Guernsey Financial Services Commission

CHANGES IN THE LARGE EXPOSURE REGIME

A CONSULTATION PAPER ISSUED BY THE GUERNSEY FINANCIAL SERVICES COMMISSION

April 2013

The Guernsey Financial Services Commission invites comments on this consultation paper. Lynn Harris in the Commission's Banking Division is co-ordinating responses from industry and your comments should be submitted by no later than Friday 21 June 2013.

Responses should be sent to:

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If you require assistance or clarification in respect of any aspect of the proposals prior to formulating a response, the Commission's contact is:

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Additionally, the Commission would encourage subsidiary banks who wish to discuss specific scenarios to meet with it during the consultation period.

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Glossary of Terms

BSL/2 return	Quarterly prudential statistics supplied by licensed institutions to the Commission.
Cash	Cash in the same currency as the exposure and held over the same term as the exposure.
Large exposure	An exposure to an individual counterparty or a group of connected counterparties, where that exposure is greater than or equal to 10% of the reporting bank's net capital. Exposures in excess of 25% the reporting bank's net capital must be notified to the Commission in advance of entering into the transaction.
Licensed institution	An institution which holds or is deemed to hold a deposit taking licence under the Banking Supervision (Bailiwick of Guernsey) Law, 1994.
Net capital base	Total Tier 1 and Tier 2 capital less any deductions. It is the "Adjusted Capital Base (Tiers 1 & 2)" figure reported in Module 6 of the quarterly BSL/2 prudential return.
OECD	Organisation for Economic Co-operation and Development.

1: Executive Summary

1.1 Overview

This paper contains full details of the proposals to substantially alter the Large Exposure principles and guidance that apply to licensed deposit takers that are incorporated in Guernsey. It is proposed that the new regime would take effect from 1 January 2014.

These proposals include changes to enhance the quarterly prudential reporting to the Commission and this would affect not only licensed deposit takers incorporated in the Bailiwick, but also those licensed deposit takers whose principal place of business is outside the Bailiwick.

The context for the review is that the existing Principle 1/1994/24 "*Principles and Guidance to be followed by a locally incorporated licensed deposit taking institution entering into a large exposure*" paper published by the Commission in 1994 no longer adequately addresses the risks associated with large exposures, particularly those arising from the systemic and market risks that became evident as a result of the 2007/2008 financial crisis.

In respect of large exposures, the Commission has tended to be a "pragmatic" supervisor rather than a rigid standard based supervisor, and, it has from time to time allowed suitably collateralised large exposures in excess of 25% of net capital base. Given that any change to a more restrictive approach may have a business impact on licensees the Commission feels that it is appropriate to seek the views of industry. The Commission is proposing to retain several elements of its pragmatic approach and in seeking the views of industry it will be open to bilateral discussions with licensees about particular types of exposures.

1.2 What is proposed?

The substantive changes being proposed in updated guidance are as follows:

- Exposures to central governments and market loans of less than 12 months' maturity, which are exempt from the current large exposure regime, will be deemed to be large exposures under the new regime.
- The current upstreaming regime will change to express agreed exposure limits to parent/group banks as a proportion (i.e. %) of capital base rather than a proportion of assets. The upstreaming regime will include on balance sheet and off balance sheet exposures.
- Exposures to third party banks will normally be limited to a maximum of 100% of net capital base and will comprise cash placements, holding of debt instruments and off balance sheet exposures. The maximum proportion (%) of exposure will be determined according to the rating of the third party bank, although limited flexibility will be permitted in the case of exceptional short-term excesses.
- In relation to exposures to sovereigns, the concept of Zone A and Zone B countries will be replaced with two different OECD-based groupings - High Income OECD countries and other countries. Exposures will be capped at a maximum of 1000% of net capital base and will be determined according to the rating of the sovereign.

- Exposures to clients or groups of connected clients will be capped at a maximum of 25% of net capital base, unless the exposure is secured by cash and/or High Income OECD government securities, or the exposure is subject to a parental guarantee (which in itself would need to be included in any upstreaming limit). Sub-participation agreements that transfer credit risk off the balance sheet of the Guernsey bank will also be considered.
- Better definition of what constitutes “connected clients” will be provided.
- The prudential reporting forms will be changed to better capture large exposures that have not previously been reported; e.g. holdings of debt that equate to more than 10% of a bank’s net capital base. In accordance with expected international developments, the Commission also proposes to capture the top twenty, rather than the current top ten, largest exposures. Branches will be asked to report similar details, but in terms of their parental capital, so that data on any significant credit concentration risk in a branch in Guernsey that may impact on a head office elsewhere can be collected.
- Breaches of large exposure limits will be a reportable event. The Commission is proposing a staged approach to dealing with exposures that cannot be regularised.
- The 800% aggregate limit on exposures would be retained, but exposures to Group, to third party banks and to sovereigns would be excluded from this aggregate.
- Large exposures existing prior to the intended effective date for the new regime of 1 January 2014 would be grandfathered in.

1.3 Rationale for change

The large exposure regime is all about capturing concentration risk and it is covered by s24 of The Banking Supervision (Bailiwick of Guernsey) Law, 1994. Conventional wisdom, as dictated by the Capital Requirements Directive and the Basel Core Principles for Effective Banking Supervision, states that no exposure to a client or connected group of clients should equate to more than 25% of net capital. Short term interbank exposures have historically been exempt from this requirement. Our current environment reflects these exemptions and also permits exposures to clients to exceed the 25% limit.

Whilst pure concentration risk to single obligor counterparties was not seen as a major direct contributor to the 2008 financial crisis, nonetheless elements of concentration risk were seen as indirect contributors. Interconnectedness within and between groups were seen as magnifiers of some exposures and concentrations through sectoral exposures to particular economic sectors (e.g. the Irish property development sector) affected credit assessments of many organisations. That said, the guidance on large exposures remains historic in nature; the Basel Committee guidance on measuring and controlling large exposures dates back to 1991, and our own local regime has not been significantly updated since 1994. However, there have been substantial changes to the EU large exposure regime.

These substantial changes have their origin in late 2007 and early 2008, when the Committee of European Banking Supervisors (CEBS), which has since become the European Banking Authority, reported to the European Commission on the effectiveness of the large exposure provisions of the Capital Requirements Directive. The report concluded that market failures associated with systemic risk and moral hazard applied to interbank exposures regardless of maturity. Accordingly, the large exposure regime for EU member states was revised with effect from December 2010 to tighten large exposure limits, particularly in relation to interbank and intra-group lending, which the European Commission agreed was a major systemic risk in the wake of the financial crisis. Under the revised EU regime, short term loans to banks are no longer exempt and whilst limited national discretion is available to member states in relation to intra-group lending, loans to third party banks are now capped at 25% of net capital, unless the lending bank is very small. In reality, by the time the changes to the EU regime came along, market practice had already changed to reflect this more cautious approach to interbank lending.

It is worth noting that the CEBS conclusions were also reflected in the UK Government's response to the report on banking reform by the Independent Commission on Banking ("the Vickers Report"). The HM Treasury white paper "*Banking Reform – delivering stability and supporting a stable economy*" published in June 2012 envisages the limiting of a ring-fenced bank's exposure to financial institutions in order to prevent systemic shocks.

Clearly Guernsey is not in the EU, but nevertheless we would not wish to be a complete outlier in respect of large exposures. The Basel Core Principles for Effective Banking Supervision do give the supervisor some latitude in permitting "minor deviations" from the 25% limit, but the economic climate that has prevailed for all but the last few years combined with the Commission's wish to be a pragmatic regulator has meant that these "minor deviations" have been permitted more frequently in the past than is arguably now prudent in the current economic and regulatory climate. The guidance however, remains the same and a change is needed to manage expectations and formalise a prudent approach.

