



BVI Financial Services Commission

FSC COMPLIANCE INSPECTION PROCEDURES MANUAL

(Revised 2010)



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Glossary of Terms

AIMA	Alternative Investment Managers Association
AMLR	Anti-money Laundering Regulations
AML/CFT	Anti-money Laundering/Countering the Financing of Terrorism
AMLRO	Anti-money Laundering Reporting Officer
AMLTF COP	Anti-money Laundering and Terrorist Financing Code of Practice
BCBS	Basel Committee on Banking Supervision
CDD	Customer Due Diligence
EC	Enforcement Committee
FSB	Financial Stability Board
FSC	Financial Services Commission
IAIS	International Association of Insurance Supervisors
IOSCO	International Organisation of Securities Commissions
LSC	Licensing and Supervisory Committee
OGBS	Offshore Group of Banking Supervisors
PCCA	Proceeds of Criminal Conduct Act

Introduction

The British Virgin Islands Financial Services Commission (the “Commission”) is responsible for licensing, regulating and supervising the financial services industry in the Virgin Islands. One of the key components to ensuring that the industry is prudently regulated and supervised is the conduct of inspections, both onsite and off-site. The main goal of the onsite inspection regime is to effectively monitor the entities licensed under the regulatory legislation with a view to identifying the systemic risks inherent in their operation and the consequential impact(s) on the jurisdiction and then seek to address the systemic risks in a timely manner. At present the Commission conducts onsite inspections on licensed banks, fiduciary services business providers, fund administrators and fund managers, insurers and insurance managers and insolvency practitioners.¹ This process entails, in appropriate cases, the sampling of specific matters within the portfolios of licensed entities.

2. Historically, the Commission devoted most of its time to detailed audit and verification procedures. However, as a result of the improved quality of internal controls and internal and external audit programs, especially as it relates to banks, the Commission is now able to carry out a more important function: the evaluation of the risk profile and condition of the licensed entities.

3. This Procedures Manual places particular emphasis on the evaluation of the policies and procedures of licensees and their level of compliance with current laws, including the established policies, guidelines, practice directions and codes issued by the Commission. This enables the Commission to make an evaluation of the licensees’ ability to manage a variety of risks associated with their businesses and recommend and/or require relevant remedial action. Generally, these risks would relate (as appropriate having regard to the type and nature of the licensee’s business) to resource requirements, management control and accountability, credit, interest rates, foreign exchange, liquidity, operations and solvency.

4. It is the Commission’s belief that it can play an important role in the regulation and supervision of its licensees by encouraging them to develop written policies and procedures in all areas of their businesses, in addition to ensuring full compliance with current laws and the established processes and procedures of the Commission. This requires a critical evaluation of the licensees’ compliance culture during an inspection process and providing appropriate recommendations to correct identified deficiencies thereby avoiding potentially dangerous situations from arising. The Commission also contributes to the soundness of its licensees by encouraging them to follow ‘best practices’ in all aspects of their operations.

5. Individual regulators, whether acting alone or collectively during inspections, function as official representatives of the Commission and have an obligation to conduct their business in a manner that instills and enhances trust and confidence. It is important, therefore, that

¹ This Manual’s Procedure does not cover the inspection of insolvency practitioners which is dealt with in a separate manual’s procedure.

regulators engage in direct and honest dialogue with licensees being inspected and any information obtained by the regulators during that process is maintained confidentially and must not be divulged save in accordance with law.

6. Accordingly, every regulator and Commission staff in non-regulatory Divisions who may be tasked with assisting in inspections and writing inspection reports must familiarize himself/herself with this Procedures Manual. Any deviation from the established procedures herein must be for good reason in a specified context and after the approval of the Inspection Coordinator or the Director of the subject matter concerned has been obtained.

PART I

Purpose, Objectives and Types of Compliance Inspection and Related Matters

Purpose of the Procedures Manual

7. The purpose of this Procedures Manual is to provide the Commission's staff with an effective tool with which to carry out their onsite inspection² functions. The Procedures Manual provides guidance in planning and conducting inspections. The objective in this regard is to ensure the consistent application of agreed upon procedures thereby enhancing the quality of the onsite inspections undertaken by the Commission. The Procedures Manual also achieves another of the Commission's aims – providing a useful tool in training regulators and others in the proper conduct of onsite inspections.

Organisation of the Procedures Manual

8. The Procedures Manual contains different sections that relate to the various aspects of the onsite inspection process. These sections contain the inspection objectives and suggested procedures to achieve the objectives. The objectives contain a description of the goals that are of primary interest to the Commission. They are important in determining the scope of the inspection of specific areas of a regulated activity. In this context and in relation to the person that is or is to be the subject of inspection, wherever the terms "licensee" and "licence holder" are used in the Procedures Manual, they are to be construed to mean the same thing: the person licensed by the Commission in accordance with the relevant regulatory legislation.

9. Furthermore, the Procedures Manual includes processes and procedures that, in specific circumstances, regulators should adhere to. These guide the regulators to accomplish the target objectives for each area of interest that is the subject of a specific inspection.

10. While the Procedures Manual is of general application to all regulated activities supervised by the Commission (save as specifically stated otherwise), it is recognized that some of the provisions of the Procedures may not apply to every regulated activity. The established processes and procedures should, in such circumstances, be appropriately modified to achieve the desired objective for which a licensee is inspected and also ensure consistency in the approach adopted with respect to the areas inspected. Where considered necessary, specific reference is made in relation to specific areas of regulated activity and the processes and procedures in respect thereof specifically outlined. In any case of doubt, reference should be made to the Inspections Coordinator for guidance.

² The term "onsite inspection" is used in this Procedures Manual as the process of onsite inspection is considered the primary supervisory mechanism of the Financial Services Commission for establishing compliance. However, the Procedures Manual apply generally to all compliance inspections in whatever form undertaken (including offsite inspections) and in this case reference should be made to paragraph 10.

11. Specific Parts are provided with respect to banking business, and every inspection of a licensee that is a bank must take account of those Parts that relate to banks, in addition to the other general applicable Parts.

12. The Procedures Manual is effectively a working tool rather than a reference document. No two licensees are necessarily alike, especially with regard to nature, size, volume of operations, organisational structure and types of services rendered. Therefore the regulators and other Commission staff involved in the conduct of onsite inspections must appropriately draw on professional experience and judgment in the application of the provisions of this Procedures Manual and, where considered necessary in any particular case or circumstance, to modify the application of the Procedures, with liberty to seek appropriate guidance from the Inspections Coordinator.

13. Generally, the Procedures Manual provides specific guidance

- (a) concerning the determination of the scope of general and special inspections;
- (b) in determining the procedures to be used in the inspection of specific risk areas of a licensee;
- (c) with regard to the evaluation of written policies, practices, processes and procedures, degree of compliance with those policies, practices, processes and procedures, and the adequacy of the system of internal controls;
- (d) with respect to the evaluation of the quality of the work performed by internal and external auditors;
- (e) in relation to the evaluation of the performance of management and directors;
- (f) with respect to the formulation of objective criteria for evaluating the condition and quality of a licensee and its management; and
- (g) on the adoption of appropriate processes with respect to identified areas of interest in relation to the inspection of banks.

Supporting Legislation

14. Section 35(2) of the Financial Services Commission Act, 2001 provides that *“The Commission may, for the purposes of the prudential supervision of a financial services business carried on in or from within the Territory,*

- (a) *inspect the premises and business, whether in or outside the Territory, including the systems and controls, of a relevant person;*
- (b) *inspect the assets, including cash, belonging to or in the possession or control of a relevant person;*
- (c) *examine and make copies of documents belonging to or in the possession or control of a relevant person that in the opinion of the Commission, relate to the carrying on of financial services business by the relevant person; and*
- (d) *seek information and explanations from the officers, employees, agents and representatives of relevant person, whether verbally or in writing, and whether in preparation for, during or after a compliance inspection."*

A "relevant person" refers to a licensee, former licensee or subsidiary or holding company of a licensee or former licensee, of the Commission. The inspection or examination by the Commission of a licensee essentially relates to the supervision of financial services business that is carried on in or from within the Territory; this process includes the monitoring and assessing of compliance with applicable financial services legislation and the Financial Services Commission Act, 2001, the Regulatory Code and any relevant guidelines or directive issued by the Commission.

15. The inspection further relates to monitoring and assessing compliance with the requirements and obligations outlined in the Anti-money Laundering Regulations, 2008, (AMLR) Anti-money Laundering and Terrorist Financing Code of Practice, 2008 ("the Code") and other enactments and guidelines relative to money laundering or the financing of terrorism. In particular, section 8 (1) of the Code provides that *"It is the duty of the Commission to monitor compliance by its licensees and other persons who are subject to compliance measures with this Code and any other enactment (including any other code and any guidelines) relating to money laundering and terrorist financing as may be prescribed by this Code or any other enactment."* Further, section 9 of the Code provides that *"As part of its prudential inspection of an entity that it regulates, the Commission is expected to review the entity's risk assessment on money laundering and terrorist financing, including the entity's policies, processes, procedures and control systems...."*

16. The legislative remit outlined above effectively accord with the regulatory, supervisory and compliance functions of the Commission as outlined in section 4 of the Financial Services Commission Act, 2001 and all regulators and other Commission staff concerned with inspections are required to familiarize themselves with the requirements and obligations outlined in that section as part of the process of ensuring efficient and effective inspection of licensees.

Objectives of Onsite Inspections

17. The onsite inspection represents the fact-finding part of the Commission's supervisory functions. It comprises the inspection work, including interviews with management and junior staff, and a review and evaluation of records, procedures and processes, of licensees. It also includes holding discussions with the external auditors of licensees (where applicable) and engaging in concluding meetings with senior management to outline the initial findings of the inspections. It is therefore important in this context that an inspection of a licensee is carried out seriously and objectively.

18. The objectives of an inspection may be varied, depending on the area of regulated activity that is being inspected. However, an inspection generally is premised on the following objectives:

- (a) to understand the licensee's business, environment and operations with a view to ascertaining whether there are any risks inherent in its line of business and, if any risks are identified, whether appropriate measures are in place to properly deal with those risks and indeed those risks are adequately addressed and mitigated;³
- (b) to establish whether, having regard to the nature, size and complexity of a licensee and/or a licensee's business, the licensee poses a specific systemic risk to the financial services industry and/or the reputation of the Territory; in particular, where an inspection identifies a licensee as a problem, this must be reported immediately to the Managing Director with such recommendations as may be considered necessary;
- (c) to review the licensee's management, internal controls, internal testing, training, accounting practices, investor services, valuation services and AML/CFT processes and procedures;
- (d) to establish the level of adherence by the licensee to the relevant financial services legislation, Financial Services Commission Act, 2001, regulations, Regulatory Code and any guidelines, practice directions and directives issued by the Commission, including adherence to applicable international best practices;
- (e) to establish whether the licensee continues to be fit and proper⁴ and, where deficiencies are identified, to make such recommendations as are appropriate;

³ See paragraph 3 for some of the risks that are inherent in a licensee's business.

⁴ For guidance on the Commission's fit and proper criteria, please refer to Schedule 1A of the Regulatory Code, 2009 as amended in 2010.

- (f) to establish and properly evaluate the soundness and continued viability of the licensee;
- (g) to identify matters that require policy or other consideration by the Commission with respect to any specific financial services business, including the need to review any current policy, practice or financial services legislation; and
- (h) to communicate, at the end of the inspection, the initial findings of the inspection to the licensee and, where considered appropriate, to make appropriate recommendations to the licensee to assist in addressing the problems identified in the inspection; this constitutes the closing out meeting between the inspecting team and the licensee.

19. At the end of an inspection, the inspection team may, where possible, provide the licensee with a draft outline inspection report regarding its findings and recommendations. This will not constitute the report; it is simply an outline which gives the licensee a head-start on the inspection findings and may therefore be in an abbreviated form until such time as the full report is prepared and made available to the licensee. This arrangement may not be possible in every inspection during an inspection cycle. It is a matter solely for the inspection team, under the guidance of the inspection team leader, to determine. In any case, the full report may deviate from any matter contained in the outline if the inspection team leader, upon further review, forms the view that there is justification for doing so (this is expected to be the exception rather than the rule).

20. The results of an inspection enable the Commission to evaluate a licensee's assessment, management of risks and compliance culture and whether the licensee continues to be fit and proper to continue to be licensed by the Commission.

Types of Onsite Inspections

21. Generally, an onsite inspection of a licensee may comprise a

- ❖ full scope inspection;
- ❖ themed or limited inspection; or
- ❖ follow up inspection.

22. The Commission makes a determination at an early stage as to which type of inspection should be undertaken in relation to a licensee. Various factors are taken into account in making such a decision and these include (although not limited to) the following:

- (a) whether the licensee has ever been inspected;

- (b) whether, having regard to the nature, size and complexity of the licensee and/or the type of financial services business it carries out, the licensee is of low, medium or high risk;
- (c) whether the licensee is considered to be of systemic importance to the financial system, domestically or globally, and poses or has the potential to pose a systemic risk thereto;
- (d) having undergone an inspection previously, the licensee had exhibited serious deficiencies which required remedial action;
- (e) where the licensee generally has a poor compliance culture which may give rise to questions regarding its fitness and propriety;
- (f) whether enforcement action had been taken against the licensee which, in the Commission's opinion, raises concerns regarding the licensee's ability or willingness to comply with relevant financial services legislation and/or established policies, guidelines, codes or practice directions or any directive of the Commission;
- (g) where an important specific issue arises in relation to a licensee which warrants an inspection; and
- (h) where the public interest dictates the need for an inspection.

Full Scope Inspection

23. A full scope inspection entails a review of the full operations and lines of business of the licensee. It is carried out on a case by case basis and is designed to be a comprehensive review process in respect of a licensee. **Appendix 2** provides a sample full scope inspection questionnaire based on a previous such inspection. It is expected, however, that any subsequent full scope inspection would be suitably tailored in terms of the objectives to be achieved and may therefore necessarily deviate from the sample full scope questionnaire.

Themed or Limited Scope Inspection

24. A themed or limited scope inspection involves a review of a particular line of business or a review of a particular function carried out by the licensee. The Commission would normally have identified in advance the specific areas/subject matters it wishes to inspect with regard to a licensee.

Follow-up Inspection

25. A follow-up inspection is carried out to ascertain the progress of the licensee in implementing corrective actions mandated by the Commission following the conclusion of an onsite inspection and submission of a final report. This process enables the Commission to get an overall understanding of the licensee's compliance culture.

PART II

Phases of the Inspection Process

26. The inspection process is divided into four phases as follows:

- ❖ pre-onsite inspection planning and analysis;
- ❖ onsite inspection;
- ❖ post-onsite inspection (reporting); and
- ❖ post-inspection monitoring.

General

27. The processes and procedures for conducting each of these phases are outlined in the appropriate sections of this Procedures Manual⁵. An understanding of the licensee (which includes individual licensees such as insolvency practitioners) and its environment includes having a firm grasp of its activities and associated risks, the involvement of the board of directors and the role of auditors (where applicable). It also involves an in-depth knowledge of trends in the relevant industry with respect to which a licensee is to be inspected. The objective also encompasses assessments of the appropriateness of reliance on internal and external audits, the adequacy of management controls and the quality of management.

28. The objective of detecting solvency or capital adequacy requirement problems involves focusing on materiality and on areas of greatest risk. This includes an assessment of the risks inherent in the licensee's activities as well as the risks in the economy. It also involves (where applicable) analysing the financial statements for signs of a developing potential for risks or problems.

29. With regard to compliance problems, this involves reviewing the licensee's activities for compliance with applicable financial services legislation, regulations and other supervisory rules. Of particular importance for banks, for instance, would be compliance requirements that are solvency based – loan size, concentration and capital adequacy. All problems should be documented and handled in a manner consistent with their materiality.

30. The objective of gathering information on policy matters involves collecting information that may be used as the basis for recommending changes to relevant financial services legislation, regulations and industry guidelines. It includes relevant information relating to current policy issues and to regulatory provisions that are difficult to administer, that are

⁵ The onsite inspection, post-onsite inspection and monitoring are covered under Part III of the Procedures Manual.

causing licensees to make bad decisions or that are being interpreted in different ways as indicated by unusual activities.

31. In addition to detecting problems, the Commission has the obligation to also facilitate the resolution of the problems identified in an inspection. This involves developing recommendations for corrective action and following up on such recommendations to ensure that they are complied with by the licensee.

Pre- Onsite Inspection Planning and Analysis

General

32. The pre-inspection planning and analysis phase consists of **four stages** – preparatory work, analysis, inspection plan and plan approval. Each stage contributes to the objective of conducting the inspection in an efficient and effective manner. It is the Commission's policy that the conduct of an inspection should not be disruptive to a licensee's business. Thus whenever possible, the Commission will conduct joint inspections where a licensee holds multiple categories of licences.

33. In this regard, the Commission requires, at the beginning of every inspection cycle, the various Divisions to put forth their proposed inspection schedules based on their inputs and variables. The proposal is submitted to the Inspections Coordinator who has the responsibility of putting together an appropriate matrix for the inspection cycle. The matrix must be prepared on the basis of what is realistic and achievable in a given inspection cycle, paying particular attention to licensees that are considered high risk or sufficiently significant as to pose systemic risks or those that are known to have a deficient compliance culture. The Inspections Coordinator then submits the matrix, along with any necessary report, to the Enforcement Committee which takes the final decision on the scope and content of the matrix for the inspection cycle concerned.

34. The Inspections Unit (under the supervision of the Inspections Coordinator) has the duty of determining in any particular case whether the element of surprise is essential for a successful inspection or whether to notify the licensee. Notice can result in a significant saving in time and staff resources. Therefore, the general principle is that the Inspections Unit should always notify licensees of a proposed inspection, unless it is intended to conduct a surprise inspection.⁶

⁶ A surprise inspection is normally founded on good reason, such as where the licensee has a poor compliance culture, where a complaint of a serious nature has been received, where giving advance notice might defeat the objective of a specific inspection or lead to the dissipation of valuable potential information, etc.

35. The objectives in the preparatory stage of an inspection are two-fold: firstly, to obtain relevant information so that the regulators can conduct a meaningful analysis of the licensee's operations; and secondly, to provide relevant input into the inspection plan.

Preparatory Work (Information Gathering)

36. In order to commence the inspection process, the Commission must ensure that it has the information necessary to gain an initial understanding of the operations of the licensee. This is achieved through a review of the licensee's file(s) and a request from the licensee for various documents by way of a notice of inspection letter (attached as **Appendix 1**)⁷. Included as an attachment to the notice of inspection letter are pre-inspection questionnaires (attached as **Appendices 3A, 3B, 3C, 3D, 3E and 3F** for the relevant sectors). This process is essentially geared towards ascertaining the general profile of the licensee and its mandate, an understanding of the licensee's group structure and the risks relative to the licensee with respect to AML/CFT and the procedures in place to mitigate those risks and the details of the licensee's financial resources, insurance coverage, training procedures and pending court proceedings. The notice of inspection letter outlines the detailed information required from the licensee for inspection purposes; this information is complemented and enhanced by the responses to the pre-inspection questionnaires.

37. It should be noted that in relation to licensed **banks**, there are regular monitoring reports that include information on overall credit losses, including write-offs, provisions and reserves. The regulators should therefore have in their files the bank's

- (a) balance sheet and income statement information for the three previous years (consolidated);
- (b) previous inspection reports; and
- (c) the latest external auditors management letter.

