Jersey Financial Services Commission

Appendix J: Changes to the Banking Code

Consultation Paper No. 3 2017

Basel III: Liquidity Management

[Draft] Proposed amendments to Sections 5 and 6, Appendix II and the Schedule in the Banking Code

Issued: 26 April 2017

Contents

1 Overview

1.1 Introduction

1.1.1 This document outlines draft *Banking Code* amendments affecting the Introduction, Sections 5 and 6 of the *Banking Code* and the Schedule.

1.1.2 For each change the proposal is outlined in full, providing the existing and new text, and a short rationale is provided.

1.1.3 Where relevant, the consultation paper versions of the relevant documents are referenced here, using [highlighted text], which would be removed in the final version.

1.1.4 The current Banking Code text uses the abbreviation "Jersey Bank" to refer to a *JIB*. Herein the term *JIB* is used (and highlighted where this is different to the existing text) in order to preserve uniformity with the rest of the consultation.

2 Changes to the Introduction

2.1 Revision of the Banking Code

2.1.1 In the part of the Introduction headed "Revision of the Banking Code", it is proposed to replace:

2.1.1.1 *"In accordance with Article 19A(1)(b) of the Banking Law and Article 19(1)(b) of the FS(J)L, the Commission may, after consultation with such persons or bodies as appear to be representative of the interests concerned, revise the Banking Code by revoking, varying, amending or adding to its provisions.*

2.1.1.2 *In December 2015 the Commission published Consultation Paper No. 12, proposing a number of amendments to the Banking Code and, in May 2016, published a feedback paper summarising respondents' comments and the Commission's responses.*

2.1.1.3 *Rather than detail the amendments here, the Commission has published a version of the Banking Code that highlights the amendments applied."*

With:

2.1.1.4 *"In accordance with Article 19A(1)(b) of the Banking Law and Article 19(1)(b) of the FS(J)L, the Commission may, after consultation with such persons or bodies as appear to be representative of the interests concerned, revise the Banking Code by revoking, varying, amending or adding to its provisions.*

2.1.1.5 *Two Consultation papers were issued that are reflected herein:*

- *In July 2015 the Commission published Consultation Paper No. 8 2017, and, in March 2016, published a feedback paper summarising respondents' comments and the Commission's responses.*
- *In April 2017 the Commission published Consultation Paper No. [X] 2017, and, in [month], published a feedback paper summarising respondents' comments and the Commission's responses.*

2.1.1.6 *Sections 5 and 6, Appendix II and the Schedule have subsequently been amended to reflect the new requirements relating to (1) capital adequacy, (2) liquidity management and reporting, (3) Large Exposures and (4) prudential reporting.*

2.1.1.7 *Full details of the proposed changes were set out in Appendix J of Consultation Paper No X 2017.* [This document]

2.1.1.8 *Only the changes to prudential reporting impact on OIBs; all other changes only impact on JIBs."*

2.2 Effective Date

2.2.1 In the part of the Introduction headed “Effective Date”, it is proposed to replace:

2.2.1.1 “*This revised Banking Code is effective from 1 September 2016 for all registered persons*”

With:

2.2.1.2 “*This revised Banking Code is effective from 31 December 2018 for all registered persons*”

3 Changes to Section 5

3.1 Heading

3.1.1 It is proposed to amend the heading from:

3.1.1.1 *"A registered person must maintain, and be able to demonstrate the existence of, adequate capital resources."*

3.1.2 To:

3.1.2.1 *"A registered person must maintain, and be able to demonstrate the existence of, adequate financial resources."*

3.2 Initial Note 2

3.2.1 It is proposed to remove the second initial Note:

3.2.1.1 "See "Guidance regarding the completion of the "AT1 and total Tier 1 capital" prudential reporting module" for appropriate calculations and definitions."

3.2.2 With

3.2.2.1 "See "Guidance regarding the completion of the relevant prudential reporting modules for appropriate calculations and definitions." [Appendices to Consultation Paper No. 8 2015]

3.3 Minimum capital requirement

3.3.1 It is proposed to add a Note stating:

3.3.1.1 "See "Guidance regarding the completion of the relevant prudential reporting module" for appropriate calculations and definitions." [Appendices to Consultation Paper No. 8 2015]

3.4 Risk Asset Ratio (RAR)

3.4.1 It is proposed to rename this subsection "5.2 Adequacy of capital and liquidity ratios".

3.4.2 It is proposed to replace the existing paragraph 5.2.1 with the following four paragraphs (subsequent paragraphs will be renumbered):

3.4.2.1 "A JIB must maintain a level of capital commensurate with the nature and scale of its business and full risk profile.

3.4.2.2 Notwithstanding this, a JIB's capital ratios must be maintained at all times, at or above:

- *Core Equity Tier 1 ratio: 8.5% of risk weighted assets;*
- *Tier 1 ratio: 8.5% of risk weighted assets; and*

› *Total capital ratio: 10% of risk weighted assets,*

Or such other ratio as agreed with the Commission and established by application of a registration condition in accordance with Article 11 of the Banking Law.

3.4.2.3 *A JIB must manage its liquidity position commensurate with the nature and scale of its business and full risk profile.*

3.4.2.4 Notwithstanding this, the JIB must monitor its LCR ratio at all times unless the JFSC has agreed to vary this code and instead required that the LMR should be monitored."