In developing proposals for a new large exposure regime the Commission has had regard to a number of other regimes, including those operating in the UK and the other Crown Dependencies. None of these are a good fit in their entirety for the type of banking business done in and from within the Bailiwick. The Commission has therefore tried to balance the requirements of other regimes against the type of banking business that exists in the Bailiwick, recognising also the intra-group funding that many licensees provide.

1.4 Who would be affected?

Licensed deposit takers that are incorporated in Guernsey would be those principally affected, given that limits on exposures are being proposed in relation to capital. However, the proposed revisions to the large exposure regime include enhanced quarterly prudential reporting for all licensees and branches would therefore be affected by these changes to the BSL/2 reports.

2: Consultation

2.1 Basis for the consultation

The Commission has issued this consultation paper in accordance with s36A(1) of the Banking Supervision (Bailiwick of Guernsey) Law 1994 as amended, under which the Commission, "*after consultation with such other persons as appear to the Commission to be appropriate including, without limitation, persons representative of that part of the Bailiwick's financial services industry which carries on business regulated by this Law, may issue such codes of practice as the Commission thinks necessary*."

2.2 Responding to the consultation

The Commission invites comments from interested parties on the proposals included in this consultation paper. Paragraphs in relation to the proposed changes are numbered so wherever possible respondents should quote the paragraph reference to which their comments pertain.

Where comments are made by an industry body or association, that body or association should also provide a summary of the type of individuals and/or institutions that it represents.

Respondents are asked to respond as specifically as possible and, where costs are referred to, to quantify those costs.

The Commission would encourage those Guernsey incorporated banks who want to discuss specific scenarios to get in touch during the consultation period.

2.3 Next steps

Please respond to this consultation paper by no later than 5.00pm on Friday 21 June 2013. The Commission will take all responses into account before publishing the finalised details of the new large exposure regime, which it is intended will be effective from 1 January 2014.

3: The Commission

The Guernsey Financial Services Commission is the regulatory body for the finance sector in the Bailiwick of Guernsey. The Commission's primary objective is to regulate and supervise financial services in Guernsey, with integrity and efficiency, and in so doing help to uphold the international reputation of Guernsey as a finance centre.

The Commission's general functions are prescribed in The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as follows:

- To take such steps as the Commission considers appropriate or expedient for the effective supervision of finance business in the Bailiwick.
- To provide the States of Guernsey, the States of Alderney or the Chief Pleas of Sark with reports, advice and assistance with any matter connected with finance business.
- To prepare and submit to the States of Guernsey, the States of Alderney or the Chief Pleas of Sark with reports, recommendations and schemes for the statutory regulation of finance business and generally for the revision of legislation appertaining to companies and other forms of business undertakings.
- The countering of financial crime and the financing of terrorism.
- To take such steps as the Commission considers necessary or expedient for
    - maintaining confidence in the Bailiwick's financial services sector, and
    - the safety, soundness and integrity of that part of the Bailiwick's financial services sector for which it has supervisory responsibility.
- All such other functions as the States of Guernsey may assign.

4: Background

4.1 Current legislation and policy

Section 24 of The Banking Supervision (Bailiwick of Guernsey) Law, 1994 deals with the obligations of licensed institutions in respect of reporting large exposures. The principal requirements of section 24 are as follows:

- S24(1) – "*A licensed institution other than one whose principal place of business is outside the Bailiwick shall make a report to the Commission if it proposes to enter into transactions …which…would result in it being exposed to a risk of incurring losses in excess of 25 per cent of its capital base*."
- S24(4) – "*The reports required …shall be made before the transactions are entered into…and such reports shall be in such form and shall contain such particulars as the Commission may reasonably require*."
- S24(5) – *"An institution which fails to make a report in accordance with this section is guilty of an offence…"*
- S24(6) – *"The Commission, upon becoming aware….may require the institution and any relevant subsidiary thereof to make such arrangements within such time as may appear to the Commission to be desirable for the protection of the institution's capital base."*
- S24(8) – *"Any question as to whether an institution is or would be exposed to risk…shall be determined in accordance with principles published by the Commission…"*

In 1994, the Commission published Principle 1/1994/24 "*Principles and Guidance to be followed by a locally incorporated licensed deposit taking institution entering into a large exposure*" in order to set out the operational framework for the above reporting obligations under section 24 of the Law. Minor amendments to this paper were made in 2010 in respect of connected and related parties, but the regime has remained largely unchanged since 1994.

The current regime allows for certain exemptions to the reporting framework:

- Interbank exposures and building society exposures (market loans) of less than one year
- Exposures to Zone A central governments and limited exposures to Zone B central governments

4.2 International considerations driving the proposals

4.2.1 Basel Core Principles for Effective Banking Supervision

The Basel Core Principles for Effective Banking Supervision ("the Principles") are the de facto minimum standard for effective prudential regulation and supervision of banks, and this is the standard against which banking supervision in the Bailiwick is assessed by the IMF. Core Principle 19 relates to concentration risk and large exposure limits and it requires supervisors to:

- Determine that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis.
- Set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.

In respect of setting limits, the criterion is as follows:

"In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following definitions:
(a) ten per cent or more of a bank's capital is defined as a large exposure; and
(b) twenty-five per cent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.
Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialised banks."

4.2.2 Changes to the EU and FSA large exposure regime

The large exposure regime for EU Member States was changed in 2010. These substantial changes had their origin in late 2007 and early 2008, when the Committee of European Banking Supervisors (CEBS), which has since become the European Banking Authority, reported to the European Commission on the effectiveness of the large exposure provisions of the Capital Requirements Directive. The report concluded that market failures associated with systemic risk and moral hazard applied to interbank exposures regardless of maturity, and that inter-bank and intra-group exposures should be classed as large exposures. The revised EU regime, which came into force in Member States on 31 December 2010, set the following requirements:

- Interbank and intra-group exposures no longer exempt from the large exposure regime.
- Interbank exposures limited to 25% of capital unless the reporting bank is a "small bank", in which case the amount is capped at EUR150m or 100% of capital, whichever is smaller.
- National discretion on intra-group exposures provided that the exposure is to the parent undertaking, to other subsidiaries of that parent undertaking or to the credit institution's own subsidiaries. 25% limit for intra-group exposures not meeting these criteria.
- 25% limit for exposures to clients of groups of connected clients.
- Exemptions for exposures to sovereigns and central governments, providing that they would attract a 0% weighting under the standardised approach to credit risk.

The FSA chose to vary these requirements slightly in its own regime as follows:

- Interbank exposures for small banks limited to EUR150m. However, this may exceed 100% of capital in cases where the FSA issues a waiver.
- Inter-group exposures to the "core UK group" exempt.
- Inter-group exposures to the "non-core UK group" (i.e. cross border exposures) limited to 100% of capital.

4.2.3 Banking Reform White Paper

Following on from the Independent Banking Commission's report in September 2011, the HM Treasury white paper "*Banking Reform – delivering stability and supporting a stable economy*" published in June 2012 envisages the limiting of a ring-fenced bank's exposure to financial institutions in order to prevent systemic shocks.

5 The Proposals

The Commission intends to set limits around certain types of exposure which it has grouped into:

- Exposures to the parent and other group banks
- Exposures to third party banks
- Exposures to sovereigns
- Exposures to clients

The Commission also intends to enhance the prudential reporting forms to capture large exposures that have not previously been reported; e.g. the holding of a CD or FRN that equates to more than 10% of net capital base.

These proposals are dealt with in some detail below.

5.1 Exempt exposures

5.1.1 The current exempt exposures would be removed such that all exposures greater than or equal to 10% of the reporting bank's net capital base would be considered to be large exposures, regardless of maturity or counterparty. The current exempt exposures are:

- Interbank exposures and building society exposures (market loans) of less than one year.
- Exposures which are covered by a parental guarantee.
- Exposures to Zone A central governments (and limited exposures to Zone B central governments).

All exposures greater than 10% of net capital base would be in scope for the new regime.