38. There are at least two major methods of organising the inspection of **banks**. One method is by the use of an analysis of the adequacy of the bank's capital, assets, management, earnings and liquidity. This is known by the acronym "the CAMEL approach". Another method is to use the risk analysis approach. To a large extent both methods look at much the same things in the bank.

⁷ It should be noted that in addition to the information requested of licensed banks in the pre-inspection letter, the BFSB receives regular monitoring reports that include information on overall credit losses, including write-offs, provisions and reserves. The regulators should therefore have in and make reference to their files for information on (a) balance sheet and income statement information for the three previous years (consolidated); (b) previous inspection reports; and (c) the latest external auditors management letter.

39. The CAMEL approach focuses on balance sheet and income statement soundness. However, in recent years systemic risk has taken a centre-stage and has increasingly been of concern to supervisors. It is therefore important that an overall inspection process for a bank, including the pre-onsite inspection plan and analysis, takes into account any systemic risks that may be inherent in a bank

40. The risk analysis approach incorporates all of the major CAMEL considerations. In some respects the risk analysis approach is forward looking. The thrust is to determine whether or not a bank is effectively identifying and managing the various risks. This means that the bank must first of all have a clear set of policies regarding risk absorption, reduction, and transfer. It should also have in place, systems for the identification, analysis, measurement and monitoring of all major risks.

Notice of Inspection letter

41. The notice of inspection letter should be sent to the licensee at least six weeks prior to the date on which onsite inspection is supposed to begin. The letter should set a specific deadline for the submission of the information requested. This should be at the minimum two weeks before the commencement of the inspection in order to allow for the inspection team to adequately review the information submitted.

42. The notice of inspection letter should be reviewed and updated regularly by each Division to ensure that the information requested for any particular inspection will best assist in conducting the inspection of the licensee concerned.

Record Keeping

43. After all the information as detailed above has been received, an independent onsite file should be created for the licensee to be inspected. The onsite file should contain all documents, notes, etc. relevant to the onsite inspection and should not be commingled with the standard offsite file maintained by the Inspections Unit or the Division in respect of the licensee.

Analysis of Pre-inspection Material

44. The goal of the Commission in requesting and reviewing the information detailed above is to get a preliminary understanding of the licensee and its activities, size of the business as well as the nature, type and volume of services provided.

45. Additionally, the Commission reviews the documents with a view to assessing the internal controls of the licensee and more generally to assess whether the information provided by the licensee accords with the records of the Commission; this includes establishing the compliance profile of the licensee in relation to the Financial Services Commission Act, 2010, applicable financial services legislation, regulations and codes, guidelines, practice directions

and directives issued by the Commission. This is achieved by way of populating the inspection module which comprises series of questions that are answered based on the findings of the file review as well as the submissions of the licensee.

46. An analysis of the corporate structure of a licensee involves becoming familiar with the ownership (shareholding) structure including, where appropriate, the parent company, subsidiaries and affiliates; this must necessarily include an evaluation of the management structure, the regulatory environment, business activities, key financial statistics or trends, etc. It also requires an understanding of the various relationships with connected parties of the licensee that permits the identification of any risks that the licensee is subject to because of its corporate structure.

47. Regulators should therefore analyse the management structure, including the responsibilities, reporting lines and profiles of senior management and the composition and responsibility of the board of directors and related committees (where applicable). This provides insight about whether the individuals meet the "fit and proper" test and their ability to manage and control the licensee's business and risks.

48. The analysis of the regulatory structure involves being familiar with the regulatory environment under which the licensee is operating, and any restrictions imposed thereunder.

49. An analysis of the business activities of the licensee will identify the areas of significant or potential business risk and their materiality to the licensee. A review of services that the licensee offers can indicate new or discontinued services, which can influence the scope of the inspection.

50. With respect to a licensee that is a **bank**, the objectives of performing an analysis would entail the need to

- (a) review, understand and explain all significant matters in the financial statements;
- (b) obtain explanations for all significant differences between items in the current financial statements and those of prior periods;
- (c) identify the risks and risk areas in the bank and the materiality of these risks; and
- (d) assist the regulators in focusing on issues of a solvency, policy or compliance nature.

It is important also in this regard to assess the performance of a bank compared with its own strategic plans. Such a review should include the bank's profitability, capital, liquidity and assets and the key indicators and ratios associated with these areas. Most of the information

required to perform this analysis is available from the off-site monitoring by the Banking and Fiduciary Services Division through the receipt of statutory returns.

51. Furthermore, in relation to a **bank**, an assessment of the work of the internal and external auditors by the Commission establishes the basis and degree of reliance that the Commission can place on them. This assessment complements the analysis of the bank. It is important therefore to note that the objectives of assessing the internal and external auditors' work are to obtain

- (a) an understanding of their role, responsibility and competence; and
- (b) information that contributes to the identification of significant or potential risks in the bank.

Consequently, every effort should be made to review (where applicable) the external auditors' work (including management letter and, where possible, working papers) before the beginning of the onsite inspection. A review of the internal auditor's work (including his/her reports) can be done at an early stage of the onsite inspection.

52. The findings coming out of this initial analysis when compiled, help in formulating the inspection plan and thus the approach to be taken by the Commission when conducting the onsite inspection.

Inspection Plan

53. Planning will have an influence on the quality of the inspection. Thorough planning makes it easier to fulfill the purpose of the inspection and reduces the amount of time required for the inspection. The inspection team leader should therefore prepare a planning memorandum sometime before the inspection begins.

Objectives

54. The inspection plan has the following objectives:

- (a) to determine the overall objectives of the examination; and
- (b) to determine the scope of the examination, the procedures to be utilised and the extent of testing;
- (c) to document the various issues, concerns and risk areas that have been identified during the monitoring phase and the preparatory work for the on-site inspection;
- (d) to direct and organise the on-site work of the regulators;

- (e) to determine personnel requirements; and
- (f) to develop and communicate formal plans to promote efficiency throughout the inspection process.

Considerations re Inspection Plan

55. The inspection plan should ensure that regulators are familiar with the inspection process requirements and with the licensee before they conduct the on-site inspection work.

56. In preparing the inspection plan, the regulators should identify the licensee's shortcomings (if any) and risk profile and assess the degree of reliance on other parties. The risk profile includes identifying risks (and risk areas) within or in relation to the licensee and the materiality of these risks. The function of the plan is to focus the inspection on issues, or risks, of a solvency, compliance or policy nature that affect the licensee. Such risks may be material, either individually or collectively, to the licensee or to the Commission.

57. The identified shortcomings, risk profile and the assessment of reliance influence the scope of the onsite inspection. As a result, the regulators may decide not to review some areas of the licensee that are of minimal or no concern; they may inspect other areas to a limited extent and subject others to extensive inspection.

58. The information required in developing the inspection plan may be obtained from various sources. These would include the previous inspection report in respect of the licensee, periodic monitoring reports, file material, information gathering process outlined in subparagraphs 36 and 37 above and responses received to the pre-inspection questionnaires.

59. Where applicable, the inspection plan should include a summary of the analysis of the licensee and the areas identified for inspection under the applicable risk criteria. If necessary, it should also include an indication of the resources required to complete the inspection.

60. It is essential to draw up a list of the various areas the inspecting team intends to inspect, in an approved format, based on the licensee's risk profile and identified shortcomings. The list should also include any other areas requiring investigation. In particular, as regards **banks**, the inspecting team should as part of the planning phase, arrange to review the work of the internal and external auditors. This will determine the degree of reliance that can be placed on their work and to identify issues that the regulators should address during the onsite phase.

61. The inspection plan should indicate the number, and the responsibilities, of regulators required to conduct the onsite work, and an estimate of the time required to complete the onsite work. It should contain an inspection schedule, including a tentative schedule of the management interviews and a concluding or closing out meeting. If the preliminary schedule indicates that it will not be possible to complete the inspection as originally contemplated, the

regulators should discuss the circumstances with the Inspections Coordinator. The allocation of staff and the budgeting of the time for each phase of an inspection require careful consideration. The allocation of regulators and time depends on the scope of the inspection and the quality and accessibility of relevant records. It also depends on the degree of co-operation by the licensee's management, having regard to the history of cooperation the Commission has had with the licensee.

62. The use of a time and planning summary is a useful tool for improved staff planning and control. The regulators should organise the summary on a basis consistent with the structure of the sections contained in the inspection plan. It should specify which procedures the regulators will perform and provide for a comparison of actual and budgeted hours. The regulators can estimate budgeted hours based on the preceding inspection, and modified by changes in the scope or other changed conditions identified in the pre-inspection phase. When assigning inspection functions, the Inspections Coordinator should take into account the organisation of the licensee and the inter-relationships between the sections of the inspection plan.

Working Papers to be Factored into the Inspection Plan

63. Clear and well-organised working papers are important. They not only reflect the procedures followed during the inspection, but constitute the most significant support documentation for the conclusions reached during the inspection. They include inspection procedures, programmes, documentation provided by the licensee, copies of memoranda, board of directors and committee minutes, and organisational charts.

Objectives

64. The objectives of having good working papers are to

- (a) provide written support of the findings and conclusions reached during the inspection and contained in the inspection report; and
- (b) assist in planning, directing and co-ordinating the inspection and the work to be performed by the regulators.

65. Accordingly, it is important that in designing working papers, consideration is given to the following questions

- (a) what objective will the working papers satisfy?
- (b) will they aid the regulators in efficiently conducting the analysis or review of a particular area, operation or activity of the licensee?

- (c) will they adequately document and support the regulators' findings?
- (d) can they be designed for use in subsequent inspections?
- (e) will they provide all the required information?
- (f) is the format easy to manage, understand, follow and complete?
- (g) are they designed to facilitate review?
- (h) do they assist in evaluating the work performed?
- (i) do they avoid duplication of information?

66. As the initial step in the preparation of working papers, the regulators should review those prepared during the previous inspection. This would indicate permanent information and other information relevant to the current inspection.

67. Sometimes licensees' staff may prepare documents that the regulators use as working papers. The regulators must ensure that they obtain complete and useful information.

68. A widely used method of work paper organisation segregates the completed papers into two files, analysis and permanent. The analysis file contains working papers that document the procedures and support the conclusions. The permanent files should consist of working papers of continuing interest. These include

- (a) a brief history of the licensee;
- (b) the licensee's organisational chart;
- (c) a copy of the licensee's by-laws;
- (d) the licensee's written policies for the various areas of operation; and
- (e) a list of names and titles of key executives, directors and committee members (where applicable) of the licensee.

69. The regulators should review the working papers to determine that the inspection has achieved the intended scope and that the papers contain adequate evidence to support the conclusions and opinions in the report.

Final Pre-inspection Preparation

70. The Inspections Coordinator would normally serve as the inspection team leader and it is his/her responsibility to make contact with the licensee⁸ at least a week prior to the inspection to reconfirm the date of commencement of the onsite inspection. In doing so, the inspection team leader should confirm the estimated time of the management meeting with the licensee and indicate to the licensee the names, ranks and number of individuals that will be attending on behalf of the Commission and adding such other information outlined in paragraph 61 above as may be considered necessary.

71. The inspection team should create a list of all the files and supporting documentation that it will need to review during the course of the onsite inspection. The team should also create a tentative schedule detailing the dates on which various aspects of the onsite inspection will be carried out (i.e. file reviews, interviews, etc.). The relevant file reviews that may be relied upon during an inspection process in relation to insurance business, investment business, banking business and insolvency services businesses are outlined in **Appendices 4A, 4B and 4C (insurance), 5A and 5B (investment business), 6 (banking) and 7A-I (insolvency)**.⁹

Plan Approval

72. Once the inspection plan is formulated, it should be submitted by the Inspections Coordinator to the Enforcement Committee for consideration and approval. Where the exigencies of an inspection plan warrant it, the Inspections Coordinator may submit the inspection plan in respect of any planned inspection to the Managing Director for approval. However, the inspection plan must subsequently be presented to the Enforcement Committee for ratification, citing the exigencies that warranted advance approval of the plan by the Managing Director.

⁸ This responsibility may, with the approval of the Inspections Coordinator, be performed by any member of the inspection team or any member within the Inspections Unit.

⁹ The file review matters with respect to banking business are outlined in the relevant applicable Parts of this Procedures Manual.

PART III

The Onsite Inspection Phase

73. This stage of the inspection process requires that the inspection team be physically present onsite at the licensee to conduct the inspection. Having previously communicated the commencement date of the inspection to the licensee, the inspection team's arrival at the licensee's premises should not come as a surprise.

Conduct of Inspection Team

74. The inspection team should at all times conduct itself in a professional manner and within the limits of the applicable laws. It is essential in this respect that the team is cognizant and au fait with its duties and responsibilities as well as what is required of it during the inspection process. The persons constituting the inspection team should be mindful at all times that they represent the Commission and should conduct themselves in a manner as not to bring the Commission into disrepute. It is essential, in particular, that the team members are always punctual and keep closely to the inspection plan as possible. Accordingly, every member of the inspection team should familiarize himself/herself with the Commission's Code of Conduct for the Conduct of Compliance Inspections.¹⁰

75. Planning and preparation are key elements to attaining optimum levels of professionalism. In this regard, prudence dictates that prior to conducting the onsite inspection, the inspection team leader should ensure that team members are assigned specific functions as a means of facilitating the inspection and avoiding duplication of efforts. Additionally, specific individual(s) should be appointed for the purpose of communicating with the licensee on any issue in the nature of a request which is considered essential to the inspection process; any request made must be reasonable in the context of the particular inspection. Account must also be taken of any practical issues relating to availability of information and the time frame within which the information is required or obtainable. No request must be made of a licensee which has no nexus or only has a remote and insignificant nexus with a subject matter of the inspection. In addition, when taking copies of documents, the inspection team must advise the licensee that the information collected will be maintained and treated confidentially and may be divulged only in accordance with the parameters outlined in sections 49 and 49A of the Financial Services Commission Act, 2001. In circumstances where a document contains highly

¹⁰ This document is expected to be finalised and published no later than June, 2011.

sensitive information which is not considered relevant to a subject matter of the inspection, the inspection team may permit the sensitive information to be redacted.

Holding Management Meetings

76. The management meeting is the forum that marks the commencement of the onsite inspection process and it sets the groundwork and tone for the inspection process. While the membership of the inspection team may attend the management meeting, which is held with the senior managers¹¹ of the licensee, it is expected that only the senior members of the inspection team¹² will take a lead in the discussions. However, where the inspection team leader or the leader of the licensee considers it appropriate for a person of junior rank from his/her team or entity to participate in the discussion, this may be permitted by the team leader or leader of the licensee, as the case may be.

77. It is important from the outset of the management meeting that the inspection team leader and/or a director or deputy director responsible for the direct supervision of the licensee to lead the introduction and communicate the following:

- (a) introduce the members of the inspection team;
- (b) provide relevant disclaimers;
- (c) provide a brief overview and history of the Commission's onsite inspection regime;
- (d) set out the inspection team's mission in conducting the onsite inspection;
- (e) provide an explanation of the Commission's process in conducting the onsite inspection;
- (f) set out the estimated time allotted for the onsite inspection;
- (g) indicate the maximum number of team members that will be in the licensee at a given time as well as disclose the fact that additional members not currently present at the meeting may also be conducting various phases of the onsite inspection process;
- (h) indicate to the licensee that the intent of the Commission is not to be disruptive to the licensee's operations;

¹¹ For a definition of "senior managers", please refer to section 4 of the Regulatory Code, 2009.

¹² The senior members of the inspection team would ordinarily comprise the Inspections Coordinator, directors, deputy directors and senior regulators.

- (i) give an overview of the areas that will be covered during the onsite inspection (management, controls and systems, business processes, corporate governance, training, AML/CFT, etc.);
- (j) give an overview of how the inspection process is to be conducted (File Reviews, Interviews etc), without prejudice to a change in the process where the inspection team considers that to be appropriate in any particular circumstance;
- (k) require the licensee to identify somebody within the licensee who would be on call to answer questions during the inspection process;
- (l) request the licensee to provide a designated area within the licensee's premises for the purpose of enabling the inspection team to conduct its reviews (this should preferably be a quiet and private area (such as a Board room or separate office) secluded from the employees of the licensee);
- (m) indicate to the licensee that it should make available requested documentation at times allotted by the inspection team;
- (n) give an overview of how the interview process works and who the Commission will be interviewing (i.e. department head(s), mid level employee(s), front office and other junior staff, etc.);
- (o) give the licensee a list of the files as well as supporting documentation that will be required for review during the onsite inspection process;
- (p) provide the licensee with a copy of the tentative schedule for carrying out the various phases of the onsite inspection, noting at the same time that the schedule is subject to review as considered necessary during the onsite inspection process;
- (q) indicate that at the end of the onsite inspection the inspection team will conduct a concluding/close out meeting with the licensee where the inspection team's preliminary findings will be set out;
- (r) indicate that the draft onsite inspection report should be provided to the licensee within a period not exceeding six weeks following the conclusion of the onsite inspection;
- (s) indicate the specifics of the report regarding the rating system, factual rendition of the report, the processes the report goes through, providing corrective measures and possible timeframes for effecting such measures, follow-up process and the applicable enforcement process; indicate that once the draft report is provided to the licensee, the licensee will be given a specified period

(normally not exceeding two weeks) within which to provide comments on matters of fact only; failure to provide comments within the stipulated period would be taken as acceptance by the licensee of the factual renditions in the draft report; and

- (t) indicate that the Commission, upon receipt of the comments, would consider and factor them, where considered appropriate, into the final report for referral to the Enforcement Committee for approval and any necessary decision in accordance with the provisions of the Financial Services Commission Act, 2001 and any applicable financial services legislation and guidelines and procedures of the Commission.

It is essential to the efficient and effective conduct of an inspection that the licensee lends as much cooperation to the inspection team as possible. This should also be appropriately communicated to the licensee from the outset of the management meeting.

Use of K-Review (and Successor Programme)

78. The inspection team currently utilizes the electronic platform of K- Review¹³ to assist it in conducting onsite inspections. K-Review is primarily a tool whose purpose is to

- (a) serve as a database wherein all information on the licensee is maintained;
- (b) serve as a database for the basic questions generally posed to the licensee during the onsite inspection process; and
- (c) provide a generic report of the findings on the licensee following the conclusion of the inspection process.

79. It should be noted that the initial report generated by K-Review is not the final report as the initial report may be subject to reviews and amendments on the basis of the actual findings of the inspection team. Further, the report provided by K-Review does not cover the full spectrum of the onsite inspection and there are many things that may need to be added by the inspection team before the report can be finalized. It is therefore essential that the inspection team properly records its findings as the inspection process is underway to contrast such findings to the initial report generated by K-Review. The application of sound judgment is paramount and must be adhered to.

¹³ The current K-Review is being reviewed to take into account new developments within the Territory's AML/CFT regime and other related legislative developments. The review may indeed result in the adoption of a new or different software programme or an enhanced K-Review. Whatever happens, the new or enhanced programme will be applied accordingly in the inspection process and, where necessary, the provisions herein will be modified appropriately.

80. The onsite inspection process is primarily guided by industry best practices issued by bodies such as the BCBS, IOSCO, IAIS, AIMA, OGBS (on trust and corporate service providers) and FSB as well as enacted legislation and guidelines, codes, practice directions and directives issued by the Commission from time to time. Accordingly, where a particular component is guided by industry best practice, the Commission provides details of the principle and also the mechanisms to analyse, assess and establish ratings based on the inspection team's findings.

