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DRAFT GUIDELINES FOR:

CONSOLIDATED SUPERVISION OF NON-DEPOSIT–TAKING FINANCIAL INSTITUTIONS IN JAMAICA

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1.0 INTRODUCTION

1.1 This paper[1] identifies the regulatory responsibilities of a parent company, holding company as well as other members of a group containing an entity regulated by the Financial Services Commission (FSC) under the group-wide supervision framework (GSF) or consolidated supervision framework (CSF) to be executed by the FSC in conjunction with other supervisors. The paper outlines these responsibilities under the headings that comprise the key elements for an effective consolidated supervision. These key elements are as follows:

a. Supervisory powers and authority
b. Capital adequacy and liquidity
c. Contagion and group exposures / Related parties
d. Corporate governance
e. Risk management
f. Access to group –wide Information including prudential data

1.2 The FSC regards these key elements and the supervisory processes listed in this paper as minimum requirements for the groups. While the paper outlines the consolidated supervision approach to be executed by the FSC, the FSC may, in conjunction with other financial supervisors of the group members, effect other supervisory actions which are not listed here but are permitted by legislation.

2.0 BACKGROUND

2. 1 Financial groups [2] provide a wide range of financial services and non-financial services in different sectors and geographical locations. Due to (i) their economic reach, (ii) the wide range of services that they offer, and (iii) their complex structure; groups may not only exacerbate financial problems in the supervised companies but also present significant challenges for sector-specific supervisory oversight.

2.2 Due to the liquidity and solvency problems faced by the Jamaican financial sector in the mid-1990s, the Government of Jamaica (GOJ) intervened in ten (10) financial companies that were members of financial groups. Some of the groups employed a maze of related party transactions to fund their operations as well as projects. They also had complex ownership structures that had myriad of corporate governance issues.

2.3 The collapse of CLICO [3] in 2009 was caused by problems that were similar to those that led to the Jamaican crisis. It is also widely accepted that the 2008 global financial crisis revealed that the applicable regulatory

[1] This guideline has drawn extensively from the Joint Forum's ***Principles for the Supervision of Financial Conglomerates*** published in 2012.

[2] See definition of financial groups in section 3.1c

[3] Colonial Life Insurance Company (CLICO) was a member of the CL Financial Group headquartered in Trinidad with companies in the finance, real estate, energy, manufacturing, agriculture, forestry, services and communications sectors.

framework ignored downside risks that the activities of financial groups posed to individual firms, the financial system and the global and local economies.

2.4 To rectify these regulatory deficiencies, the Joint Forum, comprising of representatives from the Basel Committee on Banking Supervision, the International Organization of Securities Commission (IOSCO) and the International Association of Insurance Supervisors (IAIS), issued standards on consolidated supervision in 2012.

2.5 Consolidated supervision can be defined as a comprehensive approach to the supervision of a financial institution (FI) to (i) identify, assess and understand the non-financial and financial risks (on- and off –balance sheet) within the whole group and the possible threats that they may pose to a regulated FI; and (ii) to address any deficiencies in management, operations, capital, liquidity and intra-group exposure within an entity in the group before they pose a threat to the entire group and the wider financial market. [4]

2.6 Consolidated supervision allows financial sector supervisors to understand the relationships among the entities within the group and to assess and monitor how effectively the group identifies, measures, monitors and controls risks. Therefore, it assists financial regulators in maintaining the soundness of the financial institutions and the overall stability of the financial system.

3.0 DEFINITIONS USED IN THE GUIDELINES

3.1 For the purposes of this paper, the following will apply:

a. “Control” in relation to a company, means the exercise of power -

(i) to direct or significantly influence the direction of the management and policies of a person (whether acting alone or jointly with another, who holds or is beneficially entitled to fifty *per centum* or more of the votes in the company) to secure by means of those voting rights that the affairs of the FI or other company are conducted in accordance with the wishes of that person; or

(ii) by a person or company without the consent or concurrence of any other person can appoint or remove the holders of all or a majority of the directorships. [5]

b. “Supervisory College” means a forum for cooperation and communication among supervisors responsible for the supervision of financial institutions in a group to facilitate the effective supervision of a group and the legal entities within the group through the analysis and assessment of, among other things, financial soundness, market conduct, governance practices, risk management and internal controls. [6]

