (Jersey) Law 1999 (POC(J)L);</li> <li>• the Terrorism (Jersey) Law 2002 (T(J)L);</li> <li>• the Drug Trafficking Offences (Jersey) Law 1988 (DTO(J)L);</li> <li>• the Money Laundering (Jersey) Order 2008 (ML(J)O); and</li> <li>• the Handbook for the Prevention and Detection of Money Laundering and the Financing of Terrorism for Financial Services Business regulated under the Regulatory Laws (the AML/CFT Handbook).</li> </ul> <p>Legislation is enforced by the Attorney General and the Joint Financial Crimes Unit (JFCU). Regulatory requirements that are set in the AML/CFT Handbook are enforced by the JFSC.</p> <p><u>The JFSC</u></p> <p>The JFSC has responsibility for overseeing compliance by registered persons with requirements in relation to AML/CFT, including compliance with United Nations and EU</p>   |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p>sanctions legislation, under Article 5(1) of the Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008 (Supervisory Bodies Law). The AML/CFT Handbook, which sets regulatory requirements and provides guidance for registered persons was published in February 2008 and is issued under Article 22 of the Supervisory Bodies Law. This provides that the JFSC, and any other supervisory body designated by Order, may issue Codes of Practice for the purpose of establishing sound principles for compliance with the Supervisory Bodies Law and AML/CFT legislation. Once issued, the Codes may be revised, revoked, varied, amended or added to.</p> <p><u>Attorney General</u></p> <p>The Attorney General has statutory investigatory and prosecution powers for serious and complex fraud, money laundering and terrorist financing offences. His office (the Law Officers' Department) also acts as the central authority in mutual legal assistance matters, and is responsible for setting guidelines that set out the basis for the disclosure of financial intelligence obtained from suspicious activity reports (SARs) to authorities outside Jersey. The Law Officers' Department and the JFCU work closely together in identifying cases for investigation; the investigations themselves; and in sharing information relevant to mutual legal assistance requests.</p> <p><u>The JFCU</u></p> <p>The JFCU is a partnership between the States of Jersey Police Force and the States of Jersey Customs and Immigration Service. SARs are made to the JFCU, which analyses and shares intelligence with other financial intelligence units outside Jersey. Along with the Law Officers' Department, the JFCU conducts money laundering and terrorist financing investigations (and works closely with the Law Officers' Department in the investigation of serious or complex fraud).</p> <p>The JFSC works closely with the JFCU at an operational level. The JFCU prepares aggregate data on SARs for analysis by the JFSC (and also the Law Officers' Department), and where a SAR raises an issue at a particular registered person, then the JFCU will discuss those issues with the JFSC, which will then take appropriate action. Periodically, the JFCU also provides details to the JFSC of those registered persons that have failed to submit any SARs.</p> <p>In 2008, the JFSC is undertaking 17 on-site inspections focusing on banks' compliance with the AML/CFT Handbook. These inspections are to assess the adequacy of policies and procedures, the effective implementation of these procedures, and the reporting of suspicious activities to the appropriate authorities. It is the current intention to continue this program of inspections until the majority of registered persons have been assessed.</p> <p>The Banking Codes (paragraph 6.9.17) require that any suspicious activities or incidents of fraud, whether internal or external, that are material to the safety, soundness or reputation of the bank should be notified to the JFSC.</p> <p>Section 3 of the AML/CFT Handbook summarizes the legislative customer due diligence requirements contained in the ML(J)O and sets additional regulatory requirements, of which 'know-your-customer' (KYC) forms a part. In addition, the Banking Codes (paragraph 3.2.1.8) require that the bank's management is able to perform sufficient due diligence on its customers and prospective customers to assess adequately all relevant risks, including that of money laundering.</p> <p>Inspections in the current thematic program (see above) include in their scope whether the following are in place:</p> <ul style="list-style-type: none"> <li>• a customer acceptance policy that identifies business relationships that the bank will not accept;</li> <li>• a customer identification, verification and due diligence program including the verification of beneficial ownership;</li> <li>• policies and processes to monitor and recognize unusual or potentially suspicious transactions, particularly of higher-risk accounts;</li> <li>• escalation to senior management level of decisions on entering into business relationships with higher-risk accounts; and</li> <li>• clear rules on records to be kept on consumer identification and individual transactions and</li> </ul> |
|--|--|

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p>their retention period.</p> <p>The AML/CFT Handbook has a specific section on correspondent banking, listing out the legal and regulatory requirements placed on locally registered persons. Amongst other requirements, the banks must:</p> <ul style="list-style-type: none"> <li>• gather sufficient information about the respondent to understand fully the nature of its business;</li> <li>• determine the reputation of the respondent and the quality of its supervision; and</li> <li>• require new correspondent relationships to be approved by the board.</li> </ul> <p>The JFSC is not aware of any correspondent banking relationships where a Jersey-registered person acts as a correspondent bank for another party.</p> <p>The thematic inspection program (see above) provides the JFSC with a current view of AML/CFT controls and systems, and potential weaknesses therein. Summary findings will be published for industry guidance when the thematic reviews have been completed and interim findings have already been published.</p> <p>Compliance with the AML/CFT Handbook is considered by the JFSC in the conduct of its supervisory inspections and failure to follow a requirement that is set out in the AML/CFT Handbook can lead to regulatory action being taken by the JFSC (in line with the Supervisory Bodies Law). The ability of a registered person to comply with the AML/CFT Handbook is also directly relevant to its regulated status and any assessment of the fitness and propriety of its directors, controllers, key persons and managers. The JFSC's policy for supervising and enforcing compliance with the requirements of the AML/CFT Handbook is set out in Part 3 thereof.</p> <p>As noted in the Description for CP 17, above, the Banking Codes (paragraph 3.3) provide that a registered person must have an internal audit function and set requirements in respect of that function, including the employment of a methodology that identifies all significant risks. The JFSC's on-site route planner includes questions on whether the internal audit function meets such requirements. Copies of internal audit reports are requested from bank management in order to supplement JFSC oversight.</p> <p>For each registered person, the Banking Codes (paragraph 3.4) require that a Compliance Officer be appointed and the ML(J)O (Article 8) requires the appointment of a Money Laundering Reporting Officer (MLRO) and Money Laundering Compliance Officer (Article 7). These appointments are assessed by the JFSC to confirm fitness and propriety of the individual (BB(J)L; Article 24). The Banking Codes (paragraph 3.7) require that a bank ensures its employees are fit and proper for their roles, including adequately vetting and monitoring their probity. Article 11 of the ML(J)O also provides for policies and procedures to be in place relating to screening of employees.</p> <p>The AML/CFT Handbook (Section 7.3) provides guidance on how to demonstrate appropriate vetting procedures and sets out legal and regulatory requirements for promoting awareness and providing training to employees of KYC and the methods to detect criminal and suspicious activities (Section 7.2).</p> <p>The inspection program (see above) is providing the JFSC with a current view of registered persons' AML/CFT practices and procedures and potential weaknesses therein. Weaknesses are being reported back to the registered person concerned and their elimination followed up.</p> <p>Current inspections are assessing the adequacy of policies and procedures, including the reporting of concerns to the MLRO, and an assessment of the management information provided to the compliance teams and senior managers on the suspicions raised internally. The Banking Codes (paragraph 3.1.4.7) require that procedures are adopted for employees to be able to communicate material <i>bona fide</i> concerns confidentially to the board or senior management independently of their normal line management. (The ML(J)O also includes an obligation to make a report to the MLRO.)</p> <p>The system is designed to protect members of bank staff who report suspicious activity. Whenever a bank makes a SAR to the relevant authority, the report is made by the MLRO of</p> |