3.4.3 It is proposed to replace the existing paragraph 5.2.2 with the following paragraph:

*3.4.3.1 "A JIB must maintain adequate procedures and controls to assess and manage its capital adequacy and liquidity on an on-going basis. In particular, a JIB must create and maintain an Internal Capital and liquidity Adequacy Assessment Process (**ICAAP**) document. Whenever the board approves amendments the JFSC must be provided with a revised copy within five business days. Maintenance of the ICAAP should include both:*

› *An annual review; and*

› *A review carried out where there is a material change in the JIB's risk profile."*

3.4.4 The use of the term ICAAP has been retained, despite the extension to include liquidity, because it is not otherwise intended to change requirements regarding the ICAAP – the only change should be the mandated full inclusion from 2019 of consideration of liquidity risk.

3.4.5 It is proposed to replace the existing paragraph 5.2.3 and 5.2.4 with the following paragraphs:

3.4.5.1 *"The three capital ratios - (1) Core Equity Tier 1 ratio, (2) Tier 1 capital ratio and (3) Total capital ratio - and the liquidity ratio - (4) LCR or LMR, as applicable - must be calculated in accordance with the JFSC's prudential reporting instructions (**see Schedule**), except where otherwise agreed by the JFSC*.

3.4.5.2 Each of the four ratios must be calculated on a solo basis unless the JIB has a material banking subsidiary, when each ratio should be calculated, unless otherwise agreed by the JFSC, as the lower of the relevant:

› *Ratio calculated on a solo basis; or*

› *Ratio calculated on a solo-consolidated basis (consolidating banking subsidiaries only)."*

3.4.6 It is proposed to replace the existing paragraph 5.2.5 with the following paragraphs:

3.4.6.1 "The three capital ratios must be calculated using the methodologies agreed by the JFSC for credit, operational and market risk. Changes to the methodology, including use of advanced approaches, require prior written notification to, and approval by, the JFSC. The JIB's ICAAP document should confirm the methodology used in respect of each of these risks, within the relevant section.

3.4.6.2 The liquidity ratio must be calculated using the adjustment factors agreed with the JFSC. Changes to the adjustment factors require prior written notification to, and approval by, the JFSC. The JIB's ICAAP document should confirm the adjustment factors used in respect of each item within the section on liquidity risk."

3.4.7 The Notes that follow sub-section 5.2 will be amended to reflect the new paragraph numbering, with references to the RAR replaced by references to all three capital ratios.

4 Changes to Section 6

4.1 Changes regarding notification

4.1.1 It is proposed to replace the existing paragraph 6.13 with the following paragraph

4.1.1.1 "A JIB must notify the JFSC in writing, within a reasonable time of becoming aware of, or having resolved to undertake, any of the following events:

- *Any instrument or transaction entered into, or situation arising, that might give a misleading impression of capital adequacy;*
- *A breach of any minimum established in respect of any capital ratio (Core Equity Tier 1 capital ratio, Tier 1 capital ratio or Total capital ratio);*
- *Any capital ratio falling below any agreed buffer level; or*
- *Its LMR or LMR, as applicable, falling below 100% or any other level agreed."*

5 Changes to Appendix II

5.1 Changes regarding Large Exposures

5.1.1 To implement the proposals set out in CP No.8 2015, it is proposed to replace the existing paragraph 1.1 and 1.2 of Appendix II with the following paragraph

5.1.1.1 *"At a prudential reporting date, the ACR will equate to the JIB's Tier 1 Capital, calculated in accordance with prudential reporting guidance.*

5.1.1.2 In between prudential reporting dates, the ACR equates to the JIB's Tier 1 Capital, as calculated at the latest prudential reporting date, after adjusting for any:

- *Direct impact of exchange rates on capital since the latest prudential return date;*
- *Increase in year-to-date losses incurred;*
- *Repayment of Tier 1 capital;*
- *Payment of dividends;*
- *profits made, but only providing auditor certification has been received by the JIB in this respect and provided to the JFSC or, in the case of the year-end, where the accounts have been submitted to the JFSC; and*
- *New Tier 1 capital raised, providing the Commission has been notified of the details."*

6 Changes to the Schedule

6.1 Overview of changes to prudential reporting requirements

6.1.1 The changes required in the Schedule will depend, to an extent, on the final form of the prudential reporting system. The below is intended to provide material details of the changes, the final form of which will be provided to all banks at least six months prior to implementation.

6.1.2 For *OIBs*, it is intended that the new reports specified will replace the Branch Liquidity Module.

6.1.3 For JIBs, it is intended that each report specified in this consultation and the reporting specified in Consultation Paper No. 8 2015 will be additional modules and that the existing liquidity module will be removed and elements of the core module will be removed. One possibility is that the Consultation Paper No. 8 2015 reports would form a new "Capital Adequacy" Module and those set out in this consultation would form a new "Liquidity Module" but it is also possible that each would form a separate module.

6.1.4 This would entail the reporting of the leverage ratio and the NSFR, as well as the new capital ratios and LCR/LMR.

6.1.5 There is no intention at this time to amend other requirements relating to the prudential return set out in the Schedule in respect of any matter relating to this consultation.