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[4] The definition of consolidated supervision was adapted from the Central Bank of Nigeria’s publication entitled ***Framework for Consolidated Supervision of Financial Institutions in Nigeria***

[5] Adapted from the definition of “control” in the Banking Services Act 2014 (BSA)

[6] Adapted from the IAIS’s definition of supervisory colleges. Another term for supervisory colleges is “College of Supervisors”

c. "Financial Group" means a group of companies, including any financial holding company under common control or significant influence, which conducts financial activities in **at least two** of the regulated financial services - banking, securities, insurance and pensions.[7]

d. "Financial Institution" means a person who undertakes or engages in the financial services regulated by the FSC;

e. "Group" in relation to a company, means a company and-

(i) any other company which is its holding company or subsidiary;
(ii) any other company which is a subsidiary of the holding company;
(iii) any company, special purpose vehicles (entities), trust which directly or indirectly controls or is controlled by any company referred to in paragraph (i) or (ii); and
(iv) any company which is controlled by a person who directly or indirectly controls a company referred to in paragraph (i), (ii) or (iii); [8]

f. "Group-wide Supervisor" or "Lead Supervisor" means the supervisor that is ultimately responsible for ensuring and coordinating the input and actions of the supervisors of entities within the group to facilitate effective and efficient group-wide supervision. The activities of the group-wide supervisor include but are not limited to:

(i) Coordinate and disseminate essential information needed for reviewing and evaluating the group;
(ii) Conduct comprehensive risk assessment of the group. This will include, among other things, capital and liquidity, corporate governance, and market conduct compliance;
(iii) Determine triggers for placing an entity in resolution;
(iv) Provide timely notice of early intervention;
(v) Facilitate the development and implementation of a crisis contingency or resolution plan with the relevant authorities;
(vi) Ensure effective communication among supervisors, relevant government authorities and the public. and
(vii) Coordinate the general administration of a supervisory college or similar mechanism for cooperation; [9]

g. "Holding Company" has the same meaning as in the Companies Act, 2004.

h. "Home Supervisor" means the supervisor from the jurisdiction in which the head of a financial group is incorporated or its head office or principal place of management is located.

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[7] Adapted from the Joint Forum's Principles for the Supervision of Financial Conglomerates

[8] Adapted from the BSA

[9] Adapted from the Joint Forum's Principles for the Supervision of Financial Conglomerates and the IAIS's Guidance Paper on the Use of Supervisory Colleges in Group-Wide Supervision

i. "Host Supervisor" means any supervisor from any jurisdiction, other than the home jurisdiction, in which a company from a financial group has operations.[10]

j. "Related Party" has the same meaning as in the Insurance Regulations 2001,

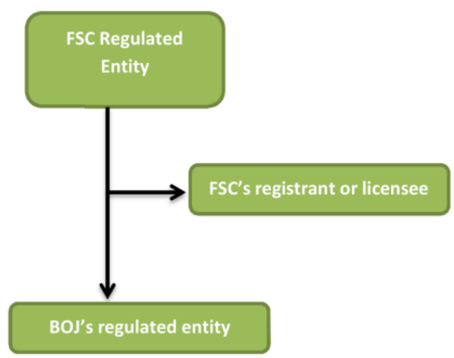
k. "Significant Influence" or "Dominant Influence" means the power to participate in the operating and financial policy decisions of an entity. The significance of the influence is determined by criteria such as direct or (indirect) participation, influence and/or other contractual obligations, interconnectedness, risk exposure, risk concentration, risk transfer and/or intra-group transactions and exposures. [11]

l. "Supervisor" means the Financial Services Commission (FSC), the Bank of Jamaica (BOJ), a foreign financial regulatory authority or any authority that has functions that are similar to the supervisory functions of the Financial Services Commission or the Bank of Jamaica.

4 SCOPE OF APPLICATION

4.1 This section of the paper identifies the group structures to which the FSC's group-wide supervision framework (GSF) or consolidated supervision framework will apply. Figures 1-3 below illustrate the three main types of group structures of a financial group.

