



**Jersey Financial
Services Commission**

Banking Business

Themed Examination Programme 2014/15: Governance

Summary findings

Issued: April 2016

› Glossary of Terms

The following table sets out a glossary of terms used in this report.

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| “AML/CFT Handbook” | the Commission’s Handbook for the prevention and detection of Money Laundering and the Financing of Terrorism |
| “Banking Codes” | the codes of practice for deposit-taking business |
| “the Commission” | the Jersey Financial Services Commission |
| “ICAAP” | internal capital adequacy assessment process |
| “NED(s)” | non-executive directors |
| “PPI” | payment protection insurance |

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1 Executive summary

1.1 Introduction

1.1.1 This report provides an overview of the findings from the Commission's Governance themed on-site examinations which were conducted by the Banking division during 2014-15.

1.1.2 The Commission's observations in this report are drawn from its examination findings of eight subsidiary banks ("bank(s)") as well as responses to a self-assessment questionnaire that was sent to each of the banks that were examined.

1.2 Observations worthy of note

1.2.1 Overall, the Commission found that the banks examined were generally satisfactory in respect of meeting the regulatory requirements in relation to Governance. This view is endorsed by the fact that there were no high rated findings identified by the Commission from the on-site examinations undertaken.

1.2.2 That said, the examination programme highlighted some areas where improvements could be made and these fell into the following categories:

- › Local board or board committee approval of policies and sign-off from internal stakeholders;
- › Recording board members' conflicts of interest;
- › Selection and ongoing vetting of executive directors and NEDs;
- › Review of board effectiveness;
- › Risk management strategy and statements; and
- › Management information reported to the board.

1.3 Conclusion

1.3.1 The Commission would encourage all banking entities to consider the findings in this report in the context of their own business, including those that represent branch operations in Jersey.

1.3.2 The Commission has issued individual examination reports with relevant recommendations to those banks that were examined.

1.4 Objectives and limitations

1.4.1 The Commission regularly undertakes on-site examinations on specific themes to assess the extent to which regulated entities are operating in accordance with their obligations under the respective Laws, Orders, Codes of Practice, Guidance Notes and international standards.

1.4.2 These examinations focussed on governance in banks and looked to identify areas in the business where the entity itself may be at risk or where standards and practices required by the regulatory regime were not being fully observed.

1.4.3 The Commission's examination activities are designed to:

- 1.4.3.1 Assess the risks faced by the entity and review the controls, procedures, policies and processes in place to mitigate those risks;

1.4.3.2 Obtain a greater understanding of the entity's activities, thereby enabling the Commission to focus attention on higher risk areas; and

1.4.3.3 Take into account existing relevant information, review the resolution of any previous examination issues and to obtain assurance on any deficiencies highlighted through off-site supervision.

1.4.4 This review did not cover all aspects of Governance and the Commission's observations set out in this report should not be treated as examples of formal regulatory guidance.

1.5 Methodology

1.5.1 This examination programme was undertaken by way of a self-assessment questionnaire and a series of on-site examinations.

1.5.2 A self-assessment questionnaire was provided to the banks selected for this on-site examination, which consisted of 22 questions covering the following areas:

- › Structure of the board;
- › Performance assessment process of executive directors and NEDs;
- › Selection process for executive directors and NEDs;
- › Assessment process in relation to the composition and performance of the board;
- › Succession planning for executive directors and senior management;
- › Board meeting format – agenda and board packs;
- › Establishment process in relation to sub-committees that assist the board;
- › Corporate values and code of conduct;
- › Whistle blowing;
- › Conflicts of interest;
- › Employee compensation and incentive schemes;
- › Risk appetite statement and risk management strategy;
- › Board review of the entity's ICAAP;
- › Board oversight of customer complaints;
- › Breaches register;
- › Internal Audit oversight of the risk management function; and
- › New product approval/product modification.

1.5.3 The information provided to the Commission by the banks examined consisted of written policies, procedures and processes maintained by those banks examined in relation to governance and these were considered against, amongst other things, board packs, terms of reference, job descriptions and the entity's ICAAP. Where appropriate, interviews were held with NEDs.

1.6 Regulatory requirements

1.6.1 The Commission considered the arrangements in place against the requirements of the risk management standards established by the Basel Committee on Banking Supervision's publication "Principles for enhancing corporate governance", issued in October 2010, the Commission's AML/CFT Handbook and section three of the Banking Codes, which states that:

"A registered person must organise and control its affairs effectively for the proper performance of its business activities and be able to demonstrate the existence of adequate risk management systems."

1.6.2 Section three of the Banking Codes establishes the Commission's requirements in relation to:

- › Corporate governance;
- › Internal systems and controls;
- › Internal Audit;
- › Compliance function, Compliance Officer, Money Laundering Reporting Officer and Money Laundering Compliance Officer;
- › Record keeping and reporting;
- › Customer complaints;
- › Integrity and competence;
- › Continuing professional development; and
- › Risk Management.

2 The Commission's prime observations from its examination findings

2.1 Local board or board committee approval of policies and sign-off from internal stakeholders

2.1.1 The Commission noted that local board or board committee approval in relation to certain policies had not been obtained.