|--|--|

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|                      |  |
|----------------------|--|
|                      | <p>the bank and is recorded as having been made by the bank and not the individual.</p> <p>Inter alia, the POC(J)L (Articles 32 and 33) states that a person (natural and legal) does not commit an offence if disclosure is made to a police officer, or appropriate person at the employer, if the disclosure is made on the person's initiative and as soon as it is reasonable for the person to make it. The POC(J)L (Article 34D) also incorporates a requirement to make a report where a person (natural or legal) has knowledge or suspicion, or reasonable grounds for knowing or suspecting that another person is carrying on money laundering or terrorist financing.</p> <p>Similar provisions are set out in the DTO(J)L and T(J)L.</p> <p>The BB(J)L (Articles 43, 44 and 45) provides domestic statutory gateways to enable the JFSC to disclose restricted information, <i>inter alia</i>, to:</p> <ul style="list-style-type: none"> <li>• the Viscount who handles matters such as bankruptcy; and</li> <li>• the Attorney General or to a police officer of information obtained by virtue of the BB(J)L (Articles 26, 28, 29, or 30).</li> </ul> <p>Under Article 23 of the ML(J)O, the JFSC is required to disclose any information that it obtains that indicates that any person has or may have been engaged in money laundering.</p> <p>The JFSC has entered into 33 MOUs, including those with banking regulators in France, Germany, and the UK, and also Guernsey, the Isle of Man, Mauritius, and Gibraltar. (However, MOUs are not essential for the JFSC to share information with external financial sector supervisors.)</p> <p>The JFSC recognizes that information exchange is a two way process, and will always consult with an overseas regulator where problems of any kind exist with a regulated person licensed in both jurisdictions on a "home" and "host" basis. The assessors had access to documentation proving that two-way communication with supervisors abroad is integral to the JFSC's supervisory strategy (see CP 25).</p> <p>Prosecution of persons for criminal activities is the responsibility of the Attorney General. In addition, the JFSC supports an experienced enforcement division that will investigate, using the powers provided by the BB(J)L, and take regulatory action where it is deemed appropriate. The aim of the Enforcement Division is to deter and detect regulatory breaches, including those under non-regulatory laws administered by the Commission. The Division also responds to requests by overseas regulators for assistance and works with the police and other relevant agencies.</p> <p>The JFSC has published a policy in respect of making referrals to the Attorney General on matters relating to the POC(J)L and the ML(J)O.</p> |
| Assessment           | Compliant  |
| Comments             |  |
| <b>Principle 19.</b> | <b>Supervisory approach.</b> An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.   |
| Description          | <p>The frequency of on-site examinations depends upon the risk profile of the bank concerned. However, regardless of this profile, most registered persons are subject to an on-site inspection at least every three years, with follow up on issues raised as a result.</p> <p>The JFSC employs both on-site and off-site supervision techniques to evaluate banking institutions. These techniques include, but are not limited to, the following:</p> <ul style="list-style-type: none"> <li>• themed on-site inspections where a subject is chosen for assessment in a sample of banks;</li> <li>• discovery on-site inspections (broad scope review of an individual bank in a fact finding inspection);</li> <li>• focused on-site inspection (to assess a particular issue at a particular bank);</li> </ul>  |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>• annual review meetings with each bank to discuss strategic objectives, change in activities, outstanding regulatory issues, and risk management considerations;</li> <li>• report by an accountant or other professional on any matter the JFSC might require (BB(J)L; Article 26);</li> <li>• reviews of internal audit reports;</li> <li>• reviews of external audit findings;</li> <li>• large exposure approvals;</li> <li>• assessing customer complaints;</li> <li>• financial statements reviews (including parent financial statements);</li> <li>• quarterly prudential returns reviews;</li> <li>• running a risk model to assess the <u>probability</u> of certain risks occurring at each bank, and the <u>impact</u> if any of these risks should crystallize; and</li> <li>• monitoring local and international press.</li> </ul> <p>In 2007, 19 banks were subject to themed on-site inspection; 3 banks were subject to discovery on-site inspection and 5 were subject to focused on-site inspection. In 2006, 11 banks were subject to themed on-site inspection; 11 banks were subject to discovery on-site inspection and 3 were subject to focused on-site inspection.</p> <p>The risk model is used to assess the probability of certain risks occurring at each registered person, and the impact should they occur. The risk model includes questions on financial standing; integrity; competence; organization; internal controls; and corporate governance.</p> <p>To assess and monitor trends in the banking system as whole (and not just trends within individual banks) the JFSC maintains, in addition to its risk model, a “Strength, Weakness, Opportunity, and Threat” (SWOT) document that is populated by the banking team. This gives an overview of matters that have been raised during the year and can be used to assess trends present in the banking system. Assessment of trends in risk levels is undertaken using summary outputs of the banking risk model, which also facilitate peer bank comparisons. In addition, the JFSC’s Banking Director and International &amp; Policy Director attend meetings of the Jersey Bankers’ Association at which current banking topics and issues are discussed.</p> <p>The JFSC’s supervision divisions are organized on financial sector lines, but cross-divisional meetings are held regularly. Board and other JFSC management meetings consider developments and all issues in regulated sectors.</p> <p>The Banking Codes (paragraph 3.4) require each “registered person” to have a Jersey based compliance officer, whose role is to ensure compliance with the laws and regulations in force in Jersey. A self assessment questionnaire was sent to every bank in 2007 to assess themselves against the requirements of the Banking Codes. An annual declaration must be submitted to the JFSC by the senior management of a bank on its compliance with relevant regulatory legislation, anti-money laundering legislation and the Banking Codes (paragraph 6.4). The JFSC’s on-site inspections also assess a bank’s compliance with relevant laws and regulations.</p> <p>Quarterly prudential returns are assessed by the JFSC for, <i>inter alia</i>, each bank’s compliance with prudential regulations. The JFSC regularly enquires of banks in respect of such returns.</p> <p>Banks must deal with the JFSC in an open and co-operative manner (Banking Codes; Principle 6). This includes notification of new activities, material changes to subsidiaries and overseas operations, any breakdown of administrative or control procedures, or any other matter that is likely to be material to the supervision of the bank.</p> <p>Quarterly prudential returns are provided to the JFSC through an on-line application that performs certain initial integrity checks. A summary report, including graphical representations of trends, is produced automatically for analysis following a standard worksheet.</p> <p>A new spreadsheet-based product was introduced in 2007 to facilitate the upload and assessment of information received, which has been subsequently updated for Basel II reporting. Deviations from expectations are investigated and enquiries made of the bank where necessary.</p> <p>The JFSC’s risk model and the ICAAP process enable it to understand and document banks’</p> |