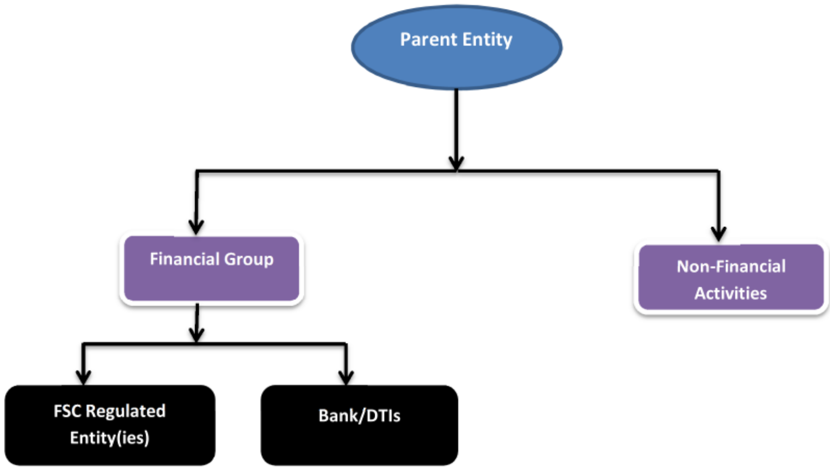
(i) Figure 1 - Downstream Group. This is where a licensee / registrant is the parent company of the group



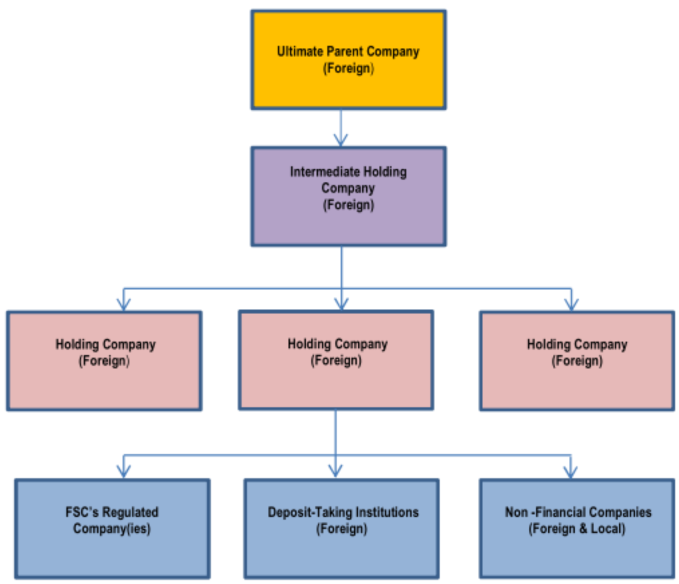
(ii) Figure 2 - A Mixed Activity Group. This is where the licensee is a subsidary of a financial group which is controlled by a parent company which also controls non-financial firms.

[10] Definition for host and home supervisors adapted from IAIS

[11] Adapted from the Central Bank of Nigeria's Draft Framework for the Consolidated Supervision of Banks in Nigeria



(iii) Figure 3 - A Complex Group. This is where the licensee / registrant is a member of a financial group which is controlled by an intermediate holding company.



4.2 The different group structures present varying degrees of risks and complexities. In determining its supervisory coverage of a financial group, the FSC will take the following into consideration:

a. the location of the group management control functions; that is, the parent company or holding company;

b. the wider group of companies such as intermediate, operating and non-operating holding companies to which the licensee belongs;

c. whether the FSC's regulated entity is a subsidiary or an affiliate of a larger group;

d. whether there are members of the wider group that may pose contagion risk (whether financial, reputational or operational) to the FI;

e. the risks arising from the activities of unregulated entities, which are entities within the financial group (or the wider group to which the financial group belongs) that are not directly prudentially regulated; and

f. "The impact of the following elements" on the FI:
   i. direct or indirect participation, influence and other contractual obligations,
   ii. interconnectedness,
   iii. risk exposure,
   iv. risk concentration,
   v. risk transfer, and
   vi. intra-group transactions and exposures,

5.0 SUPERVISORY POWERS AND AUTHORITY

Key Elements:

5.1 The insurance and the securities legislation grant the FSC the necessary powers to receive financial statements and other documents from the parent company of the group as well as from each subsidiary or associated company.

