



TURKS & CAICOS ISLANDS FINANCIAL SERVICES COMMISSION

Statement on Consolidated Supervision and the FSC's Role as a Host Supervisor

INTRODUCTION

1. Financial groups and conglomerates have become increasingly commonplace in both developed and emerging markets, owing to factors of globalization, technological advancement, evolutions in risk management capabilities and the drive of competitive forces. Banks can derive benefit from situation within a wider group, but such participation also increases their vulnerability to contagion and reputational risks. For this reason, additional supervisory scrutiny is needed over the management, funding and control arrangements of financial groups containing licensed banks to identify and respond to imprudent intra-group transactions and exposures; conflicts of interest; instances of regulatory arbitrage; and other problems that may adversely affect banks.
2. The Basel Committee on Banking Supervision (BCBS) has underscored the need for scrutiny over financial group structures and arrangements in establishing a requirement for supervisory authorities to conduct consolidated supervision, where appropriate, as a complement to supervision of banks' solo operations and as such, has included minimum requirements for supervisors on consolidated supervision among its 29 Core Principles for Effective Banking Supervision¹.
3. Consolidated supervision involves evaluation of the overall condition of the group within which a banking licensee is situated, in order to assess the potential impact that parents, subsidiaries and other related entities, can have on the bank. The aim of such supervision is not to regulate every entity in the group but rather to provide bank supervisors line of sight to activities and relationships within financial groups which may prove harmful to banks.
4. Consolidated supervision typically requires assessment of both quantitative and qualitative factors – in the case of the former, this involves assessment of prudential returns consolidated using approved accounting methods to determine, among other things, aggregate exposure levels and adequacy of capital, earnings, funding and liquidity for all relevant financial entities in the group including the parent, subsidiaries, associates and other entities in which there is a significant participation stake. Qualitative consolidated supervision, in contrast, focuses on the adequacy and appropriateness of corporate structures; risk management; board and management oversight; internal controls, among other things.

¹ Refer Appendix I – Core Principle 12: Consolidated Supervision

THE FSC'S ROLE AS A HOST SUPERVISOR

5. Consolidated reporting is required in all instances where a bank licensee is parent to other entities, and should include all relevant financial companies within a group. (Insurance subsidiaries should however be excluded from this reporting.)
6. Where group consolidation is required, the Commission will prescribe allowable methods and criteria for accounting consolidation for reporting purposes and seek to apply group-wide consolidated capital adequacy and other prudential requirements.
7. Additionally, the Commission, as host supervisor to the several branches and subsidiaries of international banks licensed in the Islands, reserves right of access to an array of financial information relating to its bank licensees, sufficient to facilitate proper oversight of all the material risks to which they are exposed. For this reason, it may also require submission of financial information for other entities within the group, including but not limited to audited and interim financial statements and supporting reports.
8. The Commission may also require provision of qualitative, non-financial information as it considers necessary to assess the strength of the group and its constituent entities, including details relating to the structure of the group and its inherent risks; details to support assessment of the fitness and propriety of significant shareholders, directors and senior managers; corporate governance practices; internal controls; risk management practices; and the adequacy and security of information systems. This, as the Commission requires whatever information that may be necessary to allow it to supervise effectively.
9. As a general rule, the Commission expects that policies, systems and processes implemented across the group will mirror in rigour those standards that the Commission requires the banking licensee to maintain.
10. The Commission will pay special regard to those entities within a consolidated group which it considers to pose significant risk to its bank licensee(s), especially where these entities are either unregulated or whose regulatory regime materially differs from the Commission's. Where the Commission has concerns regarding the risks within an entity in a consolidated group, it will likely seek to ring-fence the bank licensee to limit the exposure or require that additional capital be set aside at the group level.
11. The Commission firmly endorses the four main principles put forward by the Basel Committee in its *Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments* (1992), namely that:
 - (i) *All international banks should be supervised by a home country authority that capably performs consolidated supervision and has the right to prohibit corporate structures which impede supervision.*
 - (ii) *The creation of a cross-border banking establishment should receive the prior consent of both the host country and the home country authority.*
 - (iii) *Home country authorities should possess the right to gather information from their cross-border banking establishments.*
 - (iv) *If the host country's authority determines that any of these three standards is not being met, it could impose restrictive measures or prohibit the establishment of banking offices.*

12. In satisfaction of these principles and of the Basel Core Principle on Home-Host Relationships², the Commission has put arrangements in place with relevant home supervisory authorities to allow for the sharing of information pertinent to licensing and cross-border supervision, on a confidential basis and to the extent allowable under the law. To this effect, the Commission is signatory to memoranda of understanding with a number of regional and international supervisory authorities and participates in supervisory colleges convened to review operations of regional banking groups, particularly where local branch or subsidiary operations are significant within the Islands or to the overall group.

13. Further, the Commission has committed to working alongside and consulting with peer supervisory authorities who serve as home supervisors to its licensees to the extent allowable under the law, to ensure that financial group structures are supervisable.

² Refer Appendix II – Core Principle 13: Home-Host Relationships

Appendix I

Basel Core Principle 12: Consolidated Supervision

An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.

Essential criteria

1. The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardise the safety and soundness of the bank and the banking system.
2. The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
3. The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
4. The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.

5. The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.
6. The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:
 - (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;
 - (b) the supervision by other supervisors is not adequate relative to the risks the activities represent; and/or
 - (c) the exercise of effective supervision on a consolidated basis is hindered.
7. In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.

Additional criterion

1. For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.

Appendix II

Basel Core Principle 13: Home-host relationships

Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.

Essential criteria

1. The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
2. Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risk and risk management practices of the banking group and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
3. Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
4. The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
5. Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.

6. Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
7. The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
8. The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
9. The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
10. A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.