5.2 Exposures to parent and group banks

5.2.1 The Commission proposes to operate a pre-agreed limit, to be reviewed annually, in respect of the aggregate exposures to the parent bank or other banks within the parental group ("the upstreaming limit"). *Not new*.

5.2.2 The upstreaming limit would be expressed as a % of the reporting bank's net capital base rather than as a monetary value or a % of assets. This is because it gives a more direct indication of concentration risk in respect of net capital than expressing the exposure in terms of a % of assets. *New.*

5.2.3 The upstreaming limit would include all types of exposure, including money market placements, holding of debt securities, exposures under risk participation agreements and silent or non-silent loan sub-participation agreements, and all off balance sheet exposures, including parental guarantees of client exposures. *Not new in practice but not well articulated in current guidelines.*

5.2.4 Collateralised exposures, such as reverse repo agreements with the parent or the holding of covered bonds issued by the parent or another group bank where we would look through to the underlying security would not be included in the upstreaming limit. However, the Commission would expect a licensee would discuss with it any proposed holdings of covered bonds and any repurchase or reverse repurchase transaction before entering into such an exposure. The collateralised exposure can then be monitored by the Commission as a prudential matter. The Commission would expect banks entering into a repo or reverse repo transaction, or proposing to hold covered bonds issued by the parent or another group bank to determine the concentration risk and monitor this on an ongoing basis. *Not new in practice but not well articulated in current guidelines.*

5.2.5 As part of agreeing the upstreaming limit, the Commission would expect the reporting bank to explain the reasons why the Board is content to enter into or continue to permit exposure(s) to its parent or other group companies. The evidence to support the rationale could include credit ratings, where the counterparty is rated, and/or selected internal information on the counterparty, such as financial strength or asset quality data where the counterparty is unrated. *Not new in practice, but a more formalised approach.*

5.2.6 Once an agreed upstreaming limit was in place the reporting bank would be able to enter into exposures with the counterparties without further notification to the Commission, provided that the aggregate exposure was within the agreed limit. *Not new.*

5.2.7 The upstreaming limit would be reviewed annually by the reporting bank and the Commission would expect to be provided with a copy of that review. The Commission would expect, unless there are exceptional circumstances, that an agreed limit would endure until the next annual review. *New.*

5.2.8 The Commission would reserve the right to amend a previously agreed upstreaming limit at any point if it appeared to the Commission that this would be desirable for the protection of the reporting bank's net capital base. *Not new.*

5.2.9 Exposures to non-bank Group entities would be included in the upstreaming limit if the exposure was to the entity itself and there was no look-through to underlying assets. *Not new in practice but not well articulated in current guidelines.*

5.2.10 The aggregate exposure entered into in accordance with the upstreaming limit would not be included in the 800% limit for aggregate exposures entered into by the reporting bank. *Not new in practice but not well articulated in current guidelines.*

5.2.11 Changes would be made to the prudential reporting forms to enable all exposures to the parent and other banks within the parent Group and any other relevant exposures to non-bank entities within the parent Group to be detailed, aggregated and expressed as a % of the bank's reported net capital base. See section 6 for details. *New.*

Questions for respondents:

1 What measurement difficulties would be caused, if any, by including all on and off balance sheet exposures to the parent/other group banks and non-bank group entities in the upstreaming limit?

2 What difficulties, if any, do you foresee in agreeing an upstreaming limit that includes off-balance sheet items that would then remain in place for the next twelve months, unless there were exceptional circumstances?

3 Is there anything in the proposals that is unclear? If so, please explain.

5.3 Exposures to third party banks

5.3.1 Exposures to third party banks would comprise cash, certificates of deposit, floating rate notes, commercial paper and off balance sheets items. *Not new in practice but not well articulated in current guidelines.*

5.3.2 No exposures greater than 100% of the reporting bank's net capital base would normally be permitted. The amount of exposure as a % of net capital base would be limited according to the lowest rating of the counterparty as follows: *New.*

Basic limits:

Standard & Poor's	Fitch	Moody's	Maximum % of net capital base
AAA to AA-	AAA to AA-	Aaa to Aa3	100%
A+ to A-	A+ to A-	A1 to A3	75%
BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	50%
BB+ and below Including unrated	BB+ and below including unrated	Ba1 and below including unrated	25%

However, the Commission recognises that exceptionally an aggregate exposure to a third party bank may exceed the expected limit where, for example, the bank finds itself in receipt of an unexpectedly large deposit and needs to use one or more existing counterparties to lay this off. The Commission therefore proposes an additional flexible limit that would allow banks to manage exceptional excesses to the base limit provided that these excesses are on a short-term basis (i.e. no more than 30 calendar days). The above table is replicated below with the proposed flexible limits: *New.*

Flexible limits for managing short term excesses:

Standard & Poor's	Fitch	Moody's	Maximum % of net capital – basic limits	Maximum % of net capital base - 30 day flexible limits
AAA to AA-	AAA to AA-	Aaa to Aa3	100%	120% (+20%)
A+ to A-	A+ to A-	A1 to A3	75%	90% (+15%)

Standard & Poor's	**Fitch**	**Moody's**	**Maximum % of net capital – basic limits**	**Maximum % of net capital base - 30 day flexible limits**
BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	50%	60% (+ 10%)
BB+ and below including unrated	BB+ and below including unrated	Ba1 and below including unrated	25%	N/A (no flexibility)

5.3.3 For the avoidance of doubt, the fact that there is a 25% limit on exposures to third party banks with ratings of BB+/Ba1 and below should not be interpreted as an indication that the Commission is tacitly giving approval for banks to enter into exposures up to 25% of net capital base at any credit rating below BB+/Ba1. The Commission expects a Board of Directors to set and maintain a prudent credit policy, particularly in respect of exposures to counterparties rated as non-investment grade or below, or counterparties that are not rated. *Not new but needs to be articulated as a result of the new credit-ratings driven approach*.

5.3.4 Longer term (i.e. more than 30 days) exceptions to the 100% cap may be permitted, where there is a very strong business case that is discussed in advance with the Commission. A bank with a very small net capital base, i.e. conceptually a start-up bank, is one example of a situation where it may not be realistic to insist that no money market placement exceeds 100% of net capital base. At present this scenario is hypothetical – there are currently no very small subsidiary banks. The Commission will deal with exception requests on a case by case basis in order to develop remedial solutions. *New.*

5.3.5 The counterparty ratings would apply when the exposure is entered into. If the credit rating subsequently falls during the term of the exposure, the Commission would expect the bank to take action to reduce or remove the exposure at maturity/rollover, if not before. *Not new but not well articulated in current guidelines.*

5.3.6 There would be no requirement to notify the Commission before entering into a large exposure with a third party bank. However, the prudential reporting forms will be enhanced to allow the Commission to collect data on the counterparty, type of exposure, amount and maturity of the exposure, and the net capital equivalent. See section 6 for details. *New.*

5.3.7 The aggregate exposure to third party banks would not be included in the 800% limit for aggregate exposures entered into by the reporting bank. *Not new in practice but not well articulated in current guidelines.*

Collateralised exposures to third party banks:

5.3.8 The Commission has considered whether collateralised exposures to third party banks, such as holdings of covered bonds, and repo/reverse repo/tri-party repo programmes, should be reported as large exposures.

In these cases, the ultimate look-through is to the underlying securities. The Commission has concluded that it would be arduous to expect banks to dissect portfolios of securities in order to report on exposures to a particular line of underlying securities that exceed 10% of net capital base. *Not new in practice but not well articulated in current guidelines.*

5.3.9 Therefore, the expectation of the Commission is that a bank would discuss any proposed holdings of covered bonds, any repurchase or reverse repurchase transactions or any other collateralised exposures with the Commission before entering into such an exposure. The transactions can then be monitored by the Commission as a prudential matter rather than a purely large exposure issue.