5.2 Since more than one supervisor will be responsible for entities within local and cross–border financial groups, the GSF must involve coordination, cooperation and information sharing with the other supervisors. The FSC and the BOJ already have effective and functioning mechanisms for cooperation and information sharing. In order to enhance its cross-border coordination and collaboration between home and host supervisors, the FSC will, as permitted by the legal framework, establish efficient cooperation procedures that facilitate:

i. Sharing of information (both on-going and ad hoc bases) on financial groups that have operations in other jurisdictions both for routine supervisory purposes and during periods of crisis. The information, for example, will include;

   a. group structure (including legal, financial and operational intragroup dependencies); and

   b. risk analysis assessments and information to facilitate early identification, notification, assessment and mitigation regarding issues that may materially affect the soundness of the group or entity within the group and any other regulatory concerns of another supervisor;

ii. Cooperating and coordinating with supervisors and other relevant authorities in order to effectively manage a cross-border crisis.

5.3 Examples of the mechanisms to enhance cross-border coordination and collaboration include bilateral as well as multilateral memoranda of understanding which could also facilitate the establishment and operation of another mechanism; namely, supervisory colleges. Supervisory colleges serve to promote exchange of information, cooperation and coordination of supervisory activities on a group-wide basis among supervisors of regulated entity and to obtain a comprehensive view of the group's strategy, management, financial position and risks.

5.4 Supervisory colleges aid in reducing duplication of regulatory measures and supervisory burden. As an integral part of its GSF, the FSC will have frequent communication and annual meetings with other supervisors which have responsibility for entities within the group. However, depending on the size, nature, complexity and financial health of a group, the frequency of communication and meeting will intensify. The supervisory colleges meetings also serve as an opportunity for the involved supervisors to have discussions on relevant issues with group's senior executives who, from time to time, are requested to attend the meeting of supervisory colleges. These mechanisms will, at a minimum, facilitate the following:

i. Assigning various roles and delineated responsibilities among the supervisors including the identification of a group-wide supervisor;

ii. Conducting joint on-site inspections and investigation where possible under the laws;

iii. Establishing teams comprising of members with the requisite expertise from the various supervisors to examine specific concerns or issues relating to a group's operations;

iv. Convening discussions among the relevant supervisors and implementing appropriate regulatory actions for addressing material issues of concerns. The material issues, for example, will include:

a. the financial condition and performance of such operations in the various jurisdictions;
b. risk concentrations and intra-group transactions and exposures within the financial group;
c. material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a licensee's or registrant's operations in the host country;
d. adverse or potentially adverse developments in the local operations of an entity or financial group regulated by the home supervisor;
e. adverse assessments of the qualitative aspects of an entity's operations as risk management and controls at the offices in the host country;
f. any material remedial action taken by a supervisor regarding the operations of an entity regulated by the home supervisor; and
g. an assessment of the impact of adverse local, regional and international economic conditions.

v. dealing with a crisis situation including to address concerns or issues related to resolution and recovery.

5.5 The FSC, in conjunction with other relevant supervisors, will, when appropriate, utilize available supervisory tools to compel timely corrective actions and/or enforce compliance of group with the GSF.

Supervisory Process

5.6 The GSF will include both quantitative and qualitative assessments of the group in order to determine the potential impact of other members of the group, including offshore subsidiaries or affiliates, on the operations of the supervised entity**.** Quantitative consolidated supervision involves the assessment of financial reports (both consolidated and non-consolidated), records, statistical returns, prudential returns or other reports (external or internal) to determine the risks, intra-group exposure and the soundness of the group and its members. Qualitative consolidated supervision entails an examination of organizational and management indicators such as the standard of corporate governance and risk management practices within the group.

5.7 In addition to the parent company of a group containing an insurance company submitting audited consolidated financial statements, each subsidiary or associated company within the same group shall submit its audited financial statements. [12] For groups with securities dealers, the parent company or any other entity in the group is required to provide information including audited financial statements, as the FSC may request from time to time. [13]

6. CAPITAL & LIQUIDITY ADEQUACY

Key Elements

6.1 In addition to monitoring the capital and liquidity adequacy of the regulated financial entities, the GSF will involve the monitoring of the capital and liquidity positions of the group in order to ensure that there is an adequate level of the underlying quality resources for loss absorption and that these resources are available to the group and its subsidiaries.