2.1.2 These instances arose when Group policies had been adopted by the local bank. The Commission found that this oversight featured, particularly, in respect of new products / product modification, whistle blowing and staff compensation and incentive policies.

2.1.3 **New product/product modification policy** – whilst such policies had been approved by the board or board committee for adoption by the bank, not all relevant internal stakeholders, including Risk, had signed off the policy in accordance with paragraph 3.9.9 of the Banking Codes. It is extremely important that local statutory and regulatory requirements feature in an entity's policies when Group policies are adopted by the board or a board committee of a local bank.

2.1.4 In the absence of relevant stakeholder approvals, risks such as liquidity, money laundering and the financing of terrorism, capital adequacy or profitability, may not have been fully considered. It is therefore important to identify any such possible risks as part of the policy implementation process.

2.1.5 **Whistle blowing policies** – there were some instances where Group policies had been formally adopted by local banks, but this was inappropriate as the Group policies required local policies and procedures to be established.

- 2.1.6 From other on-site examinations previously undertaken by the Commission, similar instances have occurred where banks had not established local policies and procedures in accordance with Group requirements. The prime reason for such Group instructions is to ensure that local statutory and regulatory requirements are reflected in the local bank's policy.
- 2.1.7 **Staff compensation and incentive policies** – staff compensation and incentive systems can contribute positively to a bank's performance but increase risk-taking; related heightened risks need to be carefully considered when determining compensation practices. In recent times, examples of such risks being inadequately managed have been seen in the sale of PPI and interest rate hedging products.
- 2.1.8 It is important, therefore, for banks to have a suitably approved policy which establishes an appropriate system reflecting local circumstances, procedures and processes for staff compensation practices, which also evidences an appropriate culture, strong governance and adequate risk management oversight.

2.2 Board members' conflicts of interest

- 2.2.1 Board members' conflicts of interest need to be recorded in the board meeting minutes when relevant, which is standard governance practice. If a board member is conflicted on a particular matter, they should be precluded from voting or being counted in a quorum and this should also be recorded in the board meeting minutes.

2.3 Selection and ongoing vetting policies and procedures for executive directors and NEDs

- 2.3.1 Selection policies and procedures for executive directors and NEDs should be formally documented and approved by the board.
- 2.3.2 Executive directors and NEDs should be vetted as part of the recruitment process to ensure that they are fit and proper for their roles and have financial probity. Appropriate re-vetting should also be undertaken on a regular basis to ensure that standards are maintained and any relevant issues can be identified and suitably addressed. Documentary evidence of the vetting undertaken by a bank should be retained.

2.4 Review of board effectiveness

- 2.4.1 The Basel Committee on Banking Supervision's publication "*Principles for enhancing corporate governance*", issued in October 2010, refers to the need for both individual board members and the board collectively to have appropriate experience, competencies and personal qualities, including professionalism and personal integrity.
- 2.4.2 In order to be effective, the board collectively should have adequate knowledge and experience relevant to each of the financial activities undertaken by the bank. The board collectively should also have a reasonable understanding of economic and market forces that may impact the bank and of the legal and regulatory environment in which it operates.
- 2.4.3 Banks should have an assessment system in place which ensures that the board has members with the appropriate qualifications, skills, knowledge and experience for it to provide effective governance.

2.4.4 Individual board members' performance during the period should be assessed in terms of their sound and objective judgement of the affairs of the bank and their overall contribution to effective governance. Training needs should be considered where knowledge gaps are identified in the assessment process.

2.5 Risk management strategy and statements

2.5.1 There were a few cases where a risk management strategy had not been established by the bank, despite it being an internal Group requirement. The Commission also noted that, in some circumstances, risk appetite statements only related to AML/CFT risks.

2.5.2 It is a regulatory requirement that a bank board establish an overall risk management strategy for all significant risks faced by the bank, which should outline how risks are identified, assessed, controlled and monitored. This strategy should include a risk appetite statement.

2.6 Management information reported to the board

2.6.1 The provision of relevant management information to a board is essential for good governance and risk management oversight. The Commission noted a need to improve management information provided to some boards in relation to customer complaints.

2.6.2 The provision of customer complaint data is a very useful business management tool for a board. Analysis of the number and nature of complaints received and compensation paid can assist the board to identify any emerging trends that may require further consideration and appropriate action taken.

3 Acknowledgements and further reading

3.1.1 The Commission wishes to thank those banks that participated in this themed examination programme for their co-operation and assistance.

3.1.2 Persons wishing to gain a further insight into this topic may wish to view the following publications:

- › The Banking Codes last revised on 1 July 2014, <http://www.jerseyfsc.org/pdf/Banking-Codes-1-July-2014.pdf>;
- › The Basel Committee on Banking Supervision's paper "Principles for enhancing corporate governance" dated October 2010, <http://www.bis.org/publ/bcbs168.pdf>; and
- › The Commission's Handbook for the Prevention and Detection of Money Laundering and the Financing of Terrorism, http://www.jerseyfsc.org/anti-money_laundering/Regulated_financial_services_businesses/aml_cft_handbook.asp.

3.1.3 The Commission would welcome comments on any of the contents of this report and would also be happy to address any concerns or questions that the reader may have in this respect. Any such communications should be addressed to the relevant Supervision Manager.

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