Use of Inspection Spreadsheets

81. In some cases, the Commission may utilize established spreadsheets with respect to certain sectors of the financial services industry in relation to an inspection. In such cases, K-Review is used only as a guide and question bank to buttress the spreadsheet.¹⁴ The spreadsheet (which is placed on the N-Drive of the Commission's IT system) is populated in the same manner as K-Review and updated as the onsite inspection progresses.

Inspections in Relation to Management

82. It is important that the inspection is, amongst other matters, focused on issues of corporate governance. The senior management of the licensee should be involved or at least aware of the day-to-day operations of the licensee and their functions should be clearly designated as required by the Anti-money Laundering and Terrorist Financing Code of Practice, 2008 (section 14) and Regulatory Code, 2009 (Division 3 of Part III).¹⁵ There should also be documentation evidencing the decision-making process for material decisions as well as evidence that the appropriate individuals are involved in the decision-making process. Internal controls and systems (whether in the form of procedures manuals or other form) should normally establish the manner in which the licensee's decision-making process works; a mere statement attesting to the existence of such a process would not suffice. It is therefore important that the inspection team seeks to establish through manifested evidence the actual existence of such a process.

Conducting File Reviews

83. An onsite inspection necessarily involves a review of the licensee's files to establish certain parameters that are required by law, rules, guidelines and best practice. This process entails reviewing the licensee's governing documents, including

¹⁴ This is currently the case with the inspections concerning the Investment Business Division.

¹⁵ The Regulatory Code, 2009 does not apply to insolvency practitioners, but the corporate governance requirements should be applied with necessary modification.

- (a) minutes of its Board of Director's meetings;
- (b) minutes of the meetings of any other existing high level committee (such as audit, remuneration, risk, etc.);
- (c) business plan, where applicable; and
- (d) overall compliance with applicable laws, rules, best practice and guidelines, codes, practice directions and directives issued by the Commission from time to time.

Conducting Interviews

84. The interview process is designed to obtain new or additional information or seek clarification or establish knowledge from the licensee's senior management and other employees. The process may vary, depending on the licensee and its nature of business, in addition to other factors. The interviews must relate to matters relevant to the onsite inspection and must not delve into extraneous issues. With respect to directors, for instance, it would be relevant to inquire

- (a) how much of their time is allotted to the affairs of the licence-holder on a weekly or other periodic basis;
- (b) into their actual duties and responsibilities with respect to the licence-holder on a day-to-day basis. (i.e. review of subordinates' work, roles as regards decision-making, internal management responsibilities and how these are effected, etc.); and
- (c) into their knowledge of the licensee's regulatory and other reporting requirements under the laws (i.e. role of the licensee in relation to suspicious activity reporting, statutory notifications to the Commission under the Financial Services Commission Act, 2001 and other relevant financial services legislation, etc.).

Analysis in Relation to the Licensee's Activities

85. During the inspection process, it is important that the inspection team carries out a proper analysis of issues concerning the functions of the licensees and their senior managers. In this respect, they must seek to

- (a) ascertain if the specific responsibilities of each of the directors of the licensee are clearly set out in any official document;
- (b) review documents to ascertain if the directors of the licensee are carrying out duties that are consistent with their mandate and their levels of competence; ascertain on average, how frequently the board of director's meetings are held;
- (c) review the minutes to qualitatively ascertain the degree to which substantive strategic/material business matters are being discussed (i.e. is the board reviewing and approving management reports, divisional strategic plans, etc.?);
- (d) document the percentage of the total board of directors that actually attend meetings;
- (e) determine whether the board and its committees (where applicable) do in fact obtain regular information from management about all aspects of the licensee's prudential operations;
- (f) review files for documentation evidencing that when directors are absent from meetings they are subsequently provided with the minutes of the meetings; and
- (g) review files to confirm that the Commission has approved all relevant directors/officers/shareholders and other persons of the licensee that require approval from the Commission.

86. In relation to the review of the board minutes, the purpose would essentially be to determine the extent of the involvement of the board in the activities of the licensee; determine the extent to which the board directs or approves the activities of management; and ensure that the board understands and carry out their responsibilities.

Controls and Systems

87. A licensee should ensure that its internal controls and systems are adequate for the size, nature and complexity of its activities. Systems of control must be such as to enable the licensee to discharge properly the duties imposed upon it. The inspection team must therefore carry out the following:

General

- (a) ascertain if the licensee has a procedures manual and, if so, whether each employee has to sign a declaration attesting acknowledgment of the procedures;
- (b) review files to ascertain whether Commission's four eyes principle is being adhered to by the licensee in the provision of its day-to-day functions (this can

be evidenced by dual signatories on letters or other forms of evidence of deliberation between employees on a matter);

- (c) ascertain if employees of the licensee are carrying out functions that they are adequately qualified to carry out;
- (d) ascertain whether or not the licensee's professional indemnity insurance is adequate;
- (e) ascertain whether or not the licensee has any policies guarding against conflicts of interest;
- (f) ascertain whether or not the licensee has any document or policies addressing succession planning;

Agreements

- (a) ensure that the licensee has agreements in place with other companies within its group as well as externally where there are duties and functions being sub-delegated;
- (b) in the case of mutual funds, review the administration/management agreements between the licensee and their respective funds to ascertain whether they are consistent with the functions actually being carried out by the licensee;
- (c) in the case of mutual funds, review the administration/management agreements to ascertain responsibility for valuing the fund;
- (d) in the case of mutual funds, review the administration/management agreement to ascertain if it specifically sets out who is responsible for carrying out AML/CFT CDD measures on underlying investors;
- (e) in instances where the licensee delegates AML/CFT CDD functions, ensure that they have mechanisms in place to test whether the functions are being carried out and, if so, whether they actually carry out these tests. Additionally, the inspection team should assess whether the licensee has written into these agreements sanctions for non-compliance.

Checklists

- (a) review the licensee's checklists with a view to ascertaining their adequacy as well as the frequency at which they are utilized in the provision of particular functions;

- (b) review various functions of the licensee to ascertain whether or not the checklists are being administered in a consistent and comprehensive manner;

Record Keeping

- (a) review the licensee's files with a view to determining whether or not its records are kept in a satisfactory manner; and
- (b) ascertain if each client of the licensee has a share register, register of members, etc.

Internal Testing and Management Reports

88. A licensee should have arrangements in place to assess, through a process of internal audit and the production of management reports, the effectiveness of its internal controls and procedures, as well as its business operations. In this regard, the inspection team should

- (a) ascertain whether or not the licensee has conducted any internal audits;
- (b) review all internal audit reports and ascertain what recommendations have been implemented as well as the status of the recommendations not implemented;
- (c) conduct a review of any weekly/monthly or other periodic reports provided by department head(s), senior managers or others to the directors of the licensee; and
- (d) ascertain whether or not any weekly/monthly or other periodic departmental meetings are held and, if so, if they are minuted. If minuted, conduct a review of the minutes to assess what is discussed.

Safekeeping of Clients' Money

89. With respect to the handling of clients' funds, the inspection team should

- (a) review the clients' accounts to ensure that all clients' monies are kept in separate accounts in the names of the clients;
- (b) ensure that the title of each client bank account operated by the licensee sufficiently distinguishes the monies in the account from those of the licensee;

- (c) review the client accounts to ensure that the licensee regularly reconciles the balance and transactions of each client bank account (as recorded by the licensee) with the balance and transactions of that account (as set out on the statement or other form of confirmation issued by the bank) currency by currency; where any difference arises on reconciliation, the inspection team should request that the licensee corrects it as soon as possible, unless the difference arises solely as a result of timing differences between the accounting systems of the bank and of the licensee;
- (d) ensure that the licensee's accounting records contain the following documentation with respect to day-to-day entries:
 - (i) all money (including interest and such other payments) which is paid into or out of any client bank account;
 - (ii) all receipts and payments of clients' money passed through a client bank account identifying the persons to whom each such receipt and payment over relates; and
 - (iii) a record of the balances on each client bank account;
- (e) ensure, in respect of withdrawals/deposits, that the accounting records have documented the following:
 - (i) the name of the client concerned and the date;
 - (ii) the name of the person to whom (or, in the case of a deposit, from whom) the money was paid or transferred (or, in the case of a deposit, received); and
 - (iii) accounting entries corresponding to the date and name as above in the account held for each client concerned;
- (f) request, where applicable, that the licensee explains how subscription and redemption deals are reconciled to bank cash;
- (g) request that the licensee explains how it deals with foreign currencies; and
- (h) verify whether or not commissions and other fees are properly calculated.

Contracts of Employment

90. The inspection team should ascertain that each employee has a contract of employment which addresses their roles and responsibilities and the rules of the licensee; this should include

ascertaining whether the required undertakings in the Anti- Money Laundering and Terrorist Financing Code of Practice, 2008 are being complied with.

Training and Competence

91. A licensee must have adequate arrangements in place to ensure that on a continuing basis its employees are adequately trained and properly supervised (having regard to the nature of their responsibilities) and are competent to discharge those responsibilities. It should be noted that there is a statutory obligation under the Anti-money Laundering Regulations, 2008 and Anti-money Laundering and Terrorist Financing Code of Practice, 2008 for the licensee to ensure that its employees are properly and regularly trained. In this regard, the inspection team should

- (a) review the licensee's procedures for recruitment of employees (i.e. vetting of applications, taking up and treatment of references, interview process, short listing, etc.);
- (b) ascertain whether the licensee has a training log documenting all instances where training occurred as well as the materials utilized in the training;
- (c) review training materials with a view to ascertaining whether the training adequately covers all the functions carried out by the employees of the licensee;
- (d) determine how the licensee tests employee knowledge of information conveyed during training;
- (e) review the records of the licensee to ascertain what types of periodic assessments/reviews are carried out on the work of employees; and
- (f) ascertain what type of external training employees of the licensee are exposed to.

Complaints Handling

92. A licensee must have procedures to ensure the proper receipt and handling of complaints from clients/customers and investors relevant to its business operations, as well as to ensure that any appropriate remedial action on those complaints is promptly taken. Every licensee is required under the Guidelines for the Approved Persons Regime,¹⁶ as part of its compliance function, to establish a mechanism for receiving and dealing with complaints. In this regard, the inspection team should

¹⁶ This requirement was previously contained in the Provisional Guidance Notes on Compliance Regime.

- (a) ascertain whether the licensee has a complaints register in place;
- (b) review the register in order to get a general sense of the manner in which complaints are handled;
- (c) assess how many of the complaints (if any) have been addressed and resolved, how many are ongoing and how many are yet to be dealt with. Where complaints are ongoing or are yet to be dealt with, the inspection team should seek explanations as to the reason(s) for their current status;
- (d) assess whether or not complaints have been handled within a reasonable time frame; and
- (e) assess whether or not complaints are handled by the appropriate employee, having regard to the level of seriousness of the complaints

Disaster Recovery

93. A licensee should have in place robust and comprehensive business recovery plans, policies and procedures to ensure ongoing business continuity in the event of disasters, natural or otherwise. Moreover, the plan should cover continuation and recovery procedures for all operational business functions. Accordingly, the inspection team should

- (a) conduct a review of the licensee's disaster recovery plan;
- (b) ascertain if the disaster recovery plan covers all aspects of the licensee's business;
- (c) ascertain whether the recovery plan covers the various scenarios, both natural and otherwise, that may occur and cause an interruption to the licensee's business. Additionally, the recovery plan should explicitly designate employees to various posts and assign some or all of them specific functions ;
- (d) ensure that the licensee has fireproof safes to maintain backup tapes and documents;
- (e) review the mechanism for backing up information as well as the frequency of the back-ups;
- (f) establish whether there is a server maintaining information and, if so, if it can be accessed by affiliates in other jurisdictions;

- (g) ascertain whether the licensee's system has adequate anti-virus software to protect its data; and
- (h) examine whether the licensee has an alternate facility in place for the restoration of business in the event of a disaster.

Policies and Procedures

94. A licensee should maintain policies and procedures in respect of all of its business operations. Ideally, the policies and procedures should be in writing and contained within a manual covering the detailed processes and policies in respect of each function the licensee undertakes. The inspection team should ascertain whether the licensee's policies and procedures fully cover all the functions carried out by the licensee on a day-to-day basis.

Anti- Money Laundering/Countering the Financing of Terrorism (AML/CFT)

95. The Commission is responsible for regulating the financial services industry and fundamental to achieving the goal of prudent regulation is ensuring that the industry is, as far as possible, compliant with the relevant legislation relative to AML/CFT matters as well as internationally established standards for detecting and preventing money laundering and terrorist financing activities. The relevant domestic legislation on AML/CFT matters are the

- (a) Drug Trafficking Offences Act, 1992;
- (b) Criminal Justice (International Cooperation) Act, 1993;
- (c) Proceeds of Criminal Conduct Act, 1997 (PCCA);
- (d) The Terrorism (United Nations Measures) (Overseas Territories) Order 2001;
- (e) Anti-Terrorism (Financial and Other Measures) (Overseas Territories) Order 2002;
- (f) Anti-money Laundering Regulations, 2008 (AMLR);
- (g) Anti-money Laundering and Terrorist Financing Code of Practice, 2008 ("the Code"); and
- (h) Non-financial Business (Designation) Notice, 2008 (NBDN).

96. For the purposes of the onsite inspection, the inspection team needs to concentrate only on compliance matters relative to the PCCA, AMLR, the Code and NBDN (the FIA and Police Force administer the enforcement of the other enactments, including aspects of the PCCA). It is therefore important that every member of the inspection team is fully aware of the requirements of the relevant enactments for purposes of conducting a full and proper evaluation of licensees' compliance with their AML/CFT obligations.

97. The AML/CFT review can be carried out as part of a full scope inspection of a licensee or it can be carried out independently in the form of a limited scope of themed inspection which focuses on a specific area of the business of a licensee.

Internal Testing

98. Section 3A of the Code provides that every entity¹⁷ and professional¹⁸ shall establish and maintain an independent audit function that is adequately resourced to test compliance, including sample testing, with its or his/her written system of internal controls and the other provisions of the AMLR and the Code. It is essential in this regard therefore that the inspection team should

- (a) ascertain who is responsible for carrying out the testing of the licensee's written system of internal controls;
- (b) assess the level of independence of the testing function;
- (c) assess whether the licensee has allocated sufficient resources for carrying out the testing of the written internal controls, including identifying the licensee's Anti-money Laundering Reporting Officer (AMLRO).

Identification procedures (new and continuing business relationships and one-off transactions)

99. Regulation 4 of the AMLR provides that a relevant person¹⁹ shall establish and maintain identification procedures which, as soon as reasonably practicable after contact is first made between that person and an applicant for business²⁰ concerning any particular business relationship or one-off transaction, require that the applicant provide satisfactory evidence of his/her identity or take measures as are specified in the identification procedures that will produce satisfactory evidence of the identity of the applicant.

¹⁷ For a definition of "entity", refer to section 2 of the Code;

¹⁸ For a definition of "professional", refer to section 2 of the Code.

¹⁹ For a definition of "relevant person", refer to regulation 2 of the AMLR.

²⁰ For a definition of "applicant for business", refer to section 2 of the Code.

100. In this regard, the inspection team should ascertain whether the licensee takes reasonable steps to verify the identity of applicants for business and, where necessary, that the licensee satisfies regulation 4(2) of the AMLR.

Identification procedures (introduced persons)

101. Section 24(5) of the Code provides that a personal introduction made under subsection (4) shall contain

- “(a) the full legal name and current residential address of the individual, including
 - (i) in the case of the opening of an account, the postcode and any address printed on a personal account cheque tendered to open the account;
 - (ii) as much information as is relevant to the individual as the entity or professional may consider necessary;
- (b) the date, place of birth, nationality, telephone number, facsimile number, occupation, employer’s name and specimen signature of the individual where a personal cheque is presented to open an account; and
- (c) the full legal name and residential address and, in the case of a member of key staff, the rank of the key staff, introducing the individual and a brief description of the customer’s or key staff’s knowledge of the individual.”

Additionally section 24(6) provides that where a personal account cheque is tendered to open an account, the signature on the cheque shall be compared with the specimen signature submitted under subsection (5)(b).

102. In this respect, the inspection team should

- (a) ascertain whether the licensee maintains the information required under section 24(5) of the Code;
- (b) examine whether the licensee has mechanisms in place for determining when it would require additional information in accordance with section 24(5)(a)(ii) of the Code; and
- (c) by sample assess whether signatures on cheques to open accounts match those of the specimen signature as required under section 24(6) of the Code.

Identification procedures

103. When reviewing the licensee's identification procedures, the inspection team should establish who the applicant for business is as well as the extent of the licensee's responsibilities according to the agreements with the applicant for business.

104. The customer due diligence function is generally the responsibility of the licensee, even in circumstances where the function is delegated or outsourced. In the case of a fund, this responsibility falls to the fund, save that where the function is delegated or outsourced, the responsibility becomes that of the licensee.

105. Sections 24, 25, 27 and 28 of the Code provide that an entity or professional shall undertake identification and verification with respect to an individual, a legal person, the underlying principal of a legal person and a trust. In this regard, the entity or professional is required to collect, collate and analyze a number of different documentations required to undertake identification and verification. Thus the inspection team should assess whether

- (a) individuals that are subject to identification and verification measures are dealt with in accordance with the requirements of section 24 of the Code;-.
- (b) legal persons that are subject to identification and verification measures are dealt with in accordance with the requirements of section 25 of the Code;
- (c) underlying principals with respect to legal persons that are subject to identification and verification measures are dealt with in accordance with the requirements of section 27 of the Code; and
- (d) trusts subject to identification and verification measures are dealt with in accordance with the requirements of section 28 of the Code.

Suspicious transactions procedures

106. The Code envisages that a licensee should have a mechanism in place for handling suspicious transactions which should include clear designation of responsibility and clear reporting lines. It is therefore essential in this respect that the inspection team

- (a) ascertains, through the interview process, if employees are aware to whom they should be reporting suspicious transactions;
- (b) examines the register to ensure that the suspicious transactions are reported and handled in a consistent manner; and

- (c) establishes whether the licensee's procedures for reporting a suspicious transaction meets the requirements of section 18 of the Code and that the suspicious transaction report is in a form consistent with section 55 of the Code.

Risk assessment

107. Section 11 of the Code provides that an entity or professional shall establish a written system of internal controls which provides appropriate policies, processes and procedures for forestalling and preventing money laundering and terrorist financing. Such written controls include matters relating to implementing risk-based customer due diligence policies processes and procedures. In addition, section 12 of the Code requires that a risk assessment be carried out.

108. Furthermore, section 11A of the Code requires a licensee to adopt and maintain appropriate policies, procedures and other measures essential to preventing the misuse of technological developments for purposes of money laundering or terrorist financing.

109. Regulation 3(3) of the AMLR requires that identification procedures, record keeping procedures, internal reporting procedures and internal controls and communication procedures be submitted to the Financial Investigation Agency (FIA) for approval.

110. Accordingly, the inspection team should ascertain whether the licensee

- (a) has a risk scoring system in place for its clients;
- (b) has in place appropriate policies, procedures and related relevant measures to prevent any misuse of technology to advance money laundering or terrorist financing activities; and
- (c) has submitted the required procedures to the Financial Investigation Agency for approval.