The Commission would expect banks entering into a repo or reverse repo transaction to determine the concentration risk and monitor this on an ongoing basis. *Not new in practice but not well articulated in current guidelines.*

Questions for respondents:

4 Are there any other forms of uncollateralised exposure that you think should be included in third party bank exposures?

5 What difficulties would be caused, if any, by imposing the basic limits on uncollateralised exposures to third party banks?

6 If you envisage difficulties with the proposed ratings-driven approach, what credible alternative solution(s) would you propose to solve them?

7 Do you believe that the proposed flexible limits for managing short term excesses of the basic limits are reasonable? If not, what would you propose?

8 What practical difficulties are there, if any, in being able to provide the Commission with details, via the BSL/2 forms, of uncollateralised exposures to third party banks that equate to 10% or more of net capital?

9 Is there anything in the proposals that is unclear? If so please provide examples.

5.4 Exposures to sovereigns

5.4.1 "Sovereigns" includes sovereign governments, central banks, rated supranational authorities (e.g. the World Bank or the European Bank for Reconstruction and Development) and those local authorities which have their own credit rating. It also includes those government agencies that have an unconditional guarantee from a sovereign government (e.g. GNMA or "Ginnie Mae"). *Not new in practice but not well articulated in current guidelines.*

5.4.2 The Commission may also be willing to consider as sovereign exposures some exposures to sovereign government sponsored enterprises that are not subject to an unconditional guarantee (e.g. FHLMC or "Freddie Mac" and FMNA or "Fannie Mae"). The Commission would expect to discuss these on a case by case basis with the relevant bank, prior to the bank entering into an exposure of any amount. *Not new in practice but not articulated in current guidelines.*

5.4.3 Exposures to sovereigns may be either direct or through the purchase of debt. *Not new in practice but not well articulated in current guidelines.*

5.4.4 The extent of exposures to local domestic sovereigns (i.e. Guernsey, Jersey and the IoM) would be unlimited, provided that the exposure was in GBP. This is standard international practice. *Not new in practice but not articulated in current guidelines.*

5.4.5 The extent of the exposures to all other sovereigns would be determined by ratings which would have to be at least investment grade. The concept of Zone A and Zone B governments will be replaced with High Income OECD countries ("HI-OECD") as defined by the World Bank and countries outside this grouping ("Other countries"). *New.*

Lowest rating: S&P's / Fitch / Moody's	**HI – OECD countries: maximum % of net capital**	**Other countries: maximum % of net capital**	
		Local currency	**Non-local currency**
AAA / Aaa	1000%	1000%	500%
AA- / Aa3	500%	500%	200%
A- / A3	200%	200%	150%
BBB - / Baa3	100%	100%	50%
BB+ / Baa1 and below including unrated	25%		

5.4.6 For the avoidance of doubt, the fact that there is a 25% limit on exposures to sovereigns with ratings of BB+/Baa1 and below should not be interpreted as an indication that the Commission is tacitly giving approval for banks to enter into exposures up to 25% of net capital base at any credit rating which is BB+/Baa1 or below. The Commission expects a Board of Directors to set and maintain a prudent credit policy, particularly in respect of exposures to counterparties rated as non-investment grade or below, or counterparties that are not rated. *Not new but needs to be articulated as a result of the new credit-ratings driven approach.*

5.4.7 There would be no requirement to notify the Commission before entering into a large exposure with a sovereign. However, the prudential reporting forms will be enhanced to allow the Commission to monitor (after the event) the counterparty, type of exposure, amount and maturity of the exposure, and the net capital equivalent. See section 6 for details. *New.*

5.4.8 The aggregate exposure for sovereigns would not be included in the 800% limit for aggregate exposures entered into by the reporting bank. *Not new in practice but not well articulated in current guidelines.*

Questions for respondents:

10 Are there any other forms of exposure that you think should be included in exposures to sovereigns?

11 If you envisage difficulties with the proposed ratings-driven approach, what credible alternative solution(s) would you propose to solve them?

12 Do you envisage any measurement difficulty in being able to provide the Commission with details of exposures to sovereigns via the BSL/2?

13 Is there anything in the proposals that is unclear? If so please provide examples.

5.5 Exposures to clients

5.5.1 Exposures to clients or groups of connected clients exceeding 25% of net capital base will continue to be subject to prior notification to the Commission. *Not new.*

5.5.2 Exposures to clients or groups of connected clients should not exceed 25% of net capital base unless:

- the portion of the exposure above the 25% limit was secured by cash, by HI-OECD government securities, or a combination of both; or *New.*
- the portion of the exposure above the 25% limit was secured by a parental guarantee, (which would in itself need to be included in any upstreaming limit) and for which a legal opinion on the enforceability of the guarantee must be provided. *New.*

5.5.3 The Commission will consider exposures to clients or groups of connected clients in excess of 25% of net capital base where the exposure is subject to a sub-participation agreement such that the residual exposure of the Guernsey bank does not exceed 25% of net capital base. *New.*

There are various meanings of "sub-participation" but in the context of client large exposures, the Commission would regard a sub-participation agreement as being one in which the credit risk above 25% of net capital base is removed from the balance sheet of the Guernsey bank and there is no possibility of the credit risk returning to the balance sheet of the bank. A legal opinion would need to be provided to the Commission in this respect. Any agreement which leaves credit risk in excess of 25% of capital on the balance sheet of the Guernsey bank, or leaves in any doubt the possibility of the credit risk returning to the balance sheet, would not be eligible for consideration. *New definition.*

5.5.4 The Commission recognises that occasionally, a loan exceeding 25% of net capital base may be booked in the Guernsey to benefit the group as a whole, but that such an exposure may not be collateralised in the ways set out above. On those occasions, the Commission would consider making an exception to the proposed 25% limit but it would clearly want to discuss the circumstances with the relevant licensee to understand the case for booking the exposure with the Guernsey bank. The

Commission would also want to see documentary evidence of the parent group's commitment to the transaction, including any arrangements for sharing the risk. *Not new in practice but given the significant change to the limit and types of acceptable collateral, the pragmatic approach suggests that there should be an exceptions policy for (i) the business of lending to, for example, funds and (ii) an exceptional exposure to a private client of significant importance to the group as a whole.*

5.5.5 Exposures to clients (i.e. single obligors) or groups of connected clients should not exceed 100% of net capital base. *Not new in practice but not well articulated in current guidelines.*

5.5.6 The Commission proposes that more detail should be added to the definition of what constitutes "connected clients". The substantive definition would remain broadly unchanged as "*A group of connected clients means (a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly has control over the other or others; and (b) two or more natural or legal persons between whom there is no relationship of control as set out in (a) but who are to be regarded as constituting a single risk because they are so interconnected that if one of them were to experience funding or repayment problems, the other or all of the others would be likely to encounter funding or repayment difficulties*". *Slight rewording as per CEBS recommended definition.*

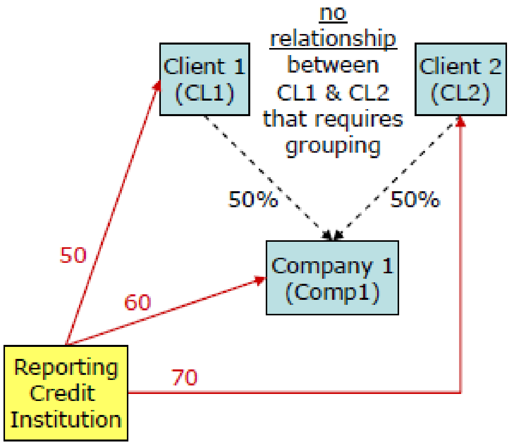
However, the Commission proposes to add examples to each of the categories in the above definition as follows:

5.5.7 Interpretation of "control" re (a) in the above definition: *New.*

Control means the relationship between a parent undertaking and a subsidiary, or a similar relationship between any natural/legal person and an undertaking. Examples of control relationships include where one party has the following powers over the other:

- Power to direct the activities of the undertaking so as to obtain benefits from its activities;
- Power to decide on crucial transactions;
- Power to govern the financial or operating policies of the undertaking;
- Power to appoint or remove the majority of directors, the supervisory board, members of the board of directors or equivalent governing body of the undertaking, where control is exercised by that board or body;
- Power to cast the majority of votes at meetings of boards of directors, general assembly or other governing body of the undertaking, where control is exercised by that board or body; and
- Power to co-ordinate the management of an undertaking with that of other undertakings in pursuit of a common objective; i.e. where the same natural persons are involved in the management or board of two or more undertakings.