|--|--|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>risk profiles, including an element of assessing future risks.</p> <p>As indicated above, the JFSC maintains a SWOT document which can be used to assess trends present in the banking system. This has been applied, during team meetings, in considering potential risks and threats to the local banking system in the future.</p>  |
| Assessment   | Compliant   |
| Comments   | While all Essential Criteria are met and the CP is assessed as compliant, the JFSC should devote more effort to assessing risks affecting the financial system as a whole, including through the undertaking of aggregate stress testing and the examination of the distribution of financial soundness indicators.   |
| <b>Principle 20.</b>   | <b>Supervisory techniques.</b> An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.  |
| Description  | <p>The JFSC employs both on-and-off-site supervision techniques to evaluate banking institutions (see CP 19, above). Any weaknesses identified are addressed with the bank, corrective action agreed and results monitored.</p> <p>On-site inspection results and off-site findings are reviewed and approved by the Banking Director/Deputy Director prior to being communicated to the registered person to provide consistency, quality and appropriateness.</p> <p>Off-site supervision is performed by the same supervision manager who is responsible for the organization and completion of on-site inspections. This concentration of responsibilities, by bank, within a relatively small team aids effective integration between on-site and off-site supervision.</p> <p><u>On-site Inspections</u></p> <p>The JFSC utilizes on-site inspections to provide verification of corporate governance practices, provide independent assurances that information provided by banks is reliable, obtain information to support the JFSC's view of risks and controls in the bank, and identify issues that require remediation.</p> <p>The frequency of on-site inspection depends upon the risk profile of the bank concerned, subject to the minimum requirements of the JFSC's "regulatory package". The "regulatory package" establishes the minimum regularity of on-site assessments required for regulated entities, depending on their perceived risk levels. The Banking Division has consistently exceeded those minimum levels, carrying out 25+ inspections per annum.</p> <p>On-site supervision is conducted with the use of "route planners". These are programs which highlight specific control objectives, common risk areas, and aspects to consider in advance of and at the time of an inspection. In addition, previous on-site findings are reviewed to assist in preparing for the upcoming inspection.</p> <p>Banks are notified 6-8 weeks in advance of an inspection and required to submit pre-inspection information for review at least one week prior to the visit. The inspection commences with an opening meeting that sets out the agenda and modalities. The inspection is undertaken by completing relevant route planners, interviewing staff, and reviewing all relevant documentation.</p> <p>A closing meeting to discuss initial findings is generally held with bank management within one week of the inspection's conclusion, with a draft report detailing findings and recommended actions usually issued within 3 weeks. This provides the bank with the opportunity to comment on the factual accuracy. Once a response has been received from the bank concerned, the final report is issued, giving deadlines for completion. Outstanding issues are then followed up with the bank to ensure that they are cleared within pre-determined timescales.</p> <p>Where the JFSC has requested a report under the BB(J)L (Article 26), meetings will be held with the competent person and bank to discuss the assignment's scope. Further meetings will be held once the JFSC has received the report to discuss the issues arising. (Such reports are required when the JFSC has particular technical concerns and requires an accountant or other person with relevant professional skills to perform an assessment or where the size of the task</p> |



**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |   |
|--|---|
|  | <p>is beyond the JFSC's resources.)</p> <p>The JFSC also conducts inspections on a particular subject or risk area across the banking sector. These 'themed' inspections usually begin with a self assessment questionnaire that is sent to all banks. A sample of banks is selected for on-site inspection by the JFSC and individual reports issued in the manner described above. Key findings from the themed inspections are then sanitized and published on the JFSC's website for the purpose of industry guidance. Themed inspection programs have, since they commenced in 2004, covered the following key risk areas:</p> <ul style="list-style-type: none"> <li>• Credit (2004)</li> <li>• Outsourcing (2005)</li> <li>• Treasury operations (2005)</li> <li>• Information Technology (2006)</li> <li>• Liquidity (2006)</li> <li>• Adherence to the Banking Codes (2007)</li> <li>• Adherence to AML/CFT requirements (2008)</li> </ul> <p>The inspection process is supported by documented procedures and checklists to ensure a consistent methodology is applied. Documentation on the inspections that was provided to the assessment team seemed thorough. For example, credit inspections looked at (1) background to original credit-granting decision; (2) collateral or other security; (3) repayment performance; (4) current status of the obligor.</p> <p><u>Off-site Supervision</u></p> <p>The off-site supervision techniques employed by the JFSC are listed above. Each of these processes has been fully documented in formal procedures to ensure consistent and correct application.</p> <p>The JFSC in its off-site work, <i>inter alia</i>, analyses prudential information obtained from registered persons. The quarterly prudential returns are assessed by supervision managers with the assistance of checklists, automated summaries and graphical representations in order to assess a bank's key financial data and its adherence to minimum prudential requirements. Indications of increased risk identified during off-site work, as recorded in the risk model, are used to prioritize and set the scope of subsequent on-site inspections and meetings.</p> <p>As well as on-site inspections, the JFSC meets with each bank to discuss strategic objectives and, in particular, whether there is likely to be any significant change in activities, outstanding regulatory issues (those highlighted by on-site inspections, quarterly prudential returns, or annual audited financial statements), risk management and common areas of interest. The review meetings are conducted for each bank annually, with interim meetings held as necessary.</p> <p>The JFSC's main contact points at each bank are its compliance officer and Chief Executive Officer or senior branch manager, as applicable. Annual review meetings are attended by board directors and senior management. The JFSC began in 2008 to ask that non-executive directors attend such meetings. Other meetings are regularly held at which the JFSC may require specific personnel, including representatives of the parent, to attend. Contact during inspections will be with a broad range of appropriate operatives. There will also be contact to follow up issues raised as a result of the examination for a period of time afterwards.</p> <p>The JFSC assesses the continuing competence and quality of the board and management of a bank through the communication it has with it, including the speed and quality of response to supervisory queries and findings raised after examinations.</p> <p>Copies of internal audit reports are regularly obtained, either upon issue or as part of the JFSC's pre-inspection work. It regularly meets with internal auditors and, where based off-Island, the internal audit team is expected to meet with the JFSC as and when it visits Jersey.</p> <p>The Banking Codes (paragraph 3.3) establish minimum standards for internal audit. The JFSC actively considers the extent to which it can rely on the findings of the internal audit function</p> |