Records, record-keeping and retrieval

111. Sections 42, 43, 44, 45 and 46 of the Code provide that an entity or a professional shall maintain complete and easily retrievable records and that these records should be maintained for at least the minimum retention period set out in the Code. In this regard, the inspection team should

- (a) review the licensee's records for completeness;

- (b) assess the licensee's level of timeliness in terms of making the records available; and
- (c) ascertain, where the licensee outsources the record keeping function, whether there is an agreement governing the arrangement and assess whether the person to whom the function is delegated is competent.

Registers

112. Regulation 12 of the AMLR requires a licensee to maintain a register detailing all the reports made by it to the FIA and all inquiries made to it by the Agency. In this respect, the inspection team should review the register to ascertain whether the licensee maintains its records in a manner consistent with regulation 12(2) of the AMLR.

Overseas interests

113. Section 53 of the Code provides that where an entity that is regulated in the Virgin Islands has branches, subsidiaries or representative offices operating in foreign jurisdictions, the entity must take reasonable steps to ensure that these branches, subsidiaries or representative offices adhere to anti-money laundering standards that are at the minimum equivalent to those of the Virgin Islands. Accordingly, the inspection team should examine whether the licensee, where it has foreign branches, subsidiaries or representative offices, has taken reasonable steps to assess the anti-money laundering laws operating in such foreign jurisdictions, and whether it has provided the relevant disclosures as required under section 53 of the Code.

Staff recruitment

114. Section 49 of the Code provides that an entity or professional shall assess the competence and probity of its or his/her employees at the time of their recruitment and at any subsequent change in role, and subject their competence and probity to ongoing monitoring. It is essential in this respect that the inspection team should assess what mechanisms are utilized by the licensee in the recruitment phase as well as on an ongoing basis.

Staff education and training

115. Section 48(1) of the Code requires every entity and professional to take such measures as are necessary to provide its or his/her employees at appropriate frequencies with adequate

training in recognizing and handling transactions, having regard to section 16 of the Code. In this respect, the inspection team should assess

- (a) the appropriateness of the training provided by the licensee;
- (b) whether the training provided is adequate;
- (c) whether the training is given frequently enough, given the risk profile of the licensee; and
- (d) whether the licensee has in place appropriate mechanisms to test employee knowledge of the information covered in the training.

Offences and penalties (understanding of)

116. As part of the Commission's enforcement process, it is essential that the inspection team should

- (a) review the activities of the licensee to ascertain whether in the provision of its functions it has failed to comply with the provisions of the Code as set out in section 57(1) and (2) of the Code; and
- (b) ascertain, if the licensee is found to have contravened section 57(1) or (2) of the Code, whether the penalty should be enforced under section 57(3) or (4) of the Code and then provide a recommendation to the Enforcement Committee.

Client file review

117. Section 30 of the Code provides that where a relevant person relies on a copy of a document presented by an applicant or customer, the relevant person shall ensure that the document is properly certified.

A copy of a document is properly certified if on the face of the certificate:

- “(a) the person certifying the document indicates that
 - (i) he has seen and compared the original document verifying the identity and residential address of the applicant for business or customer;
 - (ii) the copy of the document which he certifies is a complete and accurate copy of the original; and

- (iii) where the document contains a photograph of the applicant for business or customer, the photograph bears a true likeness to the individual to whom the certification relates;
- (b) the certificate
 - (i) bears the date of the certification;
 - (ii) bears the signature and seal of the person certifying the document; and
 - (iii) provides adequate information to enable the person certifying the document to be contacted in the event of a query or further clarification”.

118. The Code also provides that certified copies of documents will not be accepted unless the relevant person is satisfied that the person certifying the document

- (a) is independent of the individual, trust or legal person for which the certification is being provided; and
- (b) is subject to professional rules of conduct or statutory compliance measures a breach of which is subject to the application of penalties.

119. Finally, where the certifier is located in a high risk country or the relevant person has a doubt regarding the veracity of the information/documentation provided by the customer, the relevant person shall take such steps as are necessary to ensure that the person certifying the document is in fact real.

120. Sections 24, 25, 27 and 28 of the Code provide that an entity or professional shall undertake identification and verification with respect to an individual, a legal person, the underlying principal of a legal person and a trust respectively. In this regard, the entity or professional is required to collect, collate and analyse a number of different documentations required to undertake identification and verification.

121. Regulation 6 of the AMLR provides that evidence of identity of an applicant for business is not required to be obtained where, amongst other things, the applicant for business is a regulated entity. Furthermore, section 52 of the Code allows an entity or professional to carry simplified customer due diligence in relation to a recognised foreign jurisdiction.

122. It is essential in this regard that the inspection team should

- (a) ascertain whether, in circumstances where the licensee relies on a copy of a document presented by an applicant or customer, the licensee ensures that the

document is properly certified in accordance with section 30(2), (3) and (4) of the Code;

- (b) establish whether the licensee, in relation to the requirements of sections 24, 25, 27 and 28 of the Code, collects, collates and analyses the relevant documentation required to undertake identification and verification; and
- (c) ascertain whether, where the licensee appears to rely on the exemption contained in regulation 6 of the AMLR and section 52 of the Code in relation to regulated persons, the licensee has on record documentation evidencing that it has taken steps to ensure or ascertain that the relevant person concerned is indeed a regulated person as defined.

Close out Meeting

123. After the onsite inspection is completed the inspection team leader should establish and agree on a meeting date for the close out meeting to be held. The inspection team should ensure that it meets prior to the close out meeting to discuss and agree on findings and place them in a summary format for presentation to the management of the licensee. The close out meeting may be attended by the senior members of the inspection team only.

124. The inspection team should, before presenting its findings, ensure that they thank the licensee for their time (and and cooperation and hospitality) as well as any other acknowledgements as may be fit.

125. The remainder of the meeting should be structured in a manner that would allow the inspection team to properly present its findings. In doing so, the inspection team should ensure that the licensee is aware that the findings as presented are merely preliminary and not final and that the licensee will have an opportunity to make rebuttals both during the meeting and once the draft report is presented to them. Further, the licensee should be made aware of the fact that any amendments to the inspection team's findings will only be in respect to statements of fact.

126. In addition, the licensee should be afforded the opportunity to make comments and rebuttals. The inspection team should accord the licensee all necessary courtesies in making their presentation with minimal disruption.

127. In closing, the inspection team leader should confirm the time frame within which the licensee should expect the draft report, and then conclude with appropriate greetings.

Post-onsite Inspection – Preparing the Inspection Report

128. Following the conclusion of an onsite inspection of a licensee, the inspection team must immediately embark on preparing the relevant inspection report. In preparing the draft inspection report, the inspection team should be guided by the Guidelines for Preparing Compliance Inspection Reports outlined in **Appendix 8**. These Guidelines must be strictly adhered to. In addition, **Appendix 9** provides a template on the structure of an onsite inspection report detailing all the required sections to be included in the report as well as the prudential standards and legislative guidelines that govern the process. The scope of the template may be expanded as considered necessary to provide a comprehensive report; this may become necessary in many instances, considering that the nature, scope and complexities of licensees' businesses and operations differ in some respects. The template must therefore not be seen as a rigid document, but rather one that simply provides guidance with sufficient room for flexibility in terms of expanding or varying its scope. The inspection team should therefore feel free to adopt, adapt or modify the structure of the template on onsite inspection report as the nature and circumstance of the inspection requires.

129. The Inspections Coordinator has responsibility for coordinating the preparation of the inspection report. The initial draft inspection report, when prepared, is to be submitted by the Inspections Coordinator to the Director of Legal and Enforcement who will review it and advise on any pertinent legal issues relative to the report. Once the initial draft report is finalised, it is to be submitted under cover of an appropriate paper to the Licensing and Supervisory Committee seeking specific decision(s) (this process is guided by the ***Operating Procedures and Guidelines of the Licensing and Supervisory Committee***). Where the Committee takes a decision to refer the report to the Enforcement Committee – and this will happen in any case where the report identifies any breach on the part of a licensee – such a referral is to be acted upon accordingly. It should be noted that in all cases of referral the Licensing and Supervisory Committee does not approve the report; that becomes the responsibility of the Enforcement Committee. The report must not, both at the Licensing and supervisory Committee stage and the initial stage of the referral to the Enforcement Committee, contain any provisions on corrective measures. Once approved by the Enforcement Committee, the report should be forwarded to the licensee to which it relates seeking their comments on the factual aspects of the report. This must be done within the period specified in **Appendix 8**, unless for good reason the Enforcement Committee advises otherwise.

Upon the receipt of any comments, the report should then be finalised, taking into account any comments received as considered relevant, and referred once again to the Enforcement Committee with recommendations on ratings²¹ to be applied and the proposed corrective actions to be undertaken by the licensee concerned and within what time frame. Once

²¹ The current ratings applied are “Satisfactory”, “Room for Improvement” and “Unsatisfactory”. This rating method may change once the current review of the K-Review is completed. The current international rating formula in respect of reviews and assessments is “Compliant”, “Largely Compliant”, “Partially Compliant” and “Non-Compliant”.

approved, the report is referred to the licensee, following compliance with the requirements outlined in paragraph 132 below.

130. It should be noted, however, that while a licensee's comments may be taken on board in preparing the final report, the comments by themselves may not necessarily affect the rating to be applied to a particular compliance subject. This would ordinarily be the case where the essential substance of the particular compliance subject is considered not to have been performed to the required level. In each case, the scope and level of compliance is essential in assessing the appropriate rating to be applied and this must be carried out objectively.

Post-inspection Monitoring

131. The post-inspection monitoring of licensees is a fundamental aspect of the overall inspection process. It is therefore essential that appropriate steps are undertaken to ensure that corrective actions approved by the EC are indeed being adhered to. Normally the corrective actions required would stipulate the period within which the required corrective action is to be given effect. It is the duty of the Inspections Coordinator to ensure that necessary monitoring is undertaken to establish compliance with the stipulated period and prepare and submit updated reports to the EC. Unless otherwise specifically exempted by the EC, every licensee in respect of which corrective action is required will be placed on a Monitoring List maintained by the Inspections Coordinator. This means that the licensee is required to submit periodic reports (as determined by the EC) to the Commission detailing its compliance with the corrective actions required of it. The Inspections Coordinator may, where he/she considers it appropriate, recommend to the EC that a licensee be removed from the Monitoring List on account of its compliance with the required corrective actions. As a guide, **Appendix 10** outlines the template for preparing a monitoring report for the EC's consideration and this may be modified in such manner as may be necessary in order to achieve comprehensiveness.

Objectives in Relation to Inspection Report

132. The final report on the inspection that the Commission prepares and sends to the licensee should

- (a) set out the findings and observations of any solvency, compliance and policy nature that arose from the inspection;
- (b) set out the ratings and the recommendations (or corrective actions) to be carried out by the licensee, including the time frame within which they should be carried out;

- (c) request, where appropriate, that management outlines its plans for addressing the Commission's findings and recommendations;
- (d) report on the scope of the inspection, describing what was done and what was not done;
- (e) indicate the degree of reliance placed on other parties, for example, the internal and external auditors; and
- (f) outline any other pertinent matter that should be brought to the attention of the licensee.

Considerations Relevant to Inspection Report

133. The inspection report is primarily for use by the Commission and serves as a permanent record of the findings of the inspection. The Commission decides, as a matter of policy, who will receive a copy of the inspection report. There are good reasons for sending a copy of the report to the licensee if any recommendations are to be meaningfully observed to the satisfaction of the Commission. The report makes the licensee aware of the concerns of the Commission, provides the evidence for those concerns, and gives recommendations designed to resolve matters that arose during the inspection. The report should contain only the essential facts (and financial records, schedules and credit classifications in respect of banks, for example, can be attached to the report as appendices).

Requirements in Relation to Inspection Report

134. The inspection team should comment in the report on all findings that are not satisfactory to enable the Commission to provide recommendations to the licensee as to how to rectify the deficiencies. Where the Commission has made recommendations, it should specify to the licensee, whenever feasible, the nature and timing of the response.

135. Unnecessary reporting and comments should be avoided. It is important that only essential facts be presented in the report. It should not dwell on minor violations or other deficiencies that do not adversely impact the soundness of the licensee, except where such violations are considered to present serious potential for future violations. All relevant supporting documents may be attached to the report, ensuring that in each case there is an appropriate reference in the report to the attachment for the relevant nexus to be established.

136. The report should explore fully all issues considered worthy of comment by the inspection team. It must also clearly explain and define any serious deficiencies requiring recommendations or comments. Comments presented in the report must be objective and based on documented facts.

137. The inspection team, during the course of the inspection of the licensee, should have discussed all of the major findings described in the report with senior management of the licensee. The comments in the report should also show the extent to which the inspection team suggested corrective measures and the action that the licensee has taken or promised. That process should ensure that discrepancies, about which the licensee has not had the opportunity to make a comment, are not presented as serious weaknesses in the report; this may be done only after receipt of comment from the licensee.

138. The final report on the onsite inspection should be presented to the Enforcement Committee for consideration and approval. Once approved, the report will be issued with the appropriate recommendations, including the ratings applied and the corrective actions which must be completed by the licensee within the timeframe prescribed by the Commission. Therefore the first phase of the process is one of monitoring the licensee to ensure that they implement the corrective actions within the timeframes as prescribed by the Commission.

139. The Commission assesses the ratings as well as the suitability and adequacy of the corrective measures outlined. Once this process is completed the Commission will make a determination as to whether and when a follow up inspection may be required in respect of the licensee.

PART IV

Assessing Credit Risk: Banking

140. With respect to risks generally in relation to a bank, it is important for regulators (and indeed those engaged in inspections) to be fully cognizant of the risk factors outlined in Part III of the Regulatory Code, 2009. All banks will need to be assessed on their levels of compliance with the provisions of that Part.

Credit Risk

141. Credit is the provision of, or a commitment to provide, funds or substitutes for funds (both on- and off-balance sheet), on a secured or unsecured basis, to a debtor who is obliged to repay, on demand or at a fixed or determinable future time, the amount borrowed together with fees and/or interest thereon. Credit risk is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honour its financial or contractual obligations to the lending institution.

142. For most banks, extending credit comprises the major portion of their business. To a great extent, therefore, the quality of the bank's credit portfolio determines the risk to depositors.

Objectives in Reviewing Credit Risk

143. The objectives in reviewing credit risk are

- (a) to determine the adequacy of the bank's policies, practices, procedures and controls in all the phases of the credit function;
- (b) to determine the quality of the credit portfolio and how that quality relates to the soundness of the bank;
- (c) by examining all, or a selected sample of a bank's portfolio of credits of all types, to:
 - (i) determine if the credits are accurately reported on the balance sheet;
 - (ii) determine the adequacy of provisions for credit losses booked by the bank;
 - (iii) recommend, if considered appropriate, additions to provisions for credit losses booked by the bank;

- (iv) determine if the staff is operating within established internal guidelines;
- (v) determine the scope, adequacy and effectiveness of the loan review function;
- (vi) determine compliance with laws and regulations, including codes, guidelines, practice directions and directives issued by the Commission; and
- (vii) initiate corrective action if policies, practices, procedures or internal controls are deficient or if violations of law or regulations have been detected.

Credit Risk Management

144. It should be noted that banks will always be exposed to credit risk, as lending activities will continue to be a significant contributor to income. However, banks should limit risks to controllable levels by implementing sound policies that ensure the implementation of appropriate systems, procedures and controls in all three phases of the lending activity including evaluation of credit proposals, portfolio management and control, and orderly collection of the debt.

145. Managing credit risk is a fundamental component in the safe and sound management of all banks. Sound credit risk management involves prudently managing the risk/reward relationship and controlling and minimising credit risks across a variety of dimensions, such as quality, concentration, currency, maturity and security.

146. Although the particulars of credit risk management will differ among banks, depending upon the nature and complexity of their credit functions and portfolios, a comprehensive credit risk management programme requires

- (a) identifying existing or potential credit risks to which the institution is exposed in conducting its business activities and developing and implementing sound and prudent credit policies to effectively manage and control these risks;
- (b) developing and implementing effective credit granting, documentation and collection processes; and
- (c) developing and implementing comprehensive procedures to effectively monitor and control the nature, characteristics, and quality of the credit portfolio.

Credit Policies

147. Credit policies establish the framework for lending and reflect the bank's credit culture and ethical standards. To be effective, the bank must communicate its policies in a timely fashion, implement them through all levels of the organisation by appropriate procedures and revise them periodically in light of changing circumstances.

148. The establishment of a written credit policy provides the foundation for sound loan portfolio management. It is the responsibility of the board to formulate such policy. The objectives of a credit policy are to

- (a) grant loans on a sound and collectible basis;
- (b) invest the bank's funds profitably for the benefit of shareholders and the protection of depositors; and
- (c) serve the legitimate credit needs of the community.

149. In developing the credit policy, the bank must consider its available resources, staff capability, facilities and growth potential.

150. Credit policies need to contain, at a minimum,

- (a) a credit risk philosophy governing the extent to which the institution is willing to assume credit risk;
- (b) general areas of credit in which the institution is prepared to engage or is restricted from engaging;
- (c) clearly defined and appropriate levels of delegation of approval, and provision or write-off authorities; and
- (d) sound and prudent portfolio concentration limits.

151. The bank must develop and implement these policies within the context of a credit risk management environment that ensures that its staff conducts all credit dealings in the highest possible standard of ethical behaviour.

152. The lending policy should contain a general outline of the scope and allocation of the bank's credit facilities and the manner in which they are granted, serviced and collected. The policy should be broad and not too restrictive. Inflexible rules not only stifle initiative, but also may hamper profitability and prevent the bank from serving the changing needs of the community.

153. The policy guidelines must include a determination of who will receive credit, of what type and at what price. Other factors to be considered include who will grant credit, in what amount and what organisational structure will ensure compliance with established guidelines and procedures.

154. The lending policy should establish credit limits for all lending officers. The bank must also define reporting procedures and the frequency of committee meetings.

155. The lending policy should clearly define delinquent obligations of all types. It must also determine which reports should go to the board. These reports should provide sufficient detail to permit the determination of risks, loss potential and alternative courses of action.

156. Collection procedures should require a follow-up process that is systematic and progressively stronger. The bank should, at a defined period of delinquency, present accounts to the board for review and authorisation for charge-off. Small delinquent accounts that remain on the books for prolonged periods of time will cost the bank more in administrative expense than the amount of the debt.

157. The bank's lending policy, as well as its code of ethics, should state the limits and conditions under which the bank can engage in credit and other transactions with its group of related parties. These include affiliates, subsidiaries, major shareholders, directors and senior management, and their direct and related interests.

158. To ensure that a bank does not expose itself excessively to a single or associated counterparty, it needs to establish credit limits within the context of its aggregate exposure to such counterparties. This should take into account the total credit extended and the total investment in security instruments issued by such counterparties.

Evaluating Credit Proposals

159. In this phase the bank identifies the business opportunity, assesses and approves the risk and disburses funds to the borrower. Policies, systems and procedures must cover all steps of loan initiation. This includes borrower investigation; credit analysis; approval procedures; documentation required; collateral appraisal including its perfection, value and control; and the disbursement of funds.

160. Although some well-constructed credits can deteriorate because of unforeseen circumstances, most credit problems stem from disregarding or inadequately assessing basic lending principles, including

- (a) the purpose of the credit and source of repayment;

- (b) the character, integrity and reputation of the borrower to promptly and willingly repay debts or fulfill contractual obligations;
- (c) the borrower's capacity to repay, based on historical financial trends and cash flow projections; and
- (d) the adequacy of collateral.

161. For commercial credits, the borrower's business or management capability and the status of the borrower's industry and its position within that industry also need to be considered.