5.5.8 In calculating the exposure to a group of connected clients the Commission proposes that the entire exposure to a connected client must be included in the calculation. The exposure should not be limited to, nor proportional to, the formal percentage of ownership. See example in the diagram: *New.*



In circumstances where a bank has a loan to a company and a loan to a beneficial owner of that company, the following grouping of connected clients (GCC) applies:

GCC.1 → CL1 + Comp1 = 110

GCC.2 → CL2 + Comp1 = 130

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

5.5.10 Interpretation of economic "interconnectedness" re (b) in the above definition: *New.*

If it is likely that the financial problems of one client would cause difficulties for the others in terms of full and timely repayment of liabilities, there exists a single risk. Examples of possible economic interconnectedness between clients include:

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

5.5.11 The above are examples of economic dependencies that a client may not be able to overcome without experiencing repayment difficulties. However, if a bank can evidence that the client would be able to experience such a situation without facing substantial, viability threatening repayment difficulties, then there is no requirement to consider such clients to be interconnected. *New.*

Questions for respondents:

14 Are these proposals pragmatic enough to address typical client exposures likely to be generated by your banking group? If not, what credible alternative solution(s) would you propose in respect of limits and types of acceptable security?

15 How would the proposed limits on client exposures impact on your business? Please provide examples to support any comments.

16 In what circumstances do you think that there should be an exceptions policy to the 25% limit?

17 Does the Commission's "definition" of a sub-participation agreement, particularly in respect of removing the risk from the balance sheet, accord with your own understanding of the concept? If not, please explain what your understanding is and how the text might be tightened to remove any ambiguity.

18 Do you envisage any practical difficulties in applying the enhanced definition of connected clients? If so, please provide examples to illustrate your comments.

19 Is there anything in the proposals that is unclear? If so please provide examples.

6 Proposed Reporting Regime

There is currently a distinction between large exposures of 10% or more that are routinely reportable through the BSL/2 prudential returns, and large exposures greater than 25% of capital that, in addition to being captured on the quarterly returns, also require prior notification to the Commission.

The Commission is not proposing to alter this broad distinction, but in view of the fact that exemptions to the current large exposure regime would disappear under the new regime, exposures in excess of 25% to other banks and sovereigns would become notifiable in advance. This seems to the Commission to be onerous on all parties and the following treatment is therefore proposed:

6.1 For exposures to parent/group banks, the Commission proposes to deal with the aggregate exposure (whether it is over 25% or not) through the annual agreement of an upstreaming limit, which will be expressed as a % of net capital base. It is proposed that banks use an application form "*Application for Upstreaming Limit*" (see Appendix 1 for an example of the form and guidance on completion). Once the limit has been agreed, prior notification to the Commission of exposures to parent/group banks will not be required, provided that they are within the limit. The BSL/2 forms will be amended to capture all exposures to parent/group banks regardless of size (see Appendix 3 for an example of the proposed BSL/2 form). *New.*

6.2 Exposures greater than 25% of net capital base to third party banks and sovereigns would not need to be notified to the Commission in advance of entering into the exposure. The BSL/2 forms would be enhanced to capture all exposures equal to 10% or more of net capital base (see Appendices 4 & 5 respectively for examples of the proposed BSL/2 forms). *These exposures were previously exempt, but the reporting requirements are new.*

6.3 Exposures to clients or groups of connected clients that are greater than 25% of net capital base would continue to be subject to prior notification. The Commission proposes that a pro forma would need to be completed and submitted to the Commission prior to entering into the exposure, in order to ensure that all banks provide the same range and quality of information (see Appendix 2 for an example of the form and guidance on completion). The BSL/2 forms would continue to capture all client exposures equal to 10% or more of net capital base (see Appendix 6 for the BSL/2 form for clients, which remains unchanged). *Notification not new in practice but the pro forma approach is new.*

6.4 If the exposure is to a PEP, or the bank considers the exposure to be high risk for any reason (which may include not only credit risk but other risks such as reputation risk), then the Commission proposes that a copy of the credit proposal and evidence of consideration of the risk(s) and evidence of sign-off should accompany the pro forma (See Appendix 2). *New.*

6.5 Administratively the Commission would propose to identify client exposures over 25% of net capital base with a unique number, but it would change the format and give each bank its own prefix followed by a unique number, which would be sequential. For example new exposures for ABC Bank would cease to be allocated a large exposure number in the current "LE123" format and would instead have numbers allocated in a ABC LE 01, ABC LE 02, etc. format. *New format for numbering.*

6.6 Further increases in large exposures to clients or groups of connected clients that already exceed 25% of net capital base would continue to be reportable to the Commission prior to entering into the change. *Not new in practice but not well articulated in the current guidelines.*

6.7 In respect of the routine reporting of client exposures equal to or more than 10%, the BSL/2 forms currently require the top ten largest exposures to be reported or, if there are more than ten exposures of this size, then all should be reported. In view of the expected recommendations from the Basel Committee on Banking Supervision which is reviewing certain aspects of large exposure reporting at present, the Commission proposes to increase the routine reporting of client exposures equal to or more than 10% to the top twenty largest exposures or, if there are more than twenty exposures equal to or greater than 10% of capital base, then all should be reported. *New.*

6.8 For branches, the Commission proposes to roll out the same set of BSL/2 forms as for subsidiaries. However, it proposes that each exposure is expressed in terms of the % of parental capital that it represents. Parental capital base would be regarded for these reporting purposes as the parent bank's most recently published capital base. The forms for branches would therefore ask for all exposures greater or equal to 10% of parental capital to third party banks, sovereigns and parent/group banks, and the top twenty client exposures (or all exposures equal to or more than 10% of parental capital, if there are more than twenty). In respect of Appendices 4-6, the Commission would propose that column 8 of the forms for branches should read "exposure as a % of parental capital base". *New.*

The rationale for this proposal is that from a supervisory perspective, it would be helpful for the Commission to know whether there is a significant credit concentration risk in a branch in Guernsey that may impact on a head office elsewhere.

Questions for respondents:

20 What measurement difficulties, if any, are there in providing details on the BSL/2 forms of exposures to group banks, to third party banks, and to sovereigns that equate to 10% or more of net capital base?

21 What difficulties, if any, are there in providing details via the BSL/2 forms of the top twenty, rather than the top ten, largest exposures? Branches and subsidiaries are invited to respond to this question.

22 Do you think that there is a better way of tracking large exposures than the proposed changes to the large exposure (LE) number system? If so please provide details.