6.2 *Furthermore*, the GSF involves an assessment of a financial group's capital and liquidity management policies and procedures which are ought to be approved and regularly reviewed by the board, and include a clearly and formally documented capital planning process that ensures compliance with the capital requirements for the regulated entities.

Supervisory Processes

6.3 The FSC intends to enact legislation that will require a parent company or the holding company to hold and maintain adequate capital and other financial resources in order to meet the funding needs of either the group or an entity of the group in both normal times and periods of stress.

[12] See section 27 of the Insurance Act 2001
[13] See section 68D of the Securities Act 1993

6.4 The parent company, the holding company or regulated entity will be required to submit the information as requested by the FSC to enable it to make an assessment of the group's capital and liquidity position on an annual basis unless the FSC believes that a more frequent reporting is necessary.

6.5 The parent company, the holding company or the regulated entity of the group will be required to submit information to the FSC, that demonstrates that the group has a comprehensive capital and liquidity management programme that:

i. maintains adequate capital and liquidity to act as a buffer against the risks associated with the group's full range of economic activities;
ii. establishes the risk appetite for the group and the risks arising from all entities (both on- and off – balance sheet) that affect the overall risk profile and financial position of the financial group and the individual entities within the group;
iii. takes into account the availability of capital across entities within the group in its capital planning process and whether there are any regulatory, legal and other impediments to the transfer of capital across entities, sectors and jurisdictions in which the financial group operates;
iv. employs suitable measurement techniques in conducting capital adequacy assessment which address excessive leverage, double or multiple gearing;
v. routinely and adequately identifies, monitors and manages the liquidity risks of the group and each of its subsidiary;
vi. determines quantifiable internal capital and liquidity targets, along with practicable plans for achieving and maintaining these targets under both normal and stressed conditions; and
vii. incorporates forward-looking stress testing which takes into account the current and forecasted business and macroeconomic environment and identifies possible events or changes in market conditions that could adversely impact the group's capital and liquidity position.

6.6 Where there is evidence from the consolidated financial statements that a member of a group containing an insurance company is or is on the verge of becoming insolvent, the FSC, after consultation with the regulated entity, may issue directions to the regulated entity. An example of the directions is that the regulated entity increases its paid-up capital.[14]

7. CONTAGION & GROUP EXPOSURE / RELATED PARTIES

Key Elements

7.1 Intra group exposures, both on and off-balance sheet, which include direct and indirect claims such as credit or line of credits which one member of the group grants to another member, can have liquidity and solvency implications on a group which may lead to undesirable contagion risks.

[14] See section 27 of the Insurance Act 2001

7.2 It is therefore critical that financial groups have management policies and systems in place that can monitor and furnish information on risks including double gearing, contagion risk, concentration risk, conflicts of interest and intra-group exposures to its Board and the FSC.

Supervisory Processes:

7.3 The regulated entity will be required to establish criteria and policy for the identification, review, approval and monitoring of all related party transactions to ensure that they are appropriate and in the best interest of investors and other stakeholders.

7.4 The regulated entity will be required to provide information on any transaction between itself and any other member of the group which was not conducted at fair value. [15]

7.5 The parent company, the holding company and the regulated entity will be required to demonstrate that the group monitors large exposures and related party transactions by furnishing the information as requested by the FSC. The regulated entity must comply with the FSC's prudential limits and directions regarding large exposures as well as aggregate amounts.

7.6 For a group containing a securities dealer, the parent company, the holding company or the regulated entity shall furnish the FSC with information as requested by the FSC to enable an assessment of group-wide exposures to individual counter parties. [16]

8. CORPORATE GOVERNANCE

Key Elements:

8.1 A comprehensive and consistent governance framework across the group that promotes sound governance practices for the financial group, including unregulated entities, without prejudice to the governance of individual entities in the group is critical to the soundness and continuity of the group and its entities.

Supervisory Processes

8.2 For a group containing a securities dealer, the FSC may request, on a periodic basis, information to determine that the group's internal audit mechanism has the capability to scrutinise group transactions.

8.3 The parent company, the holding company or the regulated entity will be required to provide information, as requested, to demonstrate that the financial group has established a comprehensive corporate governance framework that addresses the following:

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[15] Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly and arm's length transaction between market participants at the measurement date.