162. Collateral, though important as an alternative source of repayment, should never be a substitute for a borrower's capacity or repayment source. Its forceful liquidation may cause the business to fail.

163. Traditionally, the analysis of the balance sheet and profit and loss statements provides a measurement of the repayment capacity of a borrower. Such analysis highlights components of the balance sheet in the current and preceding financial years. It calculates certain ratios to determine the reasonableness of each item in the total financial structure and the existence of favourable or unfavourable trends. This analysis, however, provides only partial information about the borrower's financial position. Ratios and changes in net working capital do not give a clear indication of how liquid or illiquid the borrower will be soon. It is important, therefore, to measure the rate at which borrowers can generate cash flow to cover expenses.

164. A review of the income statement includes an analysis of gross and net operating margins both historical and projected. This analysis must take into account any adjustment made to accruals and changes in net working capital. One should compare the gross and net operating margins with expected future outflows not related to operations, such as interest payments, taxes, short term debt repayment, dividend payments and long term debt retirement. One should also consider the expected impact of the business cycle and other structural internal and external factors.

Documentation

165. In developing and maintaining a sound portfolio, the terms of each credit must be adequately and accurately documented. Inadequate, incomplete, or unenforceable documentation could lead to non-recovery of funds, particularly in instances where lenders are obliged to resort to litigation for credit recovery.

166. For a bank to conduct meaningful credit reviews and ensure that assets are soundly and conservatively valued, it must maintain credit files supporting the credit granting and review process.

167. Each credit file needs to contain, at a minimum, information that
- (a) identifies the borrower by name and occupation or type of business, and identifies co-signers, endorsers, guarantors and connected counterparties;
 - (b) provides evidence of the borrower's legal ability to borrow, financial condition, and ability to repay including, the timing and source of repayment;
 - (c) describes the terms of the credit obligation, including the purpose of the credit;
 - (d) describes and evaluates the collateral, indicating the marketability and/or condition thereof;
 - (e) provides a history of the credit, including copies of the most recent credit authorisation and internal credit reviews, and evidence of the level of approval; and
 - (f) where applicable, describes the relationship of the borrower to owners, directors and management of the bank.

Collection

168. This is a key phase in the credit process, as all efforts made in the previous phases should come together in the orderly collection of the credit. However, if the bank does not identify loan problems during the supervision and review phase, it is this phase where close monitoring of credits occur. If problems persist, the bank may have to restructure the credit or liquidate it according to established policies.

169. If restructuring or re-negotiation occurs, the bank should carefully evaluate all factors to determine that there is a real chance of improvement in the quality of the risk resulting from such action. Obtaining additional collateral to adequately support that loan could be a part of such evaluation. However, if the deterioration of the credit is such that restructuring or re-negotiation is not viable, then the bank should initiate actions to recover the debt through legal proceedings or foreclosure or repossession.

Portfolio Management and Control

170. In order to track portfolio diversification characteristics, each bank needs to have in place a system to enable credits to be grouped by single and associated groups of counterparties, types of credit facilities, and industries.

171. Each institution needs to have a credit rating system that defines risk-rating criteria and rates credits according to those criteria. Internal credit ratings provide an effective tool for monitoring the level and trends in the quality of individual credits and the credit portfolio by highlighting credits or segments of the portfolio that warrant special attention.

172. At a minimum, a rating system should permit credits to be classified as

- (a) satisfactory or acceptable risk;
- (b) below standard risk (or substandard); and
- (c) unsatisfactory risk or doubtful (for example, credits in which payments are contractually past due, credits in which partial or complete provisions for loss have been made, or credits not adequately supported by collateral, where appropriate).

173. Furthermore, each bank needs to develop and implement appropriate policies for classifying credits as non-accrual and conservative accounting policies for recognising revenue related to such accounts. Usually, credits are classified as non-accrual whenever there is serious doubt as to the ultimate payment of principal or interest, whenever a provision for loss has been recorded against the account, or where interest owing remains uncollected 90 days following its contracted or scheduled date for payment. Normally, revenue should not be recognised through the capitalisation of interest in any manner, except where this was specifically agreed upon with the client and formed part of the original terms of the credit and the loan continues to be adequately collateralised or is otherwise in good standing.

174. The bank must institute an efficient system for monitoring adherence to established guidelines. It can accomplish this through an internal loan review function and an adequate reporting consisting of relatively smaller credits of a similar nature, may permit the adoption of procedures that rate all credits as satisfactory, unless there are indications to the system. Both of these should inform management of how policies are being followed; provide sufficient information to evaluate the performance of lending officers, and the condition and quality of the credit portfolio.

175. Each bank should also have an adequate loan review system. This assists the bank in identifying losses resulting from the incapacity of the borrower to meet its obligations. In order to be effective the loan review function must

- (a) report directly to the board of directors or its credit committee;
- (b) be independent from other phases of the credit process;
- (c) have an adequate scope of credit review including all areas of risk exposure;

- (d) have experienced and competent personnel to perform the review function; and
- (e) establish an effective mechanism to follow up on recommendations and the correction of deficiencies detected during the review.

Inspection Essentials

176. During the inspection process, regulators will find a variety of credit files and support information in banks. However, the fundamental information used in the credit review and approval system is essentially the same. In this regard, the inspection team should

- (a) obtain a list of credits from the bank, and select for review a sample of
 - (i) the larger credits;
 - (ii) credits in a non-accrual status;
 - (iii) credits on which interest is not being collected in accordance with the terms of the credit;
 - (iv) credits whose terms were modified by a reduction of interest rate or principal payment, by a deferral of interest or principal, or by other restructuring of repayment terms;
 - (v) credits considered "problem credits" by management;
 - (vi) loan commitments and contingent liabilities;
 - (vii) credits to employees, officers, directors, principal shareholders and their interests; and
 - (viii) extensions of credit to directors and officers of other financial institutions;
- (b) request any list of concentrations of credits prepared by the bank: if the bank does not maintain a list, or if it is incomplete, obtain a list of obligations that exceed 10% of the bank's capital structure. The obligations should include loans, contingent liabilities and other obligations to one borrower or related group of borrowers;
- (c) obtain and review

- (i) a copy of written policies covering all phases of the credit function;
 - (ii) copies of reports furnished to the board for its meetings; and
 - (iii) a copy of the most recent report from the internal credit review group, parent bank Regulators or home country Regulators;
- (d) examine individual credit files, completing a review sheet for each, to determine the soundness of each credit.
- (e) if the credit is classified doubtful or loss, the regulator must determine the amount of the provision and provide an analytical justification
- (f) discuss with senior credit officers any files where such discussions will be helpful in the assessment;
- (g) review the credit policies and updates thereto with particular reference to
 - (i) distribution of credits by category;
 - (ii) industrial concentration limits;
 - (iii) credit limits of committees and officers;
 - (iv) prohibited types of credits;
 - (v) maximum maturities for various types of credits;
 - (vi) collateral appraisal policies;
 - (vii) financial information requirements;
 - (viii) guidelines for loans to major shareholders, directors, officers and their interests;
- (h) determine non-adherence to policies, practices procedures and controls;
- (i) if there is a credit committee, review its minutes to obtain
 - (i) membership;
 - (ii) scope of work;
- (j) with regard to past due credits,

- (i) determine whether delinquency reports are submitted to the board;
 - (ii) compare board delinquency reports or lists with any submitted for regulatory purposes;
 - (iii) determine whether delinquency reports submitted to the board are sufficiently detailed to show risk factors;
- (k) investigate assets that were transferred prior to the date of the inspection to determine if any were transferred to avoid review by the regulators;
- (l) determine general portfolio distribution characteristics by
 - (i) determining the percentage of total credits in specific industrial classes;
 - (ii) comparing credit category distributions to policy guidelines;
- (m) determine the aggregate amount of credits in each of the levels of classification - satisfactory, sub-standard, doubtful, and loss;
- (n) compile a list of credits not supported by current and satisfactory credit information;
- (o) compile a list of all credits not supported by complete collateral documentation;
- (p) compare management's list of "problem" credits to the regulators' list of classified credits to determine the extent of management's knowledge of its own credit problems;
- (q) discuss with management
 - (i) the adequacy of written policies regarding concentration of credits;
 - (ii) the manner in which the bank's staff is acting in conformance with established policies;
 - (iii) matters requiring immediate action;
 - (iv) detection of weaknesses in the credit process;
 - (v) the adequacy of provisions and reserves for credit losses;
 - (vi) the adequacy of documentation;
 - (vii) the adequacy of collateral appraisal;

- (viii) the existence of realistic repayment programmes and their enforcement;
- (ix) the existence of updated credit analysis of the borrower's economic condition as well as the quality of the analysis performed;
- (r) prepare inspection report comments, which may include
 - (i) scope of the inspection of the credit function;
 - (ii) quality of policies, practices, procedures and controls over the credit function;
 - (iii) adherence to policies, practices, procedures and controls;
 - (iv) scope and adequacy of the credit review system;
 - (v) quality of the credit portfolio;
 - (vi) ability of management;
 - (vii) causes of existing problems;
 - (viii) correction of deficiencies promised by management;
 - (ix) credits to connected persons and their interests.

Other Assets Risk

177. The general ledger account (referred to as "Other Assets") may include all balance sheet asset accounts not usually covered in other areas of the inspection process. Often, such accounts are not significant in the overall financial condition of the bank. However, the accounts can also be used to conceal sub-quality assets and must therefore be reviewed.

Objectives in Reviewing Bank's Other Assets

178. The objectives in reviewing the bank's Other Assets are to
- (a) determine if policies, practices and procedures regarding other assets are adequate;
 - (b) evaluate the quality of other assets;

- (c) assess the marketability and diversification of other assets;
- (d) determine compliance with laws and regulations; and
- (e) initiate corrective action if policies, practices and procedures are deficient or if there have been violations of laws or regulations.

Relevant Considerations

179. "Other Assets" includes temporary holding accounts such as suspense, inter-office, teller, transit and bookkeeping differences having debit balances. Those accounts should contain temporary entries until the bank receives the offsetting entry or fully identifies and posts it to the proper account. Nothing should remain in those accounts for any significant time; usually more than ten business days. The bank should close out all differences, at least quarterly.

180. "Other Assets" also includes prepaid expenses and income earned and not collected. Prepaid expenses represent cash outflows for future goods and services. Income earned and not collected results from the accrual of income on assets, not received as of the reporting date.

181. Regulators should obtain a detailed breakdown of the components of the account. Materiality is a major factor in deciding which accounts to review. There is no need to analyse the nature and quality of each item. This is important particularly if the item is so small that it has no significant impact on the overall soundness of the bank or the quality of its earnings.

Inspection Essentials

182. The inspection team should

- (a) test for compliance with policies, practices and procedures;
- (b) obtain a list of other assets;
- (c) note particularly receivables that should be classified as loans, and large, old or unusual items;
- (d) note that of particular concern are significant amounts of interest or other income, accrued but not collected, and other assets that represent advances to related organisations, directors, officers, employees or their interests;

- (e) determine that “Other Assets” are amortised over a reasonable period, in accordance with their economic life;
- (f) request management to make the appropriate adjustments for items that are determined to be stale, abandoned, un-collectible or carried in excess of estimated values; and
- (g) prepare, in appropriate report form, after discussing with management,
 - (i) criticised Other Assets;
 - (ii) adequacy of written policies relating to Other Assets; and
 - (iii) recommended corrective action if policies, practices or procedures are deficient.

PART V

Liquidity: Banking

Liquidity Risk

183. Liquidity is the availability of funds, or assurance that funds will be available, to honour all cash outflow commitments (both on and off-balance sheet) as they fall due. Cash inflows, supplemented by assets readily convertible to cash or by the bank's capacity to borrow, generally take care of these commitments. The risk of illiquidity increases if there is a mismatch of principal and interest cash flows related to assets, liabilities and off-balance sheet items.

184. The management of liquidity is undifferentiated as to currency denomination, since in principle, through the foreign exchange markets, a bank can meet commitments in one currency with funds in another. However, banks that conduct substantial business in foreign currencies need to make distinctions between the management of liquidity in value and that in other currencies.

Objectives in Evaluating Management of Bank's Liquidity

185. The objectives in evaluating the management of the bank's liquidity are to

- (a) determine if liquidity needs are being planned for adequately, and if anticipated and potential liquidity needs can be met;
- (b) determine the adequacy of internal management reports; and
- (c) initiate corrective action if liquidity policies, practices or procedures are deficient.

Relevant Considerations

186. Forecasting is essential to liquidity planning. Management must consider the effect that certain events are likely to have on funding requirements. Management must also have contingency plans in case its projections are not accurate. Effective contingency planning involves identifying minimum and maximum liquidity needs and weighing alternative courses of action designed to meet those needs.

Liquidity Management

187. Managing liquidity is a fundamental component in the safe and sound management of all banks. Sound liquidity management involves prudently managing assets and liabilities (on- and off-balance sheet), both as to cash flow and concentration, to ensure that cash inflows have an appropriate relationship to approaching cash outflows.

188. The objectives of liquidity management are

- (a) honouring all cash outflow commitments (both on- and off-balance sheet) on an on-going daily basis;
- (b) avoiding raising funds at market premiums or through the forced sale of assets; and
- (c) satisfying statutory liquidity and statutory reserve requirements.

189. Although the particulars of liquidity management will differ among banks depending upon the nature and complexity of their operations and risk profile, a comprehensive liquidity management program requires

- (a) establishing and implementing sound and prudent liquidity and funding policies; and
- (b) developing and implementing effective techniques and procedures to monitor, measure and control the bank's liquidity requirements and position.

Asset Management

190. A bank may meet its liquidity needs by changing its asset structure through the sale or planned runoff of readily marketable assets. Liquid assets should have the following attributes:

- (a) diversified residual maturities appropriate for the bank's cash flow needs;
- (b) readily marketable or convertible into cash; and
- (c) minimal credit risk.

191. The amount of liquid assets that a bank should hold depends on the stability of its deposit structure and the potential for rapid growth of assets. Generally, if deposit accounts consist primarily of small stable accounts, a relatively lower allowance for liquidity is necessary than if deposit accounts contain a significant amount of large or rate sensitive accounts.

192. Holding assets for liquidity purposes will involve some loss of earnings relative to other investment opportunities. However, the primary objective with respect to managing the liquid assets portfolio is to ensure its quality and convertibility into cash.

Liability Management

193. A bank may also meet its liquidity needs through liability sources. The bank can compare the alternative costs of obtaining liabilities to the opportunity cost of selling various assets.

194. Liability management tends to be more prevalent among larger banks. They are usually in a better position, than smaller banks, to control the level and composition of their liabilities. When funds are required, larger banks have a wider variety of options from which to select the least costly method of generating funds.

195. The marginal cost of liquidity, the cost of incremental funds acquired, is of paramount importance in evaluating liability sources of liquidity. The bank's ability to obtain sufficient funds in the market is difficult to estimate. Until the bank attempts to increase its funding it will not know, with complete certainty, that funds will be available at a price that will maintain a positive yield spread.

196. Regulators should be aware of the following risks associated with liability management:

- (a) funds may not always be available when needed. If the market loses confidence in a bank, its liquidity may be threatened;
- (b) too great a reliance on liability management may cause a bank to minimise holdings of short term securities, or to relax asset liquidity standards. This could result in a large concentration of short term liabilities supporting assets of longer term maturity. During periods of tight money, this could cause an earnings squeeze and an illiquid condition;
- (c) a bank may incur a relatively high cost in obtaining funds and may lower credit standards to invest in higher yielding loans and securities;
- (d) if high cost liabilities are used to support assets already on the books, this may result in a negative yield spread; and

- (e) preoccupation with obtaining funds at the lowest possible cost, without considering maturity distribution, greatly intensifies exposure to the risk of interest rate fluctuations.

Other Sources of Liquidity

197. Other sources of liquidity include direct and indirect borrowing. Direct borrowings include promissory notes and inter-bank borrowings. Indirect borrowings include customer paper rediscounted, and assets sold with the bank's endorsement or guarantee or subject to repurchase agreement.

198. Liquidity lines and funding facilities may also have a role within a bank's liquidity program by helping a bank protect itself against temporary difficulties that might occur when honouring cash outflow commitments. Examples are the need to draw on credit facilities to meet unforeseen clearing commitments, and to meet credit commitments with drawdown at the customer's option. The bank should not place undue reliance on these facilities (including those that may be irrevocable or for which it has paid a fee) as substitutes for traditional funding sources as they are generally very short term in nature. In addition, they are costly compared with other funding sources, and the provider could withhold their availability. Banks using these sources for liquidity need to ensure that the provider of a facility has an appropriate credit standing and capacity.

199. If a bank borrows frequently, the regulators should conduct a complete analysis to determine what factors lead directly or indirectly to such borrowings. An effective analysis would include

- (a) the principal sources of borrowings;
- (b) the range and amounts of borrowings;
- (c) the frequency of borrowings and length of time indebted;
- (d) the reasons for such borrowings; and
- (e) a verification of the use of the funds.

200. Prudent uses of borrowings include the following:

- (a) to meet temporary or seasonal loan or cash requirements. In this case, the borrowing period is usually short;
- (b) to meet large and unanticipated deposit withdrawals that may arise during periods of economic distress; and

- (c) operating as an effective tool of liability management. Banks engaged in money market transactions may borrow on a more or less continuous basis.

201. Regulators should analyse changes in a bank's liabilities for signs of deterioration in its borrowing ability and overall credit worthiness. Indications of deterioration include

- (a) the payment of fees or commissions to obtain deposits. Such deposits generally carry higher interest rates than other sources, and are particularly susceptible to early withdrawal;
- (b) request by other banks or customers for collateral on previously unsecured borrowings or an increase in collateral requirements;
- (c) payment of above-market interest rates; and
- (d) a shortening of maturities of liabilities compared with its peer group.

Liquidity Policy

202. Every bank should have a written liquidity policy. Sound and prudent liquidity policies set out the sources and amount of liquidity required to ensure that liquidity is adequate to ensure the continuation of operations and to meet all applicable regulatory requirements. These policies must be supported by effective procedures to measure, achieve and maintain liquidity.

203. Deposit liabilities are the primary source of funding for all banks. In this context, an important element of a liquidity management program is the diversification of funding by origination and term structure. Each bank needs to have explicit and prudent policies that ensure funding does not become unduly concentrated with respect to:

- (a) individual depositor;
- (b) type of deposit instrument;
- (c) market source of deposit;
- (d) term to maturity; and
- (e) currency of deposit, if the bank has liabilities (both on-and off-balance sheet) in foreign currencies.

204. The primary funding risk is the unplanned deposit withdrawal or the reduced rate of deposit renewal at the time of maturity. Deposits may decline due to a loss of confidence in the bank, a general decline in savings, more attractive investments elsewhere, or as a result of other factors.

205. Concentrated funding sources leave the bank open to potential liquidity problems as a result of such unexpected deposit withdrawal and may also restrict a bank's flexibility in managing its cash flow. Banks with excessive funding concentrations may require additional liquid assets.

206. In the context of foreign currency deposits, funding policies also need to ensure that foreign currency cash flows are prudently managed and controlled within the policies and procedures.