23 **The Basel Committee on Banking Supervision is currently considering whether the definition of a large exposure should be refined such that any exposure equal to or above 5% of capital would be captured. Whilst the Commission does not intend to adopt this definition as part of the current review of the large exposures regime in Guernsey, it may become a future requirement. What difficulties are there, if any, in adopting the approach that any exposure equal to or above 5% of capital constitutes a large exposure?**

24 **Is there anything in the proposals that is unclear? If so please provide examples.**

25 **Do you foresee any difficulties in using the forms displayed in Appendices 1-6? If so, what changes would you suggest?**

7 Reporting of breaches

Any breach in large exposure limits must be reported to the Commission immediately the bank becomes aware. Large exposure limits in this context relate to agreed upstreaming limits, limits on exposures to third party banks and sovereigns as set out in the credit ratings tables in this paper, and large exposures to clients or connected groups of clients subject to pre-notification to the Commission. The Commission's experience is that breaches of limits are rare, short-term in nature and are often related to fund or securities settlements. *Not new, but not well articulated in the current guidelines.*

7.1 Breaches of upstreaming limits and limits on exposures to sovereigns and clients

7.1.1 The Commission proposes that where a breach of upstreaming limits, limits on exposures to sovereigns, or limits on exposures to clients or connected groups of clients has occurred, a staged approach should be adopted based on the length of time taken by the reporting bank to regularise the position. *New.*

7.1.2 The proposed approach is as follows: *New.*

- Regularisation of the position within 5 working days – no effect on capital.
- Regularisation of the position after 5 working days but within 45 calendar days – the Commission would have discretion, depending on the nature and extent of the limit breach, to continue with the "no effect on capital" approach, or to take supervisory action in cases where it appears to it that arrangements for the protection of the institution's capital base should be made, or to require that half of the excess (i.e. the amount by which the exposure exceeds the approved limit) be deducted from net capital for all regulatory purposes until such time as the position is regularised.
- Regularisation of the position after 45 calendar days – the Commission would require the full amount of the excess (i.e. the amount by which the exposure exceeds the approved limit) to be deducted from net capital for all regulatory purposes until such time as the position is regularised. The Commission may also take supervisory action, if it has not done so prior to this point, in cases where it appears to it that arrangements for the protection of the institution's capital base should be made.

7.1.3 This proposed approach recognises that Guernsey subsidiary banks have meaningful cushions of capital and the measures outlined above in respect of deducting limit excesses from capital would not normally be expected to breach minimum regulatory capital requirements. On the exceptional occasions where the minimum regulatory capital requirement may be at risk, the Commission will take appropriate action which may include, for example, a requirement that the bank obtains additional capital, or that it transfers the exposure to another lender. *New staged approach and the published intention to deduct excesses from regulatory capital is new, but action to protect the capital base has always been available to the Commission.*

7.2 Breaches of limits on third party bank exposures

7.2.1 For exposures to third party banks, exceptional short-term (i.e. 30 day) excesses of the basic limits are already built into the proposals. The Commission proposes therefore that a breach in this context should be reportable immediately the bank becomes aware that (i) it has exceeded the flexible limit at any time and for any duration, or (ii) it has stayed within the flexible limit but has not been able to regularise the position within 30 calendar days. The Commission proposes that these instances would be dealt with on a case by case basis, but that the Commission may take supervisory action in cases where it appears to it that arrangements for the protection of the institution's capital base should be made. *New approach to coincide with new flexible limit approach to third party bank exposures.*

Questions for respondents:

26 What difficulties or unintended consequences, if any, are there in the Commission's proposed approaches to handling breaches of large exposure limits for (i) upstreaming, exposures to sovereigns and exposures to clients and, (ii) limits for exposures to third party banks?

27 Is there anything in the proposals that is unclear? If so please provide examples.

8 Grandfathering in of the new regime

It is proposed that the new regime would come into force from 1 January 2014. However, large exposures equal to more than 25% of net capital base existing at this time would be grandfathered in; i.e. there would be no requirement to amend these on 1 January 2014 to conform to the requirements of the new regime and these exposures would be permitted to run their course. Grandfathered large exposures will either be single exposures in excess of 25% of net capital base, or they will be multiple exposures to a counterparty or group of connected counterparties which in aggregate exceed 25% of the net capital base.

The Commission does need to make some proposals in respect of the treatment of these grandfathered exposures in the event of a material change to an exposure after the new regime comes into force.

The principal proposals are as follows:

8.1 Grandfathering of single exposures in excess of 25% of net capital base

8.1.1 Provided that there are no changes to the contractual terms (e.g. term, mix of collateral, identity of borrowers, purpose of loan, etc.) of a single grandfathered exposure in excess of 25% of the net capital base, then the exposure should be permitted to run its course. However, any change to the contractual terms after 1 January 2014, or a rolling over of the exposure when it reaches maturity, should be viewed as a new large exposure which must conform to the requirements of the new regime.

8.1.2 An increase to a single grandfathered exposure in excess of 25% of the net capital base that takes place after 1 January 2014 would be treated such that the additional collateral necessary to cover the increase would need to conform to the requirements of the new regime.

Example. A bank has a grandfathered large exposure to a client equivalent to 30% of net capital base and secured solely by property. It receives a request, after 1 January 2014 to increase the exposure to a level equivalent to 40% of net capital base. The collateral for the entirety of the increase would have to be in cash, HI-OECD securities or a parental guarantee (subject to agreed upstreaming limits).

Example. A bank has a grandfathered large exposure to a client equivalent to 30% of net capital base and secured by property to the value of 10% of net capital base and cash to the value of 20% of net capital base. It receives a request, after 1 January 2014 to increase the exposure to a level equivalent to 40% of net capital base. In this case the collateral for the entirety of the increase does not necessarily have to be in cash, HI-OECD securities or a parental guarantee (subject to agreed upstreaming limits). Only the proportion above 25% of net capital base has to conform (in this case 15%) and the bank is already holding cash in excess of this amount.

8.2 Grandfathering of multiple exposures where the aggregate is in excess of 25% of net capital base

8.2.1 Banks may occasionally have multiple exposures to the same client or group of clients, none of which in themselves are in excess of 25% of net capital base but which, when taken in aggregate, exceed 25%. In this case, the Commission would be looking to ensure that as changes to exposures in this group occur, or new exposures are added, the overall collateral will change over time to conform to the new requirements; i.e. as new exposures are added or existing exposures change, the overall collateral mix of the aggregate exposures will alter such that cash, HI-OECD securities or a parental guarantee will form the collateral for that part of the aggregate exposure in excess of 25% of net capital base.

Example. A bank has fifteen exposures to a client, none of which in themselves equate to 10% or more of net capital base, but which when aggregated produce a total exposure to the client which equates to 50% of net capital base. These fifteen exposures are secured by a mix of collateral but cash, HI-OECD securities or a parental guarantee form only a small part of that collateral mix – equivalent to 8% of net capital base.

The Commission's expectation is that as the portfolio changes, the overall collateral mix will change such that collateral which is not cash, HI-OECD securities or a parental guarantee equates to no more than 25% of net capital base. In order to achieve this, the Commission proposed that after 1 January 2014 any new exposures to the client, any increases in existing exposures, and any renewals of existing exposures are secured only by cash, HI-OECD securities or a parental guarantee, until such time as cash, HI-OECD securities or a parental guarantee will form the collateral for that part of the aggregate exposure in excess of 25% of net capital base.

8.2.2 A new exposure entered into after 1 January 2014 that is not in itself in excess of 25% of net capital but that when added to existing exposures for a client brings the aggregate exposure to that client to in excess of 25%, would be treated such that collateral for that part of the new exposure above 25% would need to conform to the requirements of the new regime.

Example: A bank receives a request after 1 January 2014 to enter into a new exposure, equivalent to 7% of net capital, in respect of a client who already has several small exposures secured by property and a portfolio of shares, the aggregate of which is 20% of capital. The collateral for the portion of the new aggregate exposure over 25% (in this case, 2%) would have to be cash, HI-OECD securities or a parental guarantee (subject to agreed upstreaming limits).

8.3 Grandfathering scenarios

8.3.1 Using the above principal proposals, the Commission has considered some sample scenarios as follows:

- Example 1: How will the grandfathering process manage the consolidation after 1 January 2014 of existing loans where the consolidated exposure is in excess of 25% of net capital but the security does not conform to the new regime?
- *A: The portion above 25% will need to be secured by cash/HI-OECD securities/parental guarantee).*
- Example 2: How will the grandfathering process treat existing property development loans in excess of 25% of capital where the exposure may increase further in order to maximise the value of the asset used to secure the loan?
- *A: Provided that there are no changes to the contractual terms of the exposure after 1 January 2014, then the loan should be permitted to run its course. However, any change to the contractual terms, or a rolling over of the loan when it reaches maturity, should be viewed as a new exposure which must conform to the requirements of the regime.*
- Example 3: For market loans previously exempt, how would the Commission impose the limits of the new regime on loans which are habitually rolled over at maturity?
- *A: Once the regime comes into force, the limits must be applied at the next rollover date. For next day loans, the limits should apply from day 1 of the regime.*

Questions for respondents:

28 Is grandfathering a reasonable approach or should the new regime be rolled out from day one?

29 What difficulties or unintended consequences, if any, are there in applying the principal proposals in this section? If so please explain, giving examples to illustrate your comments.