[16] See section 68D of the Securities Act, 1993

a. fiduciary responsibilities of the boards of directors and senior management of the group;
b. internal control, risk management systems and internal audit and compliance functions for the financial group;
c. the existence and effectiveness of Board Committees such as Audit, Conduct Review, and Risk Management;
d. documentation of responsibilities of the Group's Board of Directors and this should include, at least the following:
   i. setting the strategic direction for the group and approval of a written strategic plan, business plan and an annual budget;
   ii. approving written policies with respect to the group's Investment and Lending Policy, AML/CFT Policy and the group's internal control standards, risk management policies, including the risk appetite, and compliance policies;
   iii. establishing proper alignment between the group's business strategies and those of the individual entities;
   iv. ensuring that the Board's policies and strategy are implemented and executed in the various entities, both regulated and unregulated;
   v. approving all new products and services of the group;
   vi. monitoring and ensuring adherence to the company's policies and continuously monitor the financial results of the group;
   vii. ensuring that appropriate remuneration is set for the management team and that succession planning is mandated for all key positions;
   viii. ensuring that the structure of the financial group is transparent and facilitates effective group-wide supervision; and
   ix. establishing systems and policies to monitor the group and its subsidiaries comply with the relevant laws and market conduct guidelines issued by the FSC.

9. RISK MANAGEMENT

Key Elements:

9.1 Given the downside risks that can arise from the activities of any financial group, it is essential that all financial groups have a comprehensive enterprise risk management programme. Similarly, the financial group should have in place processes and procedures to develop and cultivate a sound group-wide risk management culture.

Supervisory Processes

9.2 The parent company or the holding company will be required to adequately and consistently identify, monitor and manage the risks facing the group and its entities

9.3 The parent company, the holding company or the regulated entity will be required to submit to the FSC information that demonstrates that the group has established an enterprise risk management programme which must be appropriate to the nature, scale, and complexity of its business and risk exposures. The risk management programme must satisfy the following minimum requirements:

a. An independent, comprehensive, effective and robust system of internal controls and, an effective internal audit and compliance system;
b. The application of the risk management programme must be wide-ranging, consistent across entities supervised in all sectors and covers the risk management function, risk management processes and governance, and systems and controls;
c. Appropriate board approved, group-wide risk tolerance levels and a risk appetite policy is in place with effective systems and processes to manage and report group-wide intra-group transactions and exposures, as well as risks arising from off-balance sheet activities, including special purpose entities;
d. A thorough risk assessment, as determined by the Board, shall be conducted on a routine basis and at other times such as when entering into new business areas and, when considering whether to outsource a particular function. The routine risk assessment must include a range of risk management techniques for example group-wide stress tests and assets liability management to determine the group's ability to respond to adverse market and economic conditions;
e. Capabilities to conduct risk-data aggregation that takes into account correlations within their risk portfolios; and
f. Internal audit on major branches or subsidiaries to be conducted, at least annually, and the report of these audits are to be made available to the supervisor.

10. ACCESS TO PRUDENTIAL INFORMATION

Key Elements:

10.1 To assess the risk profile of the financial group, the FSC needs access to information in respect of the parent and the group members of the financial group.

Supervisory Processes

10.2 For a group containing an insurance company, the parent company or the holding company of the financial group shall prepare and submit audited consolidated financial statements annually. [17] For a group containing a securities dealer, the parent company, the holding company or the regulated entity shall provide the FSC with information as requested by the FSC to enable the FSC to determine the effect of the group's operations on the securities dealer. [18]

10.3 Additionally, the regulated entity, parent company or the holding company group will be required to submit supplementary information, as requested.

[17] See section 27 of the Insurance Act 2001
[18] See section 68D of the Securities Act, 1993

APPENDIX I: REFERENCES

LEGISLATIVE REFERENCES:

The Financial Services Commission (Overseas Regulatory Authority) (Disclosure) Regulations, 2005

The Insurance Act 2001 (IA) Section 27

Insurance Regulations 2001, Regulations 82-86

The Securities Act, sections 68D & 68F

The Pensions (Superannuation Funds and Retirement Schemes) Act

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