|--|---|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>based on its dealings with it.</p> <p>For every on-site inspection performed by the JFSC, a formal report is provided to the subject bank. Annual review meetings with the bank's board and management reconsider previous findings and resulting actions.</p> <p>Exceptions noted in off-site prudential reviews are communicated to the bank for further information and/or correction.</p> <p>The JFSC began in 2008 to seek the attendance of non-executive directors at annual review meetings. Separate meetings are held with non-executive directors where considered appropriate.</p>   |
| Assessment   | Compliant   |
| Comments   |   |
| <b>Principle 21.</b>   | <b>Supervisory reporting.</b> Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.   |
| Description  | <p>The JFSC has used its powers under the BB(J)L (Article 26) and the FSC(J)L (Article 8) to require completion of quarterly prudential returns by all banks (on a solo and/or consolidated basis). These laws provide the JFSC with the flexibility to request information more frequently, if required. The Banking Codes (paragraphs 6.2 and 6.3) require annual audited financial statements to be provided to the JFSC. These financial statements are used by the JFSC to provide further financial information to support the view obtained from quarterly prudential reporting.</p> <p>The quarterly prudential returns are sub-divided into modules, with each bank completing modules based on whether it is a branch or subsidiary, whether it has a trading book, and on the Basel II approach it follows concerning credit, market and operational risk, respectively. The standard quarterly prudential return includes:</p> <ul style="list-style-type: none"> <li>• on- and off-balance sheet assets and liabilities;</li> <li>• profit and loss;</li> <li>• capital adequacy;</li> <li>• liquidity;</li> <li>• large exposures;</li> <li>• asset concentrations;</li> <li>• asset quality;</li> <li>• loan loss provisioning;</li> <li>• interest rate risk; and</li> <li>• market risk.</li> </ul> <p>The JFSC does not require extensive reporting on related party transactions, given the Jersey banking industry's business model (all banks are members of financial groups of international stature). The quarterly prudential return's Core Financial Data Guide requires the bank to deduct from capital all investments in related party entities and - in the liquidity schedules - "All placements with group companies" and "Deposits from group companies" must be disclosed by maturity. Reporting of "upstreaming" of deposits is also required in the Large Exposures Schedule. Significant exposures to senior managers or directors must also be disclosed.</p> <p>Extensive instructions on the completion of the quarterly returns are provided as a schedule to the Banking Codes. <i>Inter alia</i>, the Banking Codes (paragraphs 6.2 and 6.3) require that the returns be prepared using accounting standards that are based on accounting principles and rules that are widely accepted internationally. (In this regard, the JFSC considered the impact on prudential reports of International Financial Reporting Standards (IFRS) valuation techniques and issued a guidance note on the subject in January 2006.) The year end quarterly return is reconciled to the year end financial statements by the external auditors, to ensure that there is no material discrepancy between the valuation rules applied.</p> <p>Where specific concerns emerge, financial information is obtained on a more regular basis, for example where a bank's ability to maintain its risk asset ratio above the required minimum is in</p> |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p>question.</p> <p>Data is collected from all banks at the end of March, June, September and December. This is fed into a summary pack which facilitates industry analysis by the JFSC, including peer comparisons.</p> <p>Standardized rules apply to the quarterly prudential returns for each bank as set out in the Schedule to the Banking Codes.</p> <p>The JFSC's powers to require submission of information from registered persons under the BB(J)L (Article 26) and the FSC(J)L (Article 8) are extended by the BB(J)L (Article 26(6)) which empowers the JFSC to require submission of information from, <i>inter alia</i>, a bank's holding company, subsidiaries, related companies, and fellow subsidiaries.</p> <p>The BB(J)L (Articles 6 and 26) and the FSC(J)L (Article 8) provide the JFSC with a legal right of access to bank records, and to any director, manager or staff member. There is no secrecy law established in Jersey legislation.</p> <p>A person who without reasonable excuse fails to supply information requested by the JFSC will be guilty of an offence and liable to imprisonment for a term not exceeding 6 months or a fine not exceeding £2,000, or both (BB(J)L; Article 26). Moreover, a person who knowingly or recklessly provides the JFSC with false or misleading information, under particular circumstances, shall be guilty of an offence and liable to a fine or imprisonment for a term not exceeding 2 years, or both (BB(J)L; Article 26).</p> <p>The Schedule to the Banking Codes states that the accurate and timely submission of quarterly returns is viewed as an indication of effective management control. Consistent late submission of the quarterly return could result in the JFSC requiring either a report from the bank's accountants (BB(J)L; Article 26) or the bank's accountants to perform the return on the bank's behalf. The JFSC could also issue a direction (BB(J)L; Article 21).</p> <p>(In addition to the above, the JFSC issued Consultation Paper No. 1 2008 on <u>Late Payment Fees, and Fees for the Late Delivery of Documents</u> that proposed the introduction of a fixed penalty for the late submission of documents to the JFSC where those documents are required to be delivered by an enactment. The JFSC issued a Feedback paper to Consultation Paper No.1 2008 in July 2008 and having considered the responses from Industry the JFSC decided to proceed with policy implementation as proposed by the consultation paper. The amendments to the Fees Notices took effect on 1 September 2008.)</p> <p>The Schedule to the Banking Codes requires that, for Jersey-incorporated subsidiaries, the quarterly prudential return must be signed off by two directors. For branches, the principal manager must sign the report, and, in the case of the year-end report, this must be signed by the senior officer approved by the JFSC (GPO; Article 11).</p> <p>The application utilized for submitting the quarterly prudential return performs validation and integrity checks on the data prior to upload, to ensure the figures balance and are correctly allocated.</p> <p>Once uploaded, the banking supervision managers complete a checklist designed to test the integrity and completeness of the quarterly prudential returns. The data is then considered in light of historic trends and the supervision manager's knowledge of the bank in question. In addition, the Banking Codes (paragraphs 6.2 and 6.3) require that one of the four quarterly returns must align to the year-end of the bank, and also require that the external auditors provide a confirmation that the relevant quarterly prudential return does not materially differ from the audited financial statements.</p> <p>The JFSC can require one or more competent persons to investigate and produce a report on a particular bank (BB(J)L; Articles 26 and 28). For such an appointment, the JFSC would formally define the scope and responsibilities of the competent person and would monitor the quality of their work. However, external experts are rarely used, with all supervisory work normally carried out by the JFSC.</p> <p>The GPO (Article 13) requires that persons appointed to make a report must immediately report</p> |