30 Are there any other types of scenario that the Commission has not mentioned in this section where you foresee the need for defined treatment under the grandfathering arrangements? If so, please provide details and suggested treatment.

31 Is there anything in the proposals that is unclear? If so please provide examples.

Appendix 1 – application for upstreaming limit pro forma and guidance

Guernsey Financial
Services Commission

Application for upstreaming limit

Part A

Bank name		**Date of application**	
Parent or group bank name(s) and location(s)			
Rating(s) of parent/group bank(s)			
Counterparty, amount and maturity of placements			
Counterparty, amount, type and maturity of debt instruments			
Exposure(s) under a participation agreement where the counterparty is sharing the Guernsey bank's risk			
Exposure(s) under a participation agreement where the Guernsey bank is sharing the counterparty's risk			
Counterparty, amount and term of any guarantees			
Counterparty, amount, type and expiry of off balance-sheet exposures			
Total amount of upstreaming in GBP			

for each counterparty			
Net capital base in GBP		**% of capital aggregate upstreaming to parent/group banks represents**	
Details of any pending exposures to this parent/group bank			

Part B

For information purposes only, please give details below of any collateralised exposures to parent or group banks; i.e. reverse repo agreements, holdings of covered bonds, etc.

These will not be included in the upstreaming limit.

Counterparty, amount, type and maturity/expiry of any collateralised exposures	

Managing Director/CEO sign off

Form completed by (block capitals please):	
Name	Position
Signature	Date

Guidance on completing the "Application for upstreaming limit" form

Part A

Exposures to non-bank Group entities should also be included on this form if the exposure is to the entity itself and there is no look-through to underlying assets.

Bank name	Name of Guernsey bank	**Date of application**	Date form submitted to Commission
Parent or group bank name(s) and location(s)	Please give the full name and location of each group counterparty that the Guernsey bank will be exposed to over the next 12 months.		
Rating(s) of parent/group bank(s)	Please give the name of the agency and the lowest rating for each counterparty listed in the previous section. Please state if any of the counterparties are unrated.		
Counterparty, amount and maturity date of placements	Self-explanatory.		
Counterparty, amount, type and maturity date of debt instruments	Self-explanatory.		
Exposure(s) under a participation agreement where the counterparty is sharing the Guernsey bank's risk	This relates to exposures subject to a participation agreement with a parent or group bank such that the credit risk remains on the Guernsey bank balance sheet, but the parent/group bank undertakes to share the risk in the event of client default or provides funding for the drawdown. Please give details of each exposure subject to such an agreement, to include counterparty, amount and term of the exposure and a brief explanation of the nature of the exposure.		
Exposure(s) under a participation agreement where the Guernsey bank is sharing the counterparty's risk	This relates to exposures subject to a participation agreement with a parent or group bank such that the credit risk remains on the counterparty's balance sheet, but the Guernsey bank undertakes to share the risk in the event of client default or provides funding for the drawdown. Please give details of each exposure subject to such an agreement, to include counterparty, amount and term of the exposure and a brief explanation of the nature of the exposure.		
Counterparty, amount and term of any guarantees	For exposures subject to a guarantee from a parent or group bank (e.g. the credit risk remains on the Guernsey bank balance sheet, but the parent/group bank has provided a guarantee in respect of the exposure) please give the required details for each exposure subject to such a guarantee.		
Counterparty, amount, type and expiry of off balance-sheet exposures	In respect of the amount, please give details of both the nominal amount and the credit equivalent amount.		

Total amount of upstreaming in GBP for each counterparty	Please list each counterparty and the total amount of upstreaming to that counterparty.		
Net capital base in GBP	Unless the capital has changed in the meantime, please give the net capital of the bank as reported in the most recent BSL/2 prudential report.	**% of capital aggregate upstreaming to parent/group banks represents**	Please state the % of net capital that the aggregate of the exposures detailed in this form represent.
Details of any pending exposures to this parent/group bank	Please provide details of the counterparty, amount, type and maturity of any known pending exposures to parent or group banks not included on this form.		

Part B

For information only.

Sign off

The form should be submitted to the Commission by the Managing Director/Chief Executive Officer of the bank.

Appendix 2 – new client large exposure pro forma and guidance

Guernsey Financial Services Commission

Notification of an exposure to a client in excess of 25% of capital

Part A – new exposure

Bank name		**Date of notification**	
Client name			
Amount of new facility (GBP)		**Amount of new facility (currency)**	
Type of facility			
Term of facility		**Date of anticipated drawdown**	
Collateral			
Purpose of facility			
Net capital base in GBP		**% of capital this facility represents**	

If this client/group of connected clients already has existing aggregate exposures in excess of 25% of capital or if, as a result of this new facility, this client/group will have aggregate exposures in excess of 25% of capital, please also complete Part B below:

Part B – other exposures

Details of existing exposures to this customer			
Aggregate value of all exposures to this customer, including the new facility		**% of capital this aggregate exposure represents**	
Connected party details			

Part C – risk assessment

Please identify the highest level at which this exposure has been sanctioned (e.g. individual lending officer, Guernsey Credit Committee, Group Credit Committee, Group Risk Committee, etc.)		
	✓	
Please tick if the client is a PEP		*If either box is ticked please attach a copy of the credit proposal, evidence of consideration of the risks and evidence of sanctioning of the exposure*
Please tick if the exposure is considered to be high risk		

Sign off

Form completed by (block capitals please):	
Name	Position
Signature	Date

Guidance notes for completion

The fields in the "**Notification of an exposure to a client in excess of 25% of capital**" form are free form. Please give as much detail as possible. If the facility is particularly complex, please provide extra information as an appendix.

Part A – new exposure

Bank name	Self explanatory
Date of notification	The date on which the bank is notifying the Commission of its intention to enter into a large exposure.
Client name	The name of the client counterparty.
Amount of new facility	The maximum amount that may be drawn under the new facility. Please note that if the exposure is in a currency other than GBP, both the GBP and currency boxes should be completed. If the loan is to be made available in tranches, please provide details.
Type of facility	E.g. mortgage, overdraft, temporary loan, etc.
Term of facility	Please state the term of the facility and the maturity date for the exposure. If the facility is a rolling facility or a revolving credit facility, please give details.
Date of anticipated drawdown	The earliest date on which the client is expected to draw down some or all of the facility.
Collateral	Please give the type and value of the collateral, its currency and its location. *E.g. Cash to the value of GBP 1,500,000 held in custody by the bank.* *E.g. US Treasury Bills to the value of USD500,000 pledged to the bank under a security interest agreement, and cash to the value of USD 250,000 held in custody by the bank.* *E.g. Parental guarantee to the value of GBP 5,000,000.* If the collateral is encumbered in any way, please also provide details. For parental guarantees, a copy of a legal opinion on the enforceability of the guarantee must be provided to the Commission with this pro forma. If there is a sub-participation agreement in place that meets the Commission's definition of such an agreement, please provide a copy of the agreement with this pro forma.
Purpose of facility	Please provide as much detail as possible on the purpose of the facility.
Net capital base in GBP	Unless the capital has changed in the meantime, please give the net capital base of the bank as reported at the most recent BSL/2 quarterly prudential report.

% of capital this new facility represents.	Please state the % of net capital that this new facility represents.