207. A good policy should consider the unique characteristics of the bank, management's goals regarding asset and liability mix, desired earnings, and the margins required to achieve such earnings. The policy should establish responsibility for funds management decisions and provide the necessary co-ordination between the different areas of the bank. In addition, the policy should set forth guidelines with respect to

- (a) limits on the percentage reliance on a particular liability category;
- (b) limits on maximum and minimum average maturity for different categories of liabilities;
- (c) limits on the rate sensitivity position;
- (d) limits on the degree of imbalance in the rate sensitivity position; and
- (e) a limit on the minimum acceptable spread (rate differential between liability cost and asset yield) on new business.

Liquidity Control

208. Each bank needs to develop and implement effective and comprehensive procedures and information systems to manage and control liquidity in accordance with its liquidity and funding policies. These procedures must be appropriate to the size and complexity of the bank's liquidity and funding activities.

209. Internal audits are a key element in managing and controlling a bank's liquidity management program. Each bank should use them to ensure that liquidity management complies with liquidity and funding policies and procedures. Internal audits should, at a minimum, randomly test all aspects of liquidity management in order to

- (a) ensure liquidity and funding policies and procedures are being adhered to;
- (b) ensure effective controls apply to managing liquidity;
- (c) verify the adequacy and accuracy of management information reports; and
- (d) ensure that staff involved in the liquidity management fully understand the bank's liquidity and funding policies and have the expertise required to make effective decisions consistent with the liquidity and funding policies.

210. Bank management should present to the board for review regular assessments of the liquidity management operation.

Inspection Essentials

211. For the purposes of establishing risks associated with liquidity, the inspection team should

- (a) review financial statements and internal management reports paying special attention to
 - (i) asset mix and trends;
 - (ii) liability mix and trends;
 - (iii) relationship between rate sensitivity assets and rate sensitivity liabilities; and
 - (iv) stability of interest margins. Identify causes for significant fluctuations.
- (b) determine if management has planned properly for liquidity needs and, if adequate sources of funds are available to meet anticipated needs over the short term, by
 - (i) reviewing the internal management report detailing liquidity requirements and sources of liquidity; and
 - (ii) evaluating the bank's ability to meet anticipated or potential needs.
- (c) note the purpose and use of borrowings and any restrictions placed on them: are borrowings for asset growth or are they used to meet seasonal deposit downswings?

- (d) determine if management is adequately planning for longer-term liquidity needs by
 - (i) discussing with management budget projections for the appropriate planning period;
 - (ii) determining the future direction of the institution and noting the growth projected, source of funding for growth and any projected changes in asset or liability mix;
 - (iii) evaluating the reasonableness of future plans regarding funds management;
 - (iv) ascertaining whether the institution can achieve the amounts and types of funding projected and can achieve the amounts and types of asset growth projected; and
 - (v) ascertaining whether the degree of risk associated with the projected rate sensitivity position will be within reasonable limits;
- (e) evaluate the effectiveness of the internal management reporting system in providing for adequate supervision of funds management;
- (f) discuss with management
 - (i) the quality of planning to meet liquidity needs and the current ability to meet anticipated and potential liquidity needs;
 - (ii) the rate sensitivity position and an assessment of the degree of risk associated with the position;
 - (iii) the quality of administrative controls and internal management reporting systems; and
 - (iv) the effect of liquidity management decisions on earnings; and
- (g) prepare inspection report comments which highlight any deficiencies and also include recommendations.

PART VI

Market Risk: Banking

Market Risk

212. Market risk is the exposure of an institution's financial condition to adverse movements in macroeconomic factors that influence asset price. These factors include interest rates, equity prices, foreign exchange rates, and commodity prices. While many such risks can be diversified away, market risk is not diversifiable.

Relevant Considerations

213. Market risk limits should be established for both the acquisition and ongoing management of an institution's securities and derivative holdings and, as appropriate, should address exposures for individual instruments, instrument types, and portfolios. These limits should be integrated fully with limits established for the entire institution. At the institutional level, the board of directors should approve market-risk exposure limits that specify percentage changes in the economic value of capital and, when applicable, in the projected earnings of the institution under various market scenarios. Similar and complementary limits on the volatility of prices or fair value should be established at the appropriate instrument, product type, and portfolio levels, based on the institution's willingness to accept market risk. Limits on the variability of effective maturities may also be desirable for certain types of instruments or portfolios.

214. Accurately measuring an institution's market risk requires timely information about the current carrying and market values of its securities and derivative holdings. Accordingly, institutions should have market risk measurement systems appropriate for the size and nature of these holdings. Institutions with significant holdings of highly complex instruments should ensure that they have independent means to value their positions. Institutions using internal models to measure risk should have adequate procedures to validate the models and periodically review all elements of the modeling process, including its assumptions and risk-measurement techniques. Institutions relying on third parties for market risk measurement systems and analyses should fully understand the assumptions and techniques used by the third party.

215. Institutions should evaluate the market-risk exposures of their securities and derivative positions and report this information to their boards of directors regularly, not less frequently than each quarter. These evaluations should assess trends in aggregate market risk exposure and the performance of portfolios relative to their established objectives and risk constraints. They also should identify compliance with board approved limits and identify any exceptions to

established standards. It is the Commission's duty to ensure that banks have mechanisms to detect and adequately address exceptions to limits and guidelines.

216. Complex and illiquid instruments often involve greater market risk than broadly traded, more liquid securities. Often, this higher potential market risk arising from illiquidity is not captured by standardized financial modelling techniques. This type of risk is particularly acute for instruments that are highly leveraged or that are designed to benefit from specific, narrowly defined market shifts. If market prices or rates do not move as expected, the demand for these instruments can evaporate. When the regulators encounter such instruments, they should review how adequately the institution has assessed its potential market risks. If the risks from these instruments are material, the institution should have a well-documented process for stress testing their value and liquidity assumptions under a variety of market scenarios.

217. In assessing market risk and the management of such risk, this Procedures Manual focuses on the two major factors influencing market risk, that is, interest rate risk and foreign exchange risk.

Interest Rate Risk

218. Interest rate risk is the potential impact on a bank's earnings and net asset values of changes in interest rates. Interest rate risk arises when a bank's principal and interest cash flows (including final maturities), both on- and off-balance sheet, have mismatched repricing dates. The amount at risk is a function of the magnitude and direction of interest rate changes and the size and maturity structure of the mismatch position.

Objectives in Relation to Interest Rate Risk

219. The objectives with respect to interest rate risk are as follows:

- (a) to evaluate the bank's interest rate risk management program;
- (b) to determine whether the bank has in place interest rate risk policies;
- (c) to evaluate the bank's interest rate risk policies;
- (d) to evaluate the bank's risk management and control procedures; and
- (e) to evaluate the interest rate risk management reporting system.

Interest Rate Risk Management

220. Managing interest rate risk involves prudently managing mismatch positions in order to control, within set parameters, the impact of changes in interest rates on the bank. A comprehensive interest rate risk management programme requires

- (a) establishing and implementing sound and prudent interest rate risk policies;
- (b) developing and implementing appropriate interest rate risk measurement techniques; and
- (c) developing and implementing effective interest rate risk management and control procedures.

Interest Rate Risk Policies

221. Sound and prudent interest rate risk management requires clear policies. These policies need to include

- (a) an interest rate risk philosophy governing the extent to which the bank is willing to assume interest rate risk; and
- (b) explicit and prudent limits on the bank's interest rate risk exposure.

Interest Rate Risk Limits

222. Each bank needs to establish explicit and prudent interest rate risk limits, and ensure that the level of interest rate risk exposure does not exceed these limits. Risk limits are usually defined in relation to the bank's capital. They are normally expressed in terms of the allowable amounts for specified or cumulative maturity periods.

223. Changes in interest rates may have an effect on earnings by affecting

- (a) the interest income or expenses relating to assets, liabilities and off-balance sheet items; and
- (b) the value of fixed-rate assets, liabilities and off-balance sheet items that are carried on a market valuation basis.

Measurement of Interest Rate Risk

224. In order to manage interest rate risk effectively, the bank must have sufficient information to enable it to take appropriate action within acceptable, often very short, time

periods. The longer it takes a bank to eliminate or reverse an unwanted exposure, the greater the possibility of loss.

225. Interest rate risk measurement techniques include gap analysis, duration analysis and simulation models. Each bank should use at least one, and preferably a combination, of these techniques in managing its interest rate risk exposure. Each technique provides a different perspective on interest rate risk, has distinct strengths and weaknesses, and is more effective when used in combination.

226. A simple gap analysis measures the difference between the amount of interest-earning assets and interest-bearing liabilities (both on- and off-balance sheet) that reprice in a particular time period.

227. A negative or liability-sensitive gap occurs when interest-bearing liabilities exceed interest-earning assets for a specific or cumulative maturity period, that is, more liabilities reprice than assets. In this situation, a decrease in interest rates should improve the net interest rate spread in the short term, as deposits are rolled over at lower rates before the corresponding assets.

228. A positive or asset-sensitive gap occurs when interest-earning assets exceed interest-bearing liabilities for a specific or cumulative maturity period, that is, more assets reprice than liabilities. In this situation, a decline in interest rates should lower or eliminate the net interest rate spread in the short term, as assets are rolled over at lower rates before the corresponding liabilities.

229. More sophisticated gap reports measure mismatches of the bank's principal and interest cash inflows and outflows (including final maturities), both on- and off-balance sheet, that reprice in a given period.

230. Some banks complement gap reports with more complex sensitivity systems, such as duration analysis or simulation models. Briefly, duration measures how price-sensitive an asset, liability or off-balance sheet item is to small changes in interest rates by using a single number to index the bank's interest rate risk. This index represents the average term to maturity of the cash flows. Like other techniques to measure interest rate risk, the use of duration analysis is subject to limitations.

231. Simulation models are a valuable complement to gap and duration analysis. Simulation models analyse interest rate risk in a dynamic context. They evaluate interest rate risk arising from both current and future business and provide a way to evaluate the effects of strategies to increase earnings or reduce interest rate risk.

Control of Interest Rate Risk

232. Each bank needs to develop and implement effective and comprehensive procedures and information systems to manage and control interest rate risk in accordance with its interest rate risk policies. These procedures should be appropriate to the size and complexity of the bank's interest rate risk activities.

233. Internal audits are a key element in managing and controlling a bank's interest rate risk management program. Each bank should use them to ensure compliance with, and the integrity of, the interest rate risk policies and procedures. Internal audits should, at a minimum, randomly test all aspects of interest rate risk management activities in order to

- (a) ensure interest rate risk management policies and procedures are being adhered to;
- (b) ensure effective management controls over interest rate risk positions;
- (c) verify the adequacy and accuracy of management information reports; and
- (d) ensure that personnel involved in interest rate risk management fully understand the bank's interest rate risk policies and risk limits and have the expertise required to make effective decisions consistent with the interest rate risk policies.

Inspection Essentials

234. The inspection team should

- (a) determine whether management has developed interest rate risk policies for approval by the board;
- (b) establish whether the policies include explicit and prudent limits to which the bank is willing to assume risk;
- (c) determine whether the limits are reasonable, having regard to the bank's capital and liquidity;
- (d) determine whether the bank reassesses the limits on a periodic basis to reflect changes in circumstances;
- (e) determine whether the bank has assigned the management of interest rate risk to a position, unit or committee;
- (f) assess whether the individual, or committee, is appropriately qualified;

- (g) obtain a copy of any reports to management regarding interest rate risk and determine whether the content, format and frequency are appropriate;
- (h) conduct an analysis of the bank's position to determine the extent and significance of any mismatch;
- (i) discuss any significant issues with operating management; and
- (j) prepare a note with conclusions and recommendations for inclusion in the inspection report.

PART VII
FOREIGN EXCHANGE RISK: BANKING

Foreign Exchange Risk

235. Banks participate in the foreign exchange market as an intermediary for their customers. They also operate for their own account. The intermediary role often leaves the bank with a position in one or more currencies. If the resulting position differs from its desired one, then the bank will deal for its own account to achieve its desired goal.

Objective in Relation to Foreign Exchange Risk

236. The inspection objective with respect to foreign exchange risk is essentially to assess the risks attributable to the foreign exchange trading activities of the bank. This entails determining whether practices, policies, procedures and internal controls exist to avoid exposure to loss.

Operations in the Foreign Exchange Market

237. In order to satisfy the needs of their customers, commercial banks hold foreign currency balances with, or have access to such balances through, correspondent banks. These balances fluctuate as a result of purchases and sales of funds owned by firms, individuals, and other banks and by the purchase of bills of exchange, travellers' cheques and other instruments denominated in foreign currencies.

238. Exchange rate risk is an inevitable consequence of trading in currencies whose values fluctuate in response to changes in market supply and demand. A bank creates a net open position when it buys or sells a foreign currency. Until the bank covers the position by selling or buying an equivalent amount of the same currency, the bank is exposed to the risk that the exchange rate might move against it. Since exchange rate movements can accumulate in one direction, a position carried overnight or over a number of days entails a greater risk than one carried a few minutes or hours.

239. A bank has a net open position in a foreign currency when its assets, including spot and future contracts to purchase, and its liabilities including spot and future contracts to sell, in that currency are not equal. An excess of assets over liabilities represent a net "long" position while liabilities in excess of assets represent a net "short" position. A long position in a currency that is depreciating will result in an exchange loss relative to book value because that position (net foreign assets) can be converted into less local currency. Similarly, a short position in a currency that is appreciating represents an exchange loss relative to book value because conversion of that position (net foreign liabilities) will cost more in local currency.

240. For management and control purposes, most banks distinguish between positions arising from actual foreign exchange transactions (trading exposure) and the overall foreign currency exposure of the bank. The latter includes all bank assets and liabilities denominated in foreign currencies.

241. When a bank enters into a foreign exchange contract, it faces a risk that the counter-party will not perform according to the terms of the contract. To limit credit risk, a careful evaluation of the credit worthiness of the customer is essential. Just as no bank can lend unlimited amounts to a single customer, no bank would want to trade unlimited amounts of foreign exchange to one counter-party.

242. In any foreign exchange transaction, each counter-party agrees to deliver a certain amount of currency to the other on a particular date. In balancing its trading position, a bank counts on that contract being carried out in accordance with the agreed upon terms. If the bank does not liquidate the contract, then its position becomes unbalanced and that creates an exposure to the risk of changes in the exchange rates. To put itself in a covered position, a bank must arrange for a new transaction that it may have to arrange at an adverse exchange rate. Another risk arises because of the time zone differences between countries.

Foreign Exchange Risk Management

243. Regulators should understand foreign exchange risk and ensure that bank management by means of policies, limits, and systems, is prudently controlling that risk. A comprehensive foreign exchange risk management program requires

- (a) establishing and implementing sound and prudent foreign exchange risk management policies; and
- (b) developing and implementing appropriate and effective foreign exchange risk management and control procedures.

Foreign Exchange Risk Management Policies

244. Well-articulated policies, setting forth the objectives of the bank's foreign exchange risk management strategy and the parameters within which this strategy is to be controlled, are the focal point of effective and prudent foreign exchange risk management. These policies should include

- (a) a statement of risk principles and objectives governing the extent to which the bank is willing to assume foreign exchange risk;

- (b) explicit and prudent limits on the bank's exposure to foreign exchange risk; and
- (c) clearly defined levels of delegation of trading authorities.

245. A bank must decide the objectives of its foreign exchange risk management program and in particular its willingness to assume risk, before it sets its foreign exchange risk limits and management controls.

Foreign Exchange Risk Limits

246. Each bank needs to establish explicit and prudent foreign exchange risk limits, and ensure that the level of its foreign exchange risk exposure does not exceed these limits. Where applicable, these limits need to cover, at a minimum,

- (a) the currencies in which the bank is permitted to incur exposure; and
- (b) the level of foreign currency exposure that the bank will assume.

247. Usually, a bank establishes risk limits in terms of a relationship between the foreign exchange position and earnings or capital, or in terms of foreign exchange volume, such as total dollars or numbers of transactions.

Measurement of Foreign Exchange Risk

248. Managing foreign exchange risk requires a clear understanding of the amount at risk and the impact of changes in exchange rates on this foreign currency exposure. To make these determinations, sufficient information must be readily available to permit the bank to take appropriate action within acceptable, often very short, time periods.

249. It is only through the accurate, timely recording and reporting of information on exchange transactions and currency transfers that the bank can measure foreign currency exposure and control foreign exchange risk. Accordingly, each bank engaged in foreign exchange activities needs to have an effective accounting and management information system in place that accurately and frequently records and measures

- (a) its foreign exchange exposure; and
- (b) the impact of potential exchange rate changes on the bank.

250. At a minimum, each bank should have in place monitoring and reporting techniques that measure

- (a) the net overnight and forward positions in each currency or pairings of currencies in which the bank is authorised to have exposure;
- (b) the aggregate net overnight and forward positions in all currencies; and
- (c) transactional gains and losses relating to trading and structural foreign exchange activities and exposures.

Control of Foreign Exchange Activities

251. The key elements of any foreign exchange control program are well-defined procedures governing

- (a) organisational controls to ensure that there exists a clear and effective segregation of duties between those persons who
 - (i) initiate foreign exchange transactions; and
 - (ii) are responsible for operational functions, such as arranging prompt and accurate settlement, and timely exchanging and reconciliation of confirmations, or account for foreign exchange activities;
- (b) procedural controls to ensure that
 - (i) transactions are fully recorded in the records and accounts of the bank;
 - (ii) transactions are correctly settled; and
 - (iii) unauthorised dealing is promptly identified and reported to management; and
- (c) controls to ensure that the bank monitors frequently its foreign exchange activities against its foreign exchange risk, counterparty and other limits and that there are reports on excesses.

Independent Audits

252. Independent audits are a key element in managing and controlling a bank's foreign exchange risk management program. Each bank should use them to ensure compliance with, and the integrity of, the foreign exchange policies and procedures. Independent audits should, at a minimum, and over a reasonable period of time, test the bank's foreign exchange risk management activities in order to

- (a) ensure foreign exchange management policies and procedures are being adhered to;
- (b) ensure effective management controls over foreign exchange positions;
- (c) verify the adequacy and accuracy of management information reports regarding the bank's foreign exchange risk management activities;
- (d) ensure that foreign exchange hedging activities are consistent with the bank's foreign exchange risk management policies, strategies and procedures; and
- (e) ensure that personnel involved in foreign exchange risk management obtain accurate and complete information about the bank's foreign exchange risk policies and risk limits. In addition, they have the expertise required to make effective decisions consistent with the foreign exchange risk management policies.

253. The bank should present regularly to the board an assessment of the foreign exchange risk operations for review.

Inspection Essentials

254. The inspection team should

- (a) identify those contracts with counterparties who are affiliates of, or related to, the bank, directors, officers, employees or shareholders;
- (b) review net position schedules;
- (c) review maturity gap schedules;
- (d) obtain information on customers who have frequent or sizeable excesses over established limits;
- (e) assess whether the various limits set by the bank are excessive relative to

- (i) the bank's capital structure;
 - (ii) the creditworthiness of counterparties;
- (f) assess the experience of traders and foreign exchange department staff;
- (g) analyse the bank's foreign exchange earnings record;
- (h) discuss with management
 - (i) any foreign exchange contracts which may be questionable in quality or ultimate settlement;
 - (ii) any deficiencies in internal controls; and
 - (iii) any other matters regarding the efficiency and general condition of the department.

PART VIII

Operating Risks: Banking

Operating Risks

255. Operating risks relate to all of those factors that have a direct or indirect bearing on the effectiveness and efficiency of the bank's operations. This includes the behaviour and performance of the board; the quality of senior management; the quality and sustainability of earnings; the adequacy of internal controls; the scope and sufficiency of the work of internal auditors; and the effectiveness of the external auditors.