|--|--|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | to the JFSC the probable existence of exceptional circumstances, with examples being fraud, irresponsible or reckless acts, or an occurrence of material significance to the JFSC's powers or functions. An auditor, or a person appointed to make a report to the JFSC (BB(J)L; Article 26) is protected, when reporting to the JFSC in good faith, information that is relevant to any function of the JFSC (BB(J)L; Article 34).  |
| Assessment   | Compliant  |
| Comments   |  |
| <b>Principle 22.</b>   | <b>Accounting and disclosure.</b> Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.   |
| Description  | <p>The Banking Codes (paragraph 3.2.1.4) require registered persons to have accounting and other records that are complete, accurate and timely and that can be used to compile financial statements, management information and returns in line with applicable regulatory and legal requirements. Moreover, it is required that there be: "clearly defined procedures which ensure that there is appropriate oversight by, in the case of Jersey companies, the board of directors or, in the case of branches, senior management, of all relevant areas of risk management, including: ...Accurate and reliable management information and reporting systems;"(paragraph 3.1.4.5).</p> <p>Given the foregoing, the JFSC has power to hold a registered person's board/senior management responsible for the bank adhering to the Banking Codes. Where performance of those responsible is deficient, remedy could be sought through issue of a direction by, for example, requiring specific, corrective action by those with board/senior management responsibilities or, at the extreme, requiring removal of any particular director or senior manager of the bank (BB(J)L; Article 21(2)(a) and (b)). Failure to comply with a direction renders a person liable, upon conviction, to imprisonment for two years and to a fine.</p> <p>The BB(J)L (Article 32) requires that each "registered person" shall keep a copy of its most recent audited financial statements at its offices and during normal business hours make the copy available for inspection by any person on request. In the case of a Jersey-incorporated "registered person", the financial statements must include the auditors' report on the financial statements (The JFSC's Guidance Notes "Information for Prospective Applicants" (14 July 2005) state: "All registered deposit-takers are required under (BB(J)L; Article 32) to keep copies of their most recent audited accounts available for inspection by any person. In the case of branches, this means the Company's published accounts; in the case of Jersey-incorporated subsidiaries, it means their own locally audited accounts.")</p> <p>The GPO (Article 11(5)) requires that each "registered person (that) is a subsidiary of an organization" must have available for access by the public, either; "(a) summarized accounts of the registered person in a form determined by the Commission, or (b) "true and fair" audited accounts". This requirement is a condition of registration of the registered person. Failure to comply with a condition of registration renders a person liable, upon conviction to imprisonment for two years and a fine. (However, remedy could be sought by issue of a direction as described above.)</p> <p>The GPO (Article 11(4)) requires that "generally accepted accounting principles" must be used for Jersey-incorporated subsidiary banks' financial statements which are to "show a true and fair value of the profit or loss... for the relevant accounting period, and of the state of the registered person's affairs at the end of the period". In most cases, international accounting standards are followed by registered persons and these utilize generally accepted valuation rules.</p> <p>The JFSC's Guidance Note (January 2006) addresses the impact of IFRS valuation techniques on prudential reporting, to which both branches and subsidiaries are subject.</p> <p>The JFSC has the power, by use of a direction (BB(J)L; Article 21(2)(a)), where appropriate, to require the external audit to follow a specified scope and standard. However, to-date use of this power has not occurred (most banks in Jersey are audited by the top 4 international auditing firms which apply internationally accepted audit standards).</p> |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p>The prospective auditor for a bank seeking registration in Jersey is assessed as part of the JFSC's authorization process. For bank branches, the GPO (Article 11(2)(c)) requires that, unless exempted by the JFSC, a registered person must appoint a branch auditor approved by the JFSC. For Jersey-incorporated subsidiaries, the GPO (Article 11(4)) sets standards for the financial statements. Were such standards not to be met, the JFSC could impose a condition on the bank under (BB(J)L; Article 11) or issue a direction (BB(J)L; Article 21) to require removal and replacement of the auditor.</p> <p>The GPO (Article 11) requires that "generally accepted accounting principles" must be used for the annual financial statements of Jersey-incorporated subsidiary banks. (There is no direct requirement on branches registered in Jersey to follow specific accounting principles. Unless otherwise exempted by the JFSC, a branch must appoint a branch auditor approved by the JFSC (GPO; Article 11(2)(c)). This enables the JFSC to satisfy itself as to the standards to be applied.)</p> <p>For the last financial year, most Jersey registered persons were audited in accordance with either International Standards on Auditing, issued by the International Auditing and Assurance Standards Board, or International Standards on Auditing (UK and Ireland), with a few exceptions (Indian, Swiss and US auditing standards applied).</p> <p>The GPO (Article 11(4)(5)) sets out requirements for Jersey-incorporated subsidiaries to publish for the use of depositors, and potential depositors, audited financial statements prepared in accordance with generally accepted accounting principles within 3 months of the date of the balance sheet.</p> <p>Because of the nature of the banks registered in Jersey, all of which are either subsidiaries or branches of large international banking groups, the JFSC has not established requirements in respect of quantitative and qualitative information to be made publicly available, over and above that required by international accounting standards. The JFSC relies on such disclosures being a requirement of home regulators at group level.</p> <p>Compliance with disclosure standards imposed by the BB(J)L (Article 32(1)) and the GPO (Article 11(4) and (5)) were found to be variable by the assessors, one of four registered persons sampled meeting the requirements in full.</p> <p>Presentation of aggregate information on Jersey's banking system is limited to schedules of outstanding deposits, categorized by currency and source, and published quarterly. (Some other limited information is published on the <a href="http://www.jerseyfsc.org">http://www.jerseyfsc.org</a> website.) The level of detail contemplated by this Core Principle is not achieved in Jersey. Application of the concept of 'market discipline' is quite limited in Jersey in that all registered persons are branches or subsidiaries of overseas banking groups, which are subject to market forces at group level. Group audited financial statements are often – but not invariably – available to the depositor or potential depositor.