Part B – other exposures

If there are multiple exposures that are already held in a separate spreadsheet, please feel to supply a copy of this sheet rather than completing this section.

<table>
<tr><td>Details of existing exposures to this client</td><td>Please use this section to provide details of all other exposures to this client. Please ensure that the following are included:
LE number (if applicable)
Amount of facility
Term of facility
Collateral held
Purpose of facility</td></tr>
<tr><td>Aggregate value of all exposures to this client, including the new facility</td><td>Please provide the aggregate value of all exposures to this client, to include all existing exposures, however small, and the new facility which is the subject of this notification.</td></tr>
<tr><td>% of capital this aggregate exposure represents</td><td>Please state the % of net capital that this aggregate exposure, including the new facility, represents.</td></tr>
<tr><td>Connected party details</td><td>If this client is connected to other parties to which the bank already has an exposure, please provide details of (i) the parties, (ii) the nature of the connection and (iii) the exposure(s) to those clients, including the amount, term, and type of the exposure(s) and the associated collateral.</td></tr>
</table>

Part C – risk assessment

<table>
<tr><td colspan="3">Please identify the highest level at which this exposure has been sanctioned (e.g. individual lending officer, Guernsey Credit Committee, Group Credit Committee, Group Risk Committee, Group Chief Risk Officer, etc.)

Self explanatory.</td></tr>
<tr><td></td><td>✓</td><td></td></tr>
<tr><td>Please tick if the client is a PEP</td><td></td><td rowspan="2">If either box is ticked please attach a copy of the credit proposal, evidence of consideration of the risks and evidence of sanctioning of the exposure at the level indicated in the previous box.</td></tr>
<tr><td>Please tick if the exposure is considered to be high risk</td><td></td></tr>
</table>

Sign off

Details of the person submitting the pro forma to the Commission.

Appendix 3 – proposed BSL/2 sheet for upstreaming

MODULE 8

UPSTREAMING - PARENT AND GROUP BANKS

All exposures, regardless of their % of capital should be listed below. Where there are multiple single exposures to the same counterparty please list each exposure on a separate line, but group them together on the sheet.

1 NAME AND LOCATION OF COUNTERPARTY	2 LOWEST RATING OF COUNTERPARTY (please preface by S, F or M)	3 NATURE OF EXPOSURE (e.g. money market placement, CD, FRN, interest rate contract, etc)	4 NOMINAL AMOUNT	5 CREDIT EQUIVALENT AMOUNT (off balance sheet exposures only)	6 MATURITY (Please tick box if rolled-over at last renewal date)	7 AMOUNT OF PROVISION MADE	8 EXPOSURE AS PER CENTAGE OF CAPITAL BASE *	9 CHANGE FROM PREVIOUS QUARTER
Parent bank, London	M - Aa3	Money market placement	150,000		Call		300.0	
Parent bank, London	M - Aa3	Interest rate contract	27,000	656	30/06/2017		50.4	
Parent bank, London	M - Aa3	Parent guarantee re LE123	10,000		31/03/2016		20.0	
Sister bank, Geneva	M - A1	Certificate of deposit	7,500		31/12/2013		12.5	
Sister bank, Geneva	M -A1	FX contract	30,700	1,942	30/09/2018		3.9	
TOTAL UPSTREAMING							386.8	

* will be automatically calculated for subsidiary undertakings

Appendix 4 – proposed BSL/2 sheet for exposures to third party banks

MODULE 8

LARGE EXPOSURES - THIRD PARTY BANKS

All single exposures over 10% of capital should be listed below. Where there are multiple exposures to a particular counterparty, please report each exposure on a separate line, but group them together.

1 NAME AND LOCATION OF COUNTERPARTY	2 LOWEST RATING OF COUNTERPARTY (please preface by S, F or M)	3 NATURE OF EXPOSURE (e.g. money market placement, guarantee, FX contract, CD, FRN, etc)	4 NOMINAL AMOUNT	5 CREDIT EQUIVALENT AMOUNT (off balance sheet exposures only)	6 MATURITY (Please tick box if rolled-over at last renewal date)	7 AMOUNT OF PROVISION MADE	8 EXPOSURE AS PER CENTAGE OF CAPITAL BASE*	9 CHANGE FROM PREVIOUS QUARTER
ABC Bank, Geneva	M - A1	CD	5,000		03/01/2015		10.0	
DEF Bank, London	F - A+	Market loan	20,000		Call		40.0	
GHI Bank, Frankfurt	S - A	Market loan	35,000		31/03/2013		70.0	

* will be automatically calculated for subsidiary undertakings

Appendix 5 – proposed BSL/2 sheet for exposures to sovereigns

MODULE 8

LARGE EXPOSURES - SOVEREIGNS

All single exposures over 10% of capital should be listed below. Where there are multiple exposures to a particular counterparty, please report each exposure on a separate line, but group them together.

1 NAME AND LOCATION OF COUNTERPARTY	2 LOWEST RATING OF COUNTERPARTY (please preface by S, F or M)	3 NATURE OF EXPOSURE (e.g. loan, guarantee, government backed securities, etc)	4 NOMINAL AMOUNT	5 CREDIT EQUIVALENT AMOUNT (off balance sheet exposures only)	6 MATURITY (Please tick box if rolled-over at last renewal date)	7 AMOUNT OF PROVISION MADE	8 EXPOSURE AS PER CENTAGE OF CAPITAL BASE*	9 CHANGE FROM PREVIOUS QUARTER
States of Guernsey, St Peter Port	Unrated	Guarantee	5,000	5,000	31/12/2018		10.0	
UK Government, London	M - Aa1	4% Treasury Gilt 2016	30,000		07/09/2016		60.0	

* **will be automatically calculated for subsidiary undertakings**

Appendix 6 – BSL/2 sheet for client exposures

MODULE 8
LARGE EXPOSURES - CLIENTS **£000's**

(1) If there are more than twenty loans each over 10% of capital base they should all be shown.
(2) Do not include loans under £50,000.

1 CUSTOMER (Please give Commission "LE" reference where applicable)	2 STATE IF PARTY CONNECTED TO THE BANK	3 AMOUNT OF FACILITY	4 AMOUNT OF FACILITY TAKEN UP	5 MATURITY (Please tick box if rolled-over at last renewal date)	6 AMOUNT OF PROVISION MADE (capital or interest)	7 NATURE OF SECURITY	8 FACILITY AS PER CENTAGE OF CAPITAL BASE *	9 CHANGE FROM PREVIOUS QUARTER
LE101	No	7,000	7,000	21/03/2018	n/a	CASH & US T BILLS	32.5	0
LE123	No	6,136	6,037	30/09/2013	n/a	CASH	28.5	-323
LE456	No	5,200	4,000	05/05/2014	n/a	PROPERTY	24.1	-45
LE789	No	5,136	5,136	30/04/2013	n/a	CASH	23.8	-1,500
Customer A	No	4,850	4,850	Various	n/a	PARENTAL GUARANTEE	22.5	0
Customer B	No	4,650	4,522	31/01/2018	n/a	POLICIES/PROPERTY	21.6	-128
Customer C	No	4,575	2,000	30/06/2014	n/a	PORTFOLIO	21.2	0
Customer D	No	3,503	3,503	03/12/2016	n/a	PROPERTY	16.2	-3
Customer E	Yes	3,500	3,500	Various	n/a	PORTFOLIO	16.2	0
Customer F	No	3,444	3,444	26/11/2014	n/a	PROPERTY	16.0	-71
Customer G	No	3,250	3,250	12/07/2013	n/a	CASH/PROPERTY	15.1	-1
Customer H	No	2,974	2,976	31/03/2017	n/a	PROPERTY	13.8	-9
Customer I	No	2,150	2,150	Various	n/a	PROPERTY	10.0	0
							0.0	0
							0.0	
							0.0	
							0.0	
							0.0	
							0.0	
							0.0	
							0.0	
							0.0	

* will be automatically calculated for subsidiary undertakings