Management

256. In this context, management includes the board of directors and the senior operating management of the bank.

Objectives of Evaluating Management

257. The objectives of evaluating management are to

- (a) determine the existence and consistency of written objectives, policies, and procedures;
- (b) determine that policies are being adhered to throughout the bank;
- (c) determine that management is planning adequately for future conditions and developments;

- (d) assess the adequacy of the bank's recruiting, training and other personnel practices as they relate to management continuity;
- (e) assess management experience and depth;
- (f) determine that management has established systems that facilitate efficient operation and communication;
- (g) assess the propriety and soundness of management decisions; and
- (h) assess the impact of management on the future conditions of the bank.

The Board of Directors

258. The board of directors is an integral part of the management of a bank. Its composition, role, and responsibilities affect the behaviour and performance of the bank. A purely political, passive or excessively aggressive board can cause serious difficulties for banks.

259. Although directors may delegate the day-to-day routine of conducting the bank's business to officers and staff, they are accountable for the consequences of unsound or imprudent policies and practices. Directors are also responsible for safeguarding the interests of depositors and shareholders through the lawful, informed, efficient, and able administration of the bank. Because of their importance in supervising the affairs of the bank, a majority of the board should be independent of active management or the interests of major shareholders.

260. It is the duty of the board to select and appoint qualified executive officers to administer the bank's affairs, effectively and soundly. It is also the responsibility of the board to remove officers who are unable to meet reasonable standards of executive ability and efficiency.

261. The directors should provide a clear framework of objectives and policies within which the chief executive officer must operate and administer the bank's affairs. These objectives and policies should cover all significant areas of the bank. These include, in particular, credit and liquidity management, and capital planning.

262. Directors who become financially dependent on the bank compromise their usefulness as directors. Unwarranted loans to a bank's directors or to their interests are a serious matter from the standpoint of credit management. Losses that arise from such loans are bad enough, but the weakening effect on the bank's general credit standards is likely to be even worse.

263. Directors should make certain that they receive the results of inspections by the Commission and audits carried out by the bank's internal and external auditors. Directors should understand the procedures that auditors use and should review their reports.

264. Directors must exercise care to ensure that the bank maintains a reasonable level of capital and that the bank observes banking laws and regulations.

265. The board is ultimately responsible for the integrity of all aspects of the institution's risk management function. In this regard, the risk management function is defined to mean all of the banking risks to which the institution is exposed. This includes risks associated with credit, liquidity, operations, interest rate, foreign exchange, off-balance sheet, conglomerate and solvency.

266. In discharging its responsibility, the board should instruct management to develop risk management policies for the board's approval, and develop and implement procedures to measure, manage and control the structure and quality of the bank's risk assets. Management must also ensure that such policies and procedures remain adequate, comprehensive and prudent.

267. The board needs to have a means of ensuring compliance with all aspects of the risk management function. The board should ensure compliance through periodic reporting by management and internal auditors. The reports should provide sufficient information to satisfy the board that the bank is complying with all aspects of its risk management policies and programme.

268. At a minimum, the board should

- (a) review and approve policies related to all aspects of risk management recommended by the bank's management;
- (b) review periodically, but at least once a year, the entire risk management programme;
- (c) ensure the selection and appointment of qualified and competent management to administer each risk function;
- (d) ensure that an independent audit function reviews the operations of each risk function to assess whether or not the bank's policies and procedures are being adhered to, and whether the policies effectively contribute to the achievement of the bank's corporate objectives;
- (e) outline the content and frequency of management reports to the board on all aspects of risk management;
- (f) specifically, with respect to credit exposure,
 - (i) review credits to, or guaranteed by, officers of the bank, including policies related thereto;

- (ii) review credits to directors or firms in which they are partners, directors or officers, including policies related thereto;
- (iii) review credits to corporations controlled by the bank, or their officers or directors, including policies related thereto;
- (iv) ratify credits exceeding the level of authority delegated to management;
- (v) review significant credit exposures; and
- (vi) review trends in portfolio quality and the adequacy of the bank's provision for credit losses.

Operating Management

269. A direct relationship exists between the overall condition of a bank and the quality of the executive officers. Therefore, the first priority in evaluating the condition of the bank is to make a good appraisal of operating management.

270. Management is responsible, not only for the operations of the bank and the quality of its assets on a day-to-day basis, but also for planning for the future. Senior management should be judged by the sufficiency of earnings and a strong and liquid future condition. In projecting future management impact, regulators should consider the depth of planning and a general forward-looking attitude of executive officers.

271. Having regard to the bank's sources of funds, the Commission must judge the appropriateness of asset distribution. It must evaluate the adequacy of the bank's capital in view of asset quality and plans for growth and expansion.

272. Regulators must not restrict their appraisals to the past and present. The past and present certainly are significant and require an in-depth analysis of financial condition, earnings and capital adequacy, both on an absolute basis and as a trend. However, the determination of what the management will do for the bank in the future is more important. A projection of future involves an appraisal of the quality and quantity of senior and middle management.

273. The clear mandate to bank management is to "perform". Performance is measured in terms of long-run profitability, liquidity and solvency. It is almost impossible for a bank to achieve those long-range goals unless careful planning and co-ordination bring efficiency to its activities.

274. Although directors have overall audit responsibility and should require that the auditor report directly to them, it is the duty of senior management, normally, to maintain a strong system of internal control.

275. Senior management is responsible for the quality of all bank staff and for succession planning. A bank's recruiting and training are vital to the development and continuity of a quality staff. The regulators must carefully evaluate those areas and must look for evidence of good personnel management.

276. Co-ordination of activity is necessary if the bank wants to achieve the goal of obtaining and maintaining a strong staff. An important feature is an organisational structure. It should set out both responsibilities and authority for all personnel and establish lines of reporting and job descriptions for each position. The regulators should also judge the quality of the bank's training programme.

277. Regulators should enquire into the basis for bonuses or other incentive payments to staff, particularly those engaged in trading activities or business generation. Bonus schemes based on trading profits, loan production, and deposit generation require supporting control procedures to ensure the quality of the business being generated.

278. The management of each bank is responsible for managing and controlling the bank's exposure to banking risks in accordance with the risk management programme set out by the board. In carrying out these responsibilities, management must implement the bank's risk management policies and ensure that procedures are put in place to manage and control risks in accordance with these policies.

279. Although specific credit risk management responsibilities will vary from one bank to another, management at each bank is responsible for

- (a) developing and recommending policies that cover all aspects of banking risk for approval by the board of directors;
- (b) implementing the risk management policies;
- (c) ensuring that all banking risks are managed and controlled within the risk management program;
- (d) ensuring the development and implementation of appropriate reporting systems with respect to the content, format and frequency of information concerning all aspects of the risk management program;
- (e) ensuring that all management reports permit the effective analysis and the sound and prudent management and control of existing and potential risk exposures;

- (f) ensuring that an independent audit function reviews and assesses all aspects of the risk management program;
- (g) developing lines of communication to ensure the timely dissemination of all risk management policies and procedures and other risk management information to all individuals involved in the risk management process;
- (h) reporting comprehensively on significant risk management activities to the board of directors at least once a year; and
- (i) specifically with respect to credit risk,
 - (i) monitoring and controlling the nature and composition of the institution's credit portfolio; and
 - (ii) monitoring the quality of the credit portfolio and ensuring that the portfolio is soundly and conservatively valued, credit losses written off, and probable losses adequately provided for.

280. Policy manuals or handbooks may often exist, and regulators must review them to determine whether they are up to date and contribute to improving the bank's operations.

281. Although it is important for the directors to assume their appropriate role in setting objectives and formulating policy, dialogue with senior management must occur. Therefore, regulators should be alert for situations in which senior management dominates the board or acts solely at the direction of either the board or a dominant influence on the board. Such situations generally are detrimental to the bank.

282. The evaluation of management is difficult and regulators must remain constantly open-minded and innovative in their approach to management appraisal.

Inspection Essentials

283. The inspection team should

- (a) obtain the following, if available:
 - (i) administrative and personnel manuals;
 - (ii) business plan;
 - (iii) types of formal training programme(s) and employee participation;
- (b) review administrative manuals and obtain relevant policy statements;

- (c) determine the functional responsibility levels of various officers and whether lines of authority correspond with the organisational chart;
- (d) review the business plan and its general applicability to the institution;
- (e) determine whether performance bonuses have been established and, if so, what are the specific provisions of the plans and who are the beneficiaries;
- (f) assess the strength of middle management and the potential for advancement;
- (g) assess the bank's recruiting programme;
- (h) analyse periodic reports submitted to executive management to determine the usefulness of the reports in monitoring the condition and operation of the bank;
- (i) assess the level of employee morale;
- (j) review employee turnover statistics;
- (k) assess the technical proficiency of officers in their area;
- (l) evaluate the quality, depth and applicability of financial planning;
- (m) review the bank's written objectives and policies;
- (n) review any internal control and policy exceptions and any other criticisms made in connection with the internal audit of all areas of the bank;
- (o) review the evaluation of the bank's capital position and expectations in view of asset quality and plans for growth and expansion;
- (p) review any major new proposal being considered or changes in asset mix or services;
- (q) assess the nature and degree of working relationships with directors;
- (r) establish whether executive management is involved in activities outside the bank that are time-consuming;
- (s) establish whether overall management objectives have been set;
- (t) establish whether individual annual goals are reviewed as part of personnel evaluations;

- (u) determine whether appropriate job descriptions have been established;
- (v) determine whether employees are periodically reviewed;
- (w) ascertain whether qualified personnel are advanced from within;
- (x) determine whether management training is given to personnel likely to assume higher level positions;
- (y) ascertain whether specified training is provided for identified positions;
- (z) establish whether there is an orientation programme for new employees;
- (aa) assess management's commitment to effecting corrective action in problem areas;
- (bb) ascertain whether there are unsafe or unsound management practices;
- (cc) ascertain whether there are any situations that might require close monitoring or removal of management; and
- (dd) prepare a memorandum on the evaluation of management.

PART IX

Off-Balance Sheet Risks: Banking

Off-Balance Sheet Risks

284. Banks may enter into a series of financial contracts that may result in the acquisition of certain assets or liabilities at some future date and under certain conditions. These contractual obligations are contingent liabilities. Accounting practices do not consider these contracts in themselves to be assets or liabilities and, thus do not recognise them on the face of the balance sheet. These off-balance sheet items are quite diverse and include such items as guarantees, letters of credit, commitments to grant loans, and future and forward contracts.

Objectives in Relation to Off-balance Sheet

285. The objectives in reviewing off-balance sheet items are to

- (a) determine if policies, procedures and internal controls regarding all off-balance sheet items are adequate;
- (b) determine if the staff is operating in conformance with established guidelines;
- (c) provide an assessment of the bank's portfolio by examining a sample of the off-balance sheet items including guarantees, letters of credit, commitments to grant loans, future and forward exchange contracts, to determine credit quality, and collateral sufficiency;
- (d) determine compliance with applicable laws and regulations; and
- (e) recommend corrective action if policies, practices, or procedures are deficient, or the quality of the guarantees issued is poor or if violations of laws or regulations have been identified.

Relevant Considerations

286. The bank's role in an off-balance sheet transaction may be that of an intermediary, guaranteeing one or more parties' payment obligations, or that of an agent. In the latter case, the bank locates and introduces the counterparties, collects a fee for its services, and then steps aside from the transaction.

287. Credit exposure is incurred with all instruments, but the degree of risk of loss varies with the commitment undertaken. For those instruments whose prime function is not the extension of credit, for example, foreign exchange contracts, the credit risks are substantially less than those relating to conventional credits. Consequently, for bank record purposes the credit limit is recorded in terms of a deemed or notional risk amount.

Guarantees

288. Banks sometimes guarantee certain transactions between third parties. These include customer debts or payment on the occurrence or non-occurrence of certain events including, non-payment of taxes and customs duties.

289. Usually, the party for whom the bank issues the guarantee will reimburse the bank should it be required to pay under the guarantee. In certain situations, some other designated party may reimburse the issuing bank. The liabilities outstanding under guarantees are subject to the same limitations as loans to a single customer.

Letters Of Credit

290. A letter of credit is an instrument issued by a bank on behalf of one of its customers. The letter authorises an individual or firm to draw drafts on the bank or on one of its correspondents, provided the supplier meets the conditions stipulated in the credit. In a broad sense a bank issuing a letter of credit lends its credit to its client whose credit may be good, but not well known.

291. All letters of credit must be issued

- (a) in favour of a definite beneficiary;
- (b) for a specific amount of money;
- (c) in a form clearly stating how payment to the beneficiary is to be made and under what conditions; and
- (d) with a definite expiration date.

292. In most cases, the letter of credit is irrevocable and cannot be cancelled without the consent of all parties concerned. Under all letters of credit, the banker expects the customer to be financially able to meet his commitment. The customer should immediately settle the banker's payment under a commercial letter of credit. It should not become a loan.

293. The issuing bank should reflect a letter of credit as a contingent liability in its books. The bank usually sets up on both the liability and asset sides an account normally referred to as "Customer's Liability Under Unused Letters of Credit." This account represents contingent assets and liabilities since there is no direct liability until the shipper has drawn his draft and presented both the draft and documents under the credit.

Commitments to Grant Loans

294. These contracts obligate the bank to extend loans, credit lines, and other similar transactions. Commitments for which the bank has charged a fee or other consideration, or has a legally binding commitment should be included for review.

Future and Forward Contracts

295. A future contract is a standardised contract to purchase or sell a specified security or money market instrument on a future date at a specified price. A forward contract is an agreement in which one party agrees to buy and another to sell a specified security at a specified price for future delivery. Such contracts specify settlement in excess of thirty days following trade.

296. Bank management uses future and forward contracts to hedge portions of their investment portfolios against interest rate risk. Future and forward contracts are also used in foreign exchange operations to exchange one currency for another as of a specified date and time at a specified rate of exchange.

297. Banks that engage in future and forward contracts should do so according to safe and sound banking practices ascertaining its capacity to fulfill those obligations. The bank should formulate policy objectives considering its entire asset and liability mix. In more sophisticated markets banks trade future contracts on organised exchanges. Forward contracts, on the other hand, are not traded; do not require margin payments and only the agreement of both parties to the transaction can terminate them.

Litigation

298. Litigation that remains unresolved may affect the condition of a bank. The regulators should be aware of the status and possible outcome of all significant litigation. Since regulators do not usually have the legal skills to evaluate the significance of the litigation, they should ask the bank to provide them with some estimate of the cost.

Other Off-balance Sheet Items

299. These may include interest rate swaps and similar items.

Inspection Essentials

300. The inspection team should

- (a) test for compliance with policies, practices and procedures;
- (b) obtain information for total outstanding, guarantees, letters of credit, commitments to grant loans, future and forward contracts and other contingent liabilities;
- (c) obtain information, where appropriate, with respect to
 - (i) delinquencies;
 - (ii) transactions with employees, officers, directors and their related interests;
- (d) compare the interim financial statements to similar statements for the corresponding period in the prior year and to budgets, profit plans, etc., for the current period, if available;
- (e) obtain from management an explanation for
 - (i) any unusual items or significant fluctuations noted;
 - (ii) changes in accounting policies and practices;
 - (iii) commencement or discontinuance of services;
- (f) obtain from management a list of all litigation in process and pending. The following information should also be obtained:
 - (i) nature of the litigation;
 - (ii) progress to date;
 - (iii) how management is responding or intends to respond; and

- (iv) the likelihood of an unfavourable outcome and an estimate, if one can be made, of the amount or range of potential loss; and
- (g) prepare comments for inclusion in the inspection report on matters which may have a material effect on the condition of the bank.

PART X

Solvency Risks/Capital Adequacy Requirements: All Licensees²²

Solvency Risk

301. The solvency of a financial institution is affected by all of the risks relative to the nature of its business (see for instance in the Regulatory Code, 2009, Division 2 of Part V in relation to banks and section 141 in relation to insurers). Ultimately, however, the solvency requires a judgment about the adequacy of capital and the factors that contribute directly to that adequacy. Among the major factors are earnings, and more specifically their retention, loan loss provisions and write-offs in relation to banks as well as dividends.

Capital Adequacy

302. Capital adequacy represents one of the critical areas of evaluation in a financial institution's condition. Capital's principal function is to provide a financial cushion against unexpected losses. It provides protection to clients, insureds, depositors and creditors, as the case may be, and ultimately governments. The protection is a source of public confidence in individual licensees and the system they operate. Another function is to provide an adequate base for growth. Accordingly, the Regulatory Code, 2009 makes provision providing for specified capital adequacy requirements for banks, trust companies, insurance companies and money services businesses.²³

Objectives in Reviewing Capital Adequacy

303. The objectives in reviewing the capital adequacy of a licensee are to

- (a) evaluate the propriety and consistency of the present and planned level of capitalisation in light of existing conditions and future plans – this takes into account the nature, size, complexity, structure and diversity of the licensee's business;

²² There is no capital adequacy requirement for investment business licensees, including mutual funds; the same applies in respect of insolvency practitioners.

²³ See Division 1 of Part III for banks, Division 1 of Part V for trust companies and company management companies, Division 1 of Part IV for insurance companies and sections 168, 169 and 172 in Part VI for money services business.

- (b) determine compliance with laws and regulations, including international best practices and codes, guidelines, practice directions, etc. issued by the Commission; and
- (c) initiate corrective action when policies are deficient or when violations of laws or regulations have been noted.

Relevant Considerations

304. Most countries have established minimum capital standards. However, standards alone do not guarantee that banks maintain an appropriate amount of capital. The minimum capital standard should include a definition of capital and a statement of how the regulatory authorities will measure risks. The definition of capital should state the elements of capital that qualify for inclusion when computing the capital ratio, and should also define the required deductions from capital (reference has already been made to the Regulatory Code, 2009). The statement regarding risk should, in the case of banks, include the identification of the appropriate balance sheet and off-balance sheet items.

305. The primary determinants of the amount of capital appropriate for a licensee are the levels of the various risks it takes and the quality of the management of those risks. The most common risks associated with banks are credit, liquidity, interest rate, foreign exchange and operational risks; those associated with insurers may be outlined as market, investment, underwriting, pricing and product design, liquidity, credit, operational, reinsurance and custodial risks

306. Because of its critical importance in the success or failure of a financial institution, ensuring that each concerned licensee always has adequate capital is a fundamental responsibility of the licensee's supervisory authorities and the compliance officers have a significant role to play in that regard as well. Licensees that reflect higher risks should hold more capital than licensees with lower levels of risk.

307. Accordingly, the Commission does not limit its role to ensuring compliance with the minimum capital standard. It encourages its licensees to maintain more capital than the required minimum. This will ensure that they establish adequate reserves for known or potential losses. It is in this context that the Regulatory Code, 2008 makes it a requirement for its concerned licensees to take appropriate measures to ensure that they maintain their capital resources at levels that are adequate to support their business, taking into account the nature, size, complexity, structure and diversity of that business and the licensees' risk profiles.²⁴ In addition, the licensees are obligated to maintain systems and controls that are adequate to monitor and assess the adequacy of their capital requirements on an ongoing basis. Thus where

²⁴ See the Regulatory Code, 2009, specifically section 74 (1) in relation to banks, section 129 (1) in relation to insurers, section 153 (1) in relation to trust companies and company management companies, and section 168 (1) in relation to money services businesses.

it becomes necessary to increase their capital resources to support their business and having regard to their risk profile, the licensee's board and senior management are expected to make the appropriate decision in that regard.