</p> <p>A Regulatory Audit Group Forum was established in 2006 and did meet approximately quarterly for the first year, but has not met for a considerable time, Bi-lateral contacts between accounting firms and the JFSC continue on an "as needed" basis.</p> <p>The GPO (Article 13) requires that the auditor of a registered person or a person appointed to make a report (BB(J)L; Article 26) must immediately report to the JFSC on the probable existence of exceptional circumstances, with examples being fraud, irresponsible or reckless acts, or an occurrence of material significance to the exercise of the JFSC's powers or functions. The BB(J)L (Article 34) protects the auditor from breaching any duty it may be subject to when reporting to the JFSC in good faith information that is relevant to any function of the JFSC.</p> <p>The JFSC does not require banks to rotate their external auditors from time to time. However, the JFSC is aware that each of the banking auditors practicing in Jersey are subject to the Auditing Practices Board's Ethical Standard rules. These rules include expectations on audit firms to monitor and react to the threat of loss of objectivity and independence.</p> <p>The JFSC places disclosure requirements on Jersey banks through the BB(J)L, Banking Codes and quarterly prudential report instructions. However, there is no direct requirement for the</p> |
|--|--|

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>bank to have a formal disclosure policy.</p> <p>The JFSC has no explicit power to require access to external audit working papers save in those instances where the JFSC has appointed a competent person to investigate and produce a report on a particular bank (BB(J)L; Articles 26 and 28).</p> <p>Discussions with external auditors on individual banks are not common.</p>  |
| Assessment   | Largely Compliant  |
| Comments   | <p>As noted in the Description of CP 1(1), there is no information available on the financial strength and performance of the banking industry in Jersey as a whole. The JFSC should consider publication of a commentary on the performance of the Jersey- incorporated “registered persons” alongside review of the activities of the branch operations.</p> <p>On a single entity basis, the JFSC should place greater emphasis on the requirements of the GPO (Article 11(5)) being met by all Jersey-incorporated “registered persons” and that the similar prescription provided by the BB(J)L (Article 32) for those “registered persons” operating as branches be observed without exception. (Here, reference is made to the JFSC’s <u>Guidance Note: Information for Prospective Applicants</u> {14 July 2007}.)</p> <p>The JFSC is not making full use of banks’ external auditors as an information source. Bilateral discussions should be held more regularly.</p>   |
| <b>Principle 23.</b>   | <b>Corrective and remedial powers of supervisors.</b> Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.   |
| Description  | <p>Supervisory concerns raised through on-site and off-site supervision are brought to the attention of the bank via a written document in each case. The concerns, if material, are addressed to the board of directors (or equivalent). An appropriate period of time is agreed for the completion of remedial action.</p> <p>A diary system maintained by the Banking Division tracks outstanding issues, together with dates for completion/resolution and monitors progress. Undue delays in responding to the JFSC’s concerns could lead to the JFSC taking further regulatory action under the BB(J)L (e.g. appointing reporting accountants (Article 26), issue of a direction or removal of a director, controller or manager (Article 21)).</p> <p>For a Jersey-incorporated bank, the JFSC may apply to the Royal Court (Companies (Jersey) Law 1991; Article 155) for a winding up order under “just and equitable” grounds. The JFSC has never had to exercise this power in the case of a bank.</p> <p>The BB(J)L (and GPO) provides the JFSC with a range of powers to deal with banks that fail to meet regulatory requirements or represent a risk to the JFSC’s guiding principles. The key powers are:</p> <ul style="list-style-type: none"> <li>• issue of a condition on a registration (Article 11);</li> <li>• issue of a direction on the bank (Article 21);</li> <li>• removal of a shareholder controller (Article 15);</li> <li>• removal of a director, controller or manager (GPO; Article 11) or by issue of a direction (Article 21);</li> <li>• appointment of a manager to a bank (Article 37A);</li> <li>• restricting rights applicable to shares of a bank (Article 17);</li> <li>• appointment of a competent person (Article 26);</li> <li>• issue of public statements (Article 48);</li> <li>• appointment of inspectors (Article 28);</li> <li>• revocation of registration (Article 10);</li> <li>• denial of permission for a new activity or acquisition (GPO; Article 11);</li> <li>• restriction of asset transfers by imposition of a condition (Article 11) or via direction (Article 21); and</li> <li>• ban an individual from working in the finance industry via a direction (Article 21).</li> </ul> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>The choice of remedial action will be commensurate with the perceived gravity of the non-compliance.</p> <p>The JFSC has, via the Pillar 2 process of Basel II, agreed trigger ratios with all Jersey-incorporated banks which, if breached, would require a bank's immediate notification to the JFSC. The BB(J)L (Article 11) allows the JFSC to attach conditions to a registered person's registration. This power has been used to establish minimum capital ratios for each Jersey-incorporated bank, based on the ICAAP assessment and perceived risk profile. Experience indicates that registered persons which find themselves in breach of the minimum risk asset ratio take prompt corrective action. In case of need, the JFSC has appropriate coercive powers noted above.</p> <p>The JFSC monitors capital ratios through quarterly prudential returns. Any material decline is promptly raised for discussion with management.</p> <p>The JFSC has applied sanctions to individuals of financial institutions in Jersey, including banning individuals from working in the industry and issuance of public statements. The JFSC has issued "Public Statements" in the past (e.g. 18 July 2000; 3 November 2004) identifying shortcomings in named banks and in one case a bank was required to remove two directors from their positions.</p> <p>Notably, the BB(J)L (Article 52) provides that where an offence committed under that law "by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of any director, controller, manager, secretary or other similar officer of that body corporate or any person purporting to act in any such capacity, those persons, as well as the body corporate shall be guilty of the same offence and liable in the same manner to the penalty provided for that offence".</p> <p>There is no specific law or regulation that guards against the JFSC unduly delaying appropriate corrective action against a bank. However, the Director General, and other executive directors, is responsible to the Board, who discuss and make decisions on required actions. Such oversight aims to protect against undue delays in necessary actions. No incidents of undue forbearance came to the assessors' attention. The JFSC's remedial powers are outlined above.</p> <p>The JFSC is the only financial services regulator in Jersey. Any decision to take action against a bank would, in passing through the normal governance procedures of the JFSC, be brought to the attention of the directors responsible for the supervision of other financial sectors.</p> |
| Assessment   | Compliant   |
| Comments   | <p>In regard to additional criterion 2 and the issue of "ring-fencing", reference is made to CP 25. Insofar as "ring-fencing" of a Jersey-incorporated bank from the actions of a parent company is concerned, the business model generally applied in Jersey (i.e., the raising of deposits for onward transmission to a parent) points to the JFSC's powers being limited in practice. This derives from the scenario that were a Jersey-incorporated bank's parent to encounter financial difficulties so extreme as to prompt equivalent use of a power on the part of its own primary regulator (e.g. appointment of a Manager), then certain actions available to the JFSC would likely be ineffective. (The JFSC's direction to a bank to retrieve deposits from its parent would likely be frustrated by the Manager, at least in the short term.) In recently experienced conditions of turbulence, albeit less severe than those prompting appointment of a Manager in the parent's "home" jurisdiction, parents have been well able to supply funding to Jersey-incorporated subsidiaries to meet deposit withdrawals.</p> <p>A direction to a Jersey-incorporated bank to withdraw "up streamed" deposits well in advance of extreme conditions affecting the parent can be contemplated, although in such conditions the raison d'être for the Jersey-incorporated bank's continued operation would likely disappear.</p>  |
| <b>Principle 24.</b>   | <b>Consolidated supervision.</b> An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.   |
| Description  | The JFSC's functional structure provides that staff responsible for supervising a bank are also aware of local activities of other parts of the bank and its subsidiaries, including investment   |

**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|  |  |
|--|--|
|  | <p>business and insurance activities.</p> <p>The JFSC maintains contact with “home” supervisors (and “host” supervisors where the JFSC acts as a quasi-“home” regulator) to remain current with relevant regulatory issues occurring outside Jersey. This includes regular visits to Guernsey, Isle of Man and the Middle East, where Jersey-incorporated banks have material activities.</p> <p>The GPO (Article 11) requires banks to obtain the JFSC’s consent to undertake any new activity within Jersey and also requires Jersey-incorporated banks to obtain consent to acquire or establish a representative office, branch, or subsidiary outside Jersey. The JFSC is thus aware of changes to the structure or activities of banking groups registered in Jersey. Moreover, its annual review meetings with senior officers facilitates discussion of the overall structure of a banking group and its activities.</p> <p>The BB(J)L (Article 26) and the FSC(J)L (Article 8) empower the JFSC to review all activities performed by banks, including those conducted in other jurisdictions. (The GPO (Article 11) requires that the JFSC’s approval is necessary before a Jersey-incorporated bank establishes or acquires a representative office, branch or subsidiary outside of Jersey.)</p> <p>All activities of banks are considered in advance of, and discussed during, on-site inspections, including investment business, trust company business, fund services business, insurance business, and non-regulated activities.</p> <p>Other financial services activities that are prudentially supervised by the JFSC will require separate authorization.</p> <p>The results of the risk assessments undertaken by other supervision divisions are provided to the relevant banking supervision manager such that an overview can be formed on the non-banking activities undertaken and their impact on the registered person’s overall risk profile. (The JFSC has assessed each Jersey-incorporated bank’s ICAAP according to Pillar 2 methodology and, where it judged appropriate, has increased the minimum risk asset ratio to take account of non-banking activities and associated risks.)</p> <p>The Banking Codes (paragraph 6.2), by cross reference to the Schedule thereto, require that Jersey-incorporated subsidiaries submit a solo prudential report as at each quarter end. An additional consolidated report is required for the period coinciding with the financial year-end if the reporting bank has a material subsidiary that is a financial services business. Prudential requirements for solo positions apply equally to consolidated positions.</p> <p>The JFSC is responsible for licensing and supervision of all types of financial services business within the scope of Jersey regulatory legislation.</p> <p>The JFSC has in place a significant number of MOUs to assist in information sharing between jurisdictions and, as well, corresponds with the “home” regulator of every Jersey-registered person on an annual basis so as to:</p> <ul style="list-style-type: none"> <li>• maintain the regulatory relationship;</li> <li>• remind the “home” regulator of the existence of the Jersey-registered person and, by inference, its supervisory responsibility in this respect;</li> <li>• give the “home” regulator an indication of the JFSC’s overall view of the bank and any specific concerns;</li> <li>• advise the “home” regulator of on-site activity conducted in the previous 12 months, any significant findings arising and their resolution; and</li> <li>• “invite” the home regulator to provide input in respect of the wider group.</li> </ul> <p>When conducting its own on-site supervision overseas, the JFSC always seeks to discuss regulated persons with the “host” supervisors.</p> <p>As noted above, the GPO (Article 11) requires that a bank obtain the JFSC’s consent to undertake any new activity within Jersey and also requires Jersey-incorporated banks to obtain consent to acquire or establish a representative office, branch, or subsidiary outside Jersey. This process enables the JFSC to consider the adequacy of “host” supervision and the degree of risk to which the new venture may be exposed. (The BB(J)L (Article 11(2)) enables the JFSC</p> |
|--|--|



**Table 3. Detailed Assessment of Compliance with the Basel Core Principles**

|                      |   |
|----------------------|---|
|                      | <p>to impose conditions on a bank's current operations. The direction power BB(J)L (Article 21) could be used to the same effect.)</p> <p>The Banking Codes (Principle 3) require banks to have adequate corporate governance arrangements in place, which include the management of foreign operations. Corporate Governance is a key focus of the on-site inspections conducted overseas by the JFSC. The on-site route planner includes questions on the adequacy of management information reporting, the effectiveness of compliance and audit functions, and whether management is aware of the bank's operational strategy and challenges facing the bank, including those in overseas operations.</p> <p>The JFSC supervises 12 banks that have overseas activities, the majority operating in Guernsey, Isle of Man and the Middle East. All are part of larger groups, which are subject to consolidated supervision. Of the 12, one is particularly significant, having operations throughout the Middle East. On-site inspections are made to a number of overseas branches on average every 15 months (including the group's regional head office). The JFSC meets with the regulators in the Middle East during these visits.</p> <p>The JFSC performs on a regular cycle on-site inspections in Guernsey and Isle of Man. When there, it meets formally to discuss supervision of hosted operations with its counterparts. (Given strong links between regulators in all three jurisdictions, issues are frequently discussed informally.)</p> <p>The JFSC does not hinder parent banks of Jersey-registered persons from accessing or transmitting material information held by their foreign branches or subsidiaries and, to-date, has not found the host countries with which it deals obstructing access to information for those banks for which it is home supervisor.</p> <p>The JFSC has the power to require the closing of an overseas office, or impose limitations on its activities through the issue of a direction on the bank (Article 21). As noted above, the GPO (Article 11) consent provisions enable the JFSC to consider the adequacy of host supervision and the degree of risk that the new venture might expose the bank to.</p> <p>Foreign activities that have a higher risk profile (or which differ from those conducted in Jersey), or concerns over the supervisory framework applied, would impact on a bank's risk profile. This in turn would lead to appropriately heightened supervision. In this regard, one Jersey-registered person with branches across the Middle East is inspected approximately every 15 months by a team from the JFSC's Banking Division.</p> <p>The JFSC has previously made use of competent persons in foreign jurisdictions to conduct on-site assessments (BB(J)L; Article 26).</p> <p>The JFSC's policy relating to new applicants includes that of only granting registrations to financial institutions of international status and reputation. Applicants must be subsidiaries or branches of the world's largest 500 banking groups by reference to Tier 1 capital, or financial conglomerates with equivalent own funds. During the authorization process for a new banking registration, the JFSC reviews the activities of the group to which the prospective bank belongs.</p> <p>The JFSC may (and does) require information on, or appoint a competent person to report on, a body corporate which is a holding company, subsidiary or related company of a registered person (BB(J)L; Article 26).</p> <p>In addition, the JFSC has a policy on dominant shareholders to be followed by banks seeking a registration in Jersey. This establishes the heightened need for full assessment of the fitness and propriety, and degree of comfort exerted by, dominant shareholders.</p> <p>The JFSC may "reasonably require" additional information, which could include additional reporting on foreign operations (BB(J)L; Article 26(3)).</p> |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 25.</b> | <b>Home-host relationships.</b> Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved,  |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |   |
|--|---|
|  | <p>primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.</p>   |
| Description  | <p>The JFSC has appropriate gateways (BB(J)L; Article 47) established for the sharing of information with home and host country supervisors. Thirty-three MOUs have been established (although an MOU is not essential for the JFSC to share information with other supervisors). The entire list of MOUs with other jurisdictions is displayed on the JFSC's website and the MOU contents published where the other regulator has agreed to its content being made public.</p> <p>A number of home supervisors regularly contact the JFSC and meetings are held with them to discuss issues of mutual interest. Formal statutory gateways are used regularly to exchange information. Home supervisors are encouraged to provide relevant information to the JFSC.</p> <p>The overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.</p> <p>The JFSC is responsible as "home" supervisor for 12 banks that have overseas activities, the majority of which operate in Guernsey and Isle of Man. It meets formally and regularly to discuss the supervision of hosted operations with its counterparts in those jurisdictions. Given the strong links between regulators in all three jurisdictions, issues are also discussed on a more frequent, informal basis.</p> <p>Of the 12 banks, one is particularly significant, having operations throughout the Middle East. On-site inspections are made to a number of overseas branches on average every 15 months (including the group's regional head office). The JFSC takes the opportunity to meet with the regulators in the Middle East during these visits.</p> <p>The JFSC formally writes to the home regulator of every Jersey-registered deposit taker on an annual basis so as to:</p> <ul style="list-style-type: none"> <li>• maintain the regulatory relationship;</li> <li>• remind the "home" regulator of the existence of the Jersey-registered person and, by inference, its supervisory responsibility in this respect;</li> <li>• give the "home" regulator an indication of the JFSC's overall view of the bank and any specific concerns;</li> <li>• advise the "home" regulator of on-site activity conducted in the previous 12 months, any significant findings arising and their resolution; and</li> <li>• "invite" the home regulator to provide input in respect of the wider group.</li> </ul> <p>Specific non-compliance with supervisory requirements, if significant, would result in timely contact with the home supervisor by the JFSC.</p> <p>Jersey regulatory requirements apply equally to all banks, independent of whether they are foreign or domestic.</p> <p>Before registration of an institution is agreed, the home country supervisor is asked to confirm knowledge of and agreement with the operation proposed for Jersey, and its role as consolidated supervisor. Registration is not permitted until the home country supervisor has confirmed that it has no objection and the JFSC has satisfied itself as to the adequacy of home supervision.</p> <p>The JFSC hosts inspections from home supervisors and has done so on a regular basis. When the JFSC is to inspect offices and subsidiaries of banking groups in other jurisdictions, the host supervisors are notified, given the reasons for and purpose of the visit and the opportunity to attend the inspections.</p> <p>No shell banks operate in Jersey. They are now formally prevented (BB(J)L; Article 10). The JFSC, however, has responsible for supervision of managed banks that are managed by a Jersey-registered deposit-taker which, by definition, is subject to the JFSC's supervision. There had been two managed banks but one has recently been wound up and the other is relatively inactive. While annual meetings have been held with both, they were last inspected on-site in</p> |

| <b>Table 3. Detailed Assessment of Compliance with the Basel Core Principles</b> |  |
|--|--|
|  | <p>2006.</p> <p>The JFSC will discuss the implications of information received from another supervisor and, as far as possible, keep them informed of any relevant developments.</p> <p>The JFSC's strategy in dealing with the host supervisors for the 12 banks that have overseas activities is discussed above.</p>  |
| <b>Assessment</b>  | <b>Compliant</b>   |
| <b>Comments</b>  | <p>While this Core Principle has been assessed as Compliant, recent global financial turmoil have served to underline limitations in the relationship between the JFSC and the home supervisor of several of the largest Jersey-registered deposit-takers, the UK Financial Services Authority (FSA). Essential Criterion 3 of CP 25 reads, in part:</p> <p>"3. The home supervisor provides information to host supervisors, on a timely basis, concerning:</p> <ul style="list-style-type: none"> <li>• where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries." <p>From enquiries made in the course of this assessment it appears that the JFSC did <u>not</u> receive timely and unprompted warning of what has been termed the "acute system-wide pressures on financial institutions" (see Bank of England: Financial Stability Report (Oct. 2008; Issue No. 24). The JFSC's enquiries of the FSA did receive prompt response, but it is evident that the asymmetry of the relationship disadvantages the JFSC. While the Jersey-incorporated subsidiaries of the clearers are important for the Jersey financial system, they are less so on a banking group basis and, consequently, for the supervisor of the consolidated group.</p> <p>It follows, first, the JFSC's practice of affording an exemption from the large exposure quantum limitations for interbank loans of one year or less warrants revisiting (this is addressed at CPs. 10 and 11). Second, depositors should be made aware of the status of their deposits in Jersey-registered banks insofar as guarantees afforded by various deposit-insurance schemes are concerned as, eventually, the guarantees afforded by various governments will be removed. Third, the JFSC should strive to obtain regularly from home supervisors a written statement indicating whether they have any knowledge of any significant problems of which the JFSC should be aware concerning those institutions for which the home supervisor has primary responsibility. Lastly, the JFSC should strive to obtain from home supervisors a commitment to communicate promptly and on their initiative information that is critical to the stability of the Jersey financial system.</p> <p>As regards managed banks, the managing institution has recently been subject to inspection. It would be constructive for the JFSC to maintain annual inspections of managed banks.</p> </li></ul> |