Inspection Essentials

308. The inspection team should

- (a) obtain from the licensee the most recent data on the various capital instruments, including as applicable,
 - (i) paid-up capital;
 - (ii) preferred stock;
 - (iii) retained earnings; and
 - (iv) other funds (if any) approved by the Commission that comprise a licensee's capital;
- (b) review the data for any unusual transactions or significant fluctuations between inspections;
- (c) calculate and review any limitations established by legislation, for example, a limit on the percentage of fixed assets to capital, size of credits, etc.
- (d) establish that the licensee has conformed to the legislation with respect to transfers to its reserve fund from profits;
- (e) analyse applicable capital ratios and compare them with the peer group;
- (f) investigate capital adequacy trends and significant variations from peer group averages;
- (g) determine if capital is sufficient to compensate for any deficiencies in asset quality that arose as a result of any credit risk analysis;
- (h) determine if the licensee can increase its capital sufficiently through internal generation to fund its expansion adequately and to remain competitive;
- (i) if the reserve for loan losses is inadequate, analyse the impact of current and potential losses on the capital structure;

- (j) discuss with management future capital plans and requirements of the licensee; and
- (k) determine what, if any, supervisory action to take regarding the licensee's capital adequacy.

PART XI
Miscellaneous Matters: All Licensees (As Referenced)

EARNINGS (BANKING ONLY)

309. Earnings are critical to a bank because they constitute the source of internal growth of capital and shape the bank's image in the market place. An analysis that involves a comparison on a period-to-period basis, in an effort to substantiate reasonableness, is perhaps the best approach to evaluate both earnings and expenses.

Objectives in Analysing Earnings

310. The objectives in analysing earnings are to
- (a) assess the profitability of the bank and determine the impact of earnings on its overall condition;
 - (b) determine if accounting policies, practices and procedures relating to income and expense are adequate;
 - (c) determine compliance with laws and regulations relating to income and expenses; and
 - (d) initiate corrective action if deficiencies or violations of law or regulation have been discovered.

Relevant Considerations

311. The inspection team should form an opinion on the quality and sustainability of the bank's earnings. It is essential to measure the level of "cash" or "real" profits and to determine that depositors' funds are not being used to pay overhead expenses. Large amounts of

uncollected interest income carried as a receivable in the assets of the bank or capitalised and included in outstanding loan balances distort profits. An indicator of a potential problem in this area would be the absence of rigorous policies and practices with respect to income recognition or loans in arrears. The inspection team should question the sustainability of profits when a significant proportion of total revenue consists of fees, commissions, trading profits and other “non-intermediation” income.

312. Perhaps the most widely accepted measure of earnings used by analysts is net income divided by average total assets, or the return on assets. This "bottom line" ratio projects the bank's overall ability to generate earnings from its existing assets. The inspection team should review the level of this profitability ratio as any significant downtrend could indicate that the bank is beginning to experience problems.

313. The inspection team should also be on the lookout for any efforts by management to manipulate this ratio in order to hide emerging financial difficulties. Such manipulation can take a variety of forms. One is for the bank to boost earnings by taking sizeable capital gains on securities and other assets. Another is for management to make an insufficient provision for loan losses.

Inspection Essentials

314. The inspection team should

- (a) determine if any significant changes have occurred in
 - (i) operations;
 - (ii) accounting practices and records;
 - (iii) financial reporting; and
 - (iv) general business conditions;
- (b) test for compliance with policies, practices and procedures;
- (c) obtain the bank's current financial statements, and other financial information available to determine the development, or continuation, of adverse trends and other significant or unusual fluctuations;
- (d) note whether

- (i) significant structural changes are occurring that may impact the earnings stream;
 - (ii) earnings are static or declining;
 - (iii) income before securities gains and losses is decreasing as a percentage of total revenues;
 - (iv) the ratio of operating expense to operating revenue is increasing;
 - (v) the spread between interest earned and interest paid is decreasing;
 - (vi) loan losses are increasing;
 - (vii) provisions for loan losses are sufficient to cover loan losses and maintain reserves at an adequate level;
 - (viii) there is evidence that the sources of interest and other revenues have changed since the last inspection;
 - (ix) significant amounts of uncollected interest are included in revenues; and
 - (x) earnings are considered inadequate to provide increased capitalisation commensurate with the institution's growth;
- (e) obtain and review planning procedures, profit plans, budgets, mid and long range financial plans and progress reports related to any of those and
- (i) compare actual results to budgeted amounts;
 - (ii) determine the impact of any broad and important specific goals which have been set;
 - (iii) determine the frequency of planning revisions;
 - (iv) determine what triggers a specific plan revision;
 - (v) determine who initiates plan revisions; and
 - (vi) determine the sources of input for forecasts, plans and budgets; and
- (f) review with management
- (i) deficiencies in and deviations from policies, practices and procedures; and

- (ii) adverse trends.

INFORMATION SYSTEMS (ALL LICENSEES)

315. Financial institutions are relying increasingly on computer systems to produce primary accounting records and to support control procedures. The Commission encourages this trend, in the hope that all of its licensees will fully embrace such systems.

Objectives in Relation to Information Technology

316. The objectives of the inspection in this regard is to
- (a) determine whether the computer and information systems are adequate to support the activities of the licensee;
 - (b) determine whether the licensee has a plan to deal with disaster;
 - (c) determine whether the licensee has adequate back-up systems; and
 - (d) assess the licensee's systems development and operation capability.

Relevant Considerations

317. The existence of reliable computer systems that are regularly upgraded to keep pace with changes in management information and operating requirements is a key factor in the success of a financial institution. It is essential in this regard that all licensees adopt as best practice the process of regularly upgrading their computer systems and testing those systems on a periodic basis.

Inspection Essentials

318. The inspection team should
- (a) obtain information with regard to staff numbers;
 - (b) assess the quality, depth and expertise of staff;
 - (c) determine what operations of the licensee are currently computerised and the licensee's plans for the future;

- (d) discuss back-up systems and recovery procedures in case of interruption, destruction or other loss of facilities or data;
- (e) determine whether back-up arrangements are periodically reviewed and tested;
- (f) determine how new systems are implemented; are they appropriately tested before implementation - what is the role of the internal auditor (where applicable), for example, is he/she required to ensure that systems are auditable before implementation?
- (g) evaluate (in applicable cases) the role of internal and external auditors in reviewing control features of new systems;
- (h) review and discuss systems access security and control;
- (i) discuss any significant issues with management; and
- (j) write a note for inclusion in the inspection report with conclusions and recommendations.

ACCOUNTING POLICIES (ALL LICENSEES)

319. There is no single source of accounting policies relating to financial institutions. Accounting principles may be derived from international accounting standards and from domestic legislation and guidelines. Particular regard must, however, be had to Division 6 of Part II of the Regulatory Code, 2009 (financial statements and audits).²⁵ Licensees that are not exempted from preparing and submitting to the Commission annual audited financial statements are required to have their statements audited by qualified auditors following the accounting standards of the professional accounting bodies they belong to and which are recognised under section 56 of the Regulatory Code, 2009.

Objectives in Relation to Accounting Policies

320. The primary focus of the inspection is to determine whether management of the licensee is pursuing appropriately conservative accounting policies.

²⁵ The Regulatory Code does not apply to insolvency practitioners and therefore any reference to the Code should be construed as excluding them. The provisions would therefore be applicable only with such modifications as may be considered fit.

Relevant Considerations

321. Items to be considered for comments include

- (a) the impact of the current business and economic environment;
- (b) issues arising from monitoring activities;
- (c) accounting issues identified by the external auditors; and
- (d) changes in accounting policies.

322. A well-defined accounting policy system within a licensee should stress conservative accounting policies and practices. In particular those related to revenue recognition (especially in relation to banks).

Inspection Essentials

323. The inspection team should obtain a copy of the accounting manual and related documents and assess the standards, policies and procedures being followed by the licensee. Compare these with industry standards and

- (a) make an evaluation of the size of the accounting staff (noting that in large licensees a separate department may exist) - are there sufficient persons to do the required tasks adequately?
- (b) assess the depth and quality of staff;
- (c) assess the accuracy, timeliness and quality of information provided to management, and the external auditors;
- (d) evaluate the ability of the management information systems to monitor existing and potential risks;
- (e) in the case of banks, discuss the bank's accounting policies with respect to non-performing loans, cessation of interest accrued on loans, provisioning for credit losses and write-offs; and
- (f) discuss, in relation to paragraph (e), the effect of those policies on the bank's balance sheet and income statement.

COMPLIANCE (ALL LICENSEES)

324. This relates to how the licensee is complying with the provisions of laws, regulations, codes, guidelines and directives.

Objectives In Relation to Compliance

325. The primary focus of the inspection is to ensure that the licensee is in compliance with the relevant laws, regulations, codes, guidelines and directives. In particular, regard must be had to Part V of the Financial Services Commission Act, 2001 and Division 4 of Part II of the Regulatory Code, 2009²⁶ in relation to the statutory requirements for compliance matters. Every licensee is required to establish and maintain adequate systems and controls to ensure full compliance with the Financial Services Commission Act, 2001, regulatory legislation, Regulatory Code, 2009 and any guidelines or directives issued by the Commission. Compliance includes adherence to the AML/CFT obligations established under the relevant legislation.

Relevant Considerations

326. A number of compliance issues are addressed elsewhere. For example, those relating to solvency, such as capital adequacy are dealt with under that section. It is important therefore that a broad survey is carried out with respect to compliance matters.

327. The inspection team should also review and comment on specific compliance issues that are difficult to document under any of the specific risk areas of any inspection matrix (especially where the K-Review is relied upon), for example, issues relating to financial disclosure requirements, provisions that limit the licensee's ability to deal with employees and directors.

Inspection Essentials

328. The inspection team should compile a compliance checklist, which relates to the provisions of the law, regulations, codes, directives, etc. The issues can be checked off during the inspection of the various areas of the licensee. The inspection team should specifically seek to establish

²⁶ See footnote 25 in relation to insolvency practitioners vis-à-vis the application of the Regulatory Code, 2009.

- (a) whether the licensee has in place an approved compliance officer, unless exempted from appointing one;
- (b) whether the licensee has in place a compliance procedures manual;
- (c) the nature of the relationship between the compliance officer and the licensee;
- (d) whether the compliance officer is appointed to a sufficiently senior level within the licensee;
- (e) whether the compliance officer has direct access to the licensee's board and functions in an independent manner in the discharge of his/her duties; and
- (f) the extent of compliance or non-compliance with the laws, regulations, codes, directives, etc.

INTERNAL CONTROLS (ALL LICENSEES)

329. Adequate internal controls exist when no one person is in a position to make significant errors or perpetrate irregularities without timely detection. A system of internal control, therefore, includes those procedures and mechanisms necessary to ensure a timely detection of a failure of accountability. It is essential to note that every licensee has an obligation to ensure that it has a span of control²⁷ that is adequate having regard to its nature, size, complexity, structure and diversity of business. The control mechanisms will thus inevitably differ in scope and emphasis, but it remains the duty of the licensee to determine the span of control to be adopted and applied.

Objectives in Relation to Internal Controls

330. The objectives in evaluating internal controls are to

- (a) determine the existence of internal control procedures;
- (b) assess the adequacy and effectiveness of those procedures;
- (c) establish the duties and responsibilities of the licensee's board and senior management;

²⁷ For guidance on a licensee's span of control, please see paragraphs (xvi) – (xxi) of the Explanatory Notes after section 24 of the Regulatory Code, 2009. See also footnote 25 in relation to insolvency practitioners.

- (d) establish whether regular reports on the effectiveness of the licensee's internal control system are made to the board; and
- (c) discuss with management any weaknesses in internal control procedures and how they are or can be remedied within a reasonable period.

Relevant Considerations

331. The existence of internal control procedures is necessary but not sufficient for effective internal control. Section 29 of the Regulatory Code, 2009, for instance, outlines the scope of the internal control procedures that should be put in place. However, if procedures exist but are not performed, that does not constitute adequate control. The inspection team should therefore ensure, through inquiry, observation and testing, that procedures not only exist but that they are being followed.

332. For internal control to be effective, competent persons must perform the required procedures. Indeed section 26 of the Regulatory Code, 2009 places obligations on the licensee's senior management to ensure that all staff are sensitized to and understand the strategies, policies, systems and controls of the licensee and that they have adequate knowledge of the licensee and its business. Evaluation of competence sometimes requires some degree of subjective judgment. Thus, the inspection team should be alert for indications that employees have failed so substantially to perform their duties that there is a serious question about their ability.

333. If an employee, who is accountable for assets or other valuables, or who performs significant duties in the internal control system, can avoid the established controls by reason of the performance of other assigned tasks, the individual has incompatible duties and that weakens control. If employees who have access to assets also have access to related accounting records or also perform review operations (or immediately supervise the activities of other employees who maintain the records or perform the review operations), they may be able to perpetrate and to conceal defalcations.

334. Although all employees within an organisation may be subject to control, not all have financial responsibilities that can influence the accuracy of the accounting and financial records, or have authorised access to assets. The inspection team should investigate those positions that can influence the records and that have access to assets.

335. The inspection team should be alert to deviations from established policies, practices and procedures implemented by the licensee. Examples of such deviations include situations when instructions and directives are frequently not revised to reflect current practices; employees find "short cuts" for performing their tasks; changes in organisation and activities that may influence operating procedures in unexpected ways; employees' duties may be

rotated in ways that were not previously considered. Those and other circumstances may serve to modify prescribed procedures and so, the inspection team has an inadequate basis for evaluating internal control until they have determined the actual practices.

Inspection Essentials

336. An effective way to conduct the review of internal control is to identify the various key functions applicable to the area under review, having regard in the process to the duties and responsibilities of the board and senior management. The inspection team should ask the following questions for each position identified:

- (a) is this a critical position? That is, can a person in this position either make a significant error that will affect the recording of transactions or perpetrate material irregularities of some type?
- (b) if there is an error or an irregularity, what is the probability that normal routines will disclose it on a timely basis? That is, what controls exist that would prevent or detect significant errors or the perpetration of significant irregularities?
- (c) what are the specific opportunities open to the individual to conceal any irregularity, and are there any mitigating controls that will reduce or eliminate these opportunities?
- (d) have there been any identified deficiencies? If so, have these been reported in a timely manner to senior management and the board and what has been the outcome thereof?

INTERNAL AUDITORS (BANKING)

337. Internal auditors try to determine whether the procedures and methods used for recording and processing transactions are in compliance with the policies prescribed in the internal control standards set forth by the board of directors and management. As part of their audit programme, internal auditors perform tests and other procedures that enable them to reach these determinations.

Objectives in Relation to Internal Auditor

338. The primary objective in reviewing the internal auditor's work is to evaluate the adequacy of the internal audit programme by considering the following factors:

- (a) the scope and frequency of audit work;

- (b) the adequacy of documentation of the work performed;
- (c) the content of audit programmes;
- (d) the conclusions reached and reports issued; and
- (e) the response of departments in the bank to the auditor's recommendations.

The risk associated with each area should determine the frequency of the performance of audit procedures.

Relevant Considerations

339. Traditionally, the primary objectives of the internal audit function in banking have been the detection of irregularities and the determination of compliance with a bank's policies and procedures. In recent years, the responsibilities of internal auditors have expanded to include

- (a) appraisal of the soundness and adequacy of accounting, operating and administrative controls;
- (b) participation in the formulation of new, and revision of existing, policies and procedures;
- (c) determining bank compliance with applicable laws and regulations (this may be considered an added check on the bank's compliance functions without necessarily impinging on the compliance officer's role) ;
- (d) evaluating the effectiveness of administrative controls and procedures; and
- (e) evaluating the efficiency of operations.

340. Responsibilities and qualifications of internal auditors vary depending on the nature, size, complexity, structure and diversity of a bank's operations and on the emphasis placed on the audit function by management. Other factors to be considered by the inspection team in reviewing and evaluating the internal audit function include the competence and independence of the internal auditors and the adequacy and effectiveness of the audit programme.

341. The final measure of the competence of the internal auditor is the quality of the work and the ability to communicate the results of that work. The inspection team's conclusions regarding the auditor's competence should also reflect the adequacy of the audit programme and audit reports.

342. The ability of the internal audit function to achieve its objectives depends in large part on the independence of audit personnel. An indication of independence relates to the administrative location of the auditor and to his/her reporting level.

343. The audit function should be responsible to the board or the audit committee.²⁸ This enables the auditor to assist directors in fulfilling their responsibilities. The auditor must have the necessary authority to perform his/her job. That authority should include unrestricted access to any records necessary for the proper conduct of the audit.

344. The inspection team should also analyse the reporting process because appropriate officers can only make the required changes in the internal control system and operating procedures if they know about the deficiencies.

345. This means that the auditor must communicate all findings and recommendations in a clear, concise and timely manner, pinpointing problems and suggesting solutions. Prompt and effective management response to the auditors' recommendations is the final measure of the effectiveness of the audit programme.

Inspection Essentials

346. The inspection team should

- (a) determine the mandate of the internal audit department - what is the scope of its operations; does the department audit all aspects of the bank's operations?
- (b) determine the department's role with respect to the various risk areas - credit, foreign exchange, interest rate, computer operations, etc.; what is the depth and frequency of such audits?
- (c) determine the size, qualifications and experience of the staff;
- (d) assess the ability of the staff to perform the required functions;
- (e) obtain copies of recent reports and make an evaluation of their quality, scope and depth;
- (f) do reports to the board and management indicate whether internal controls are appropriate and effective and that deficiencies have been identified and corrected in a timely manner?

²⁸ The requirement for a bank holding a general banking licence or other financial institution so directed by the Commission to have an audit committee is outlined in section 37 of the Regulatory Code, 2009.

- (g) obtain a copy of any procedures manuals and related information and assess them for quality and completeness;
- (h) assess the independence of the auditor; what are the reporting relationships - does the auditor report directly to the board?
- (i) assess the effectiveness of the auditor - are recommendations adequately considered and implemented?
- (j) obtain the external auditors' assessment of the effectiveness of the internal audit function;
- (k) for foreign bank subsidiaries and branches, obtain and review a copy of the most recent regional or head office inspection;
- (l) discuss major issues with operating management; and
- (m) write a note with conclusions and recommendations to be included in the inspection report.

DIVIDEND POLICY (BANKING)

347. Dividends constitute distributions of earnings to owners. Although banks usually declare and pay dividends in either cash or stock, occasionally they distribute real property. Regardless of the type, all dividends must conform to statutory requirements and, equally importantly, standards of prudence.

Objectives in Relation to Dividend Policy

348. The objectives with respect to a bank's dividend policy are to

- (a) evaluate the bank's dividend policy;
- (b) determine compliance with laws and regulations; and
- (c) initiate corrective action if the bank's policy is deemed to be inappropriate or there have been violations of laws or regulations.

Inspection Essentials

349. The inspection team should
- (a) analyse dividend payments, past and projected, to determine their effect on the bank's capital;
 - (b) discuss, if appropriate, the bank's dividend policy with management; and
 - (c) prepare comments for the inspection report on the bank's dividend posture.

PROVISIONS FOR CREDIT LOSSES (BANKING)

350. Banks as a matter of prudent practice should maintain provisions or reserves for credit losses. These should be created through charges to income, at a level adequate to absorb losses in the credit portfolio.

Objectives in Relation to Loan Loss Provisions

351. The objectives in reviewing loan loss provisions are to
- (a) determine if the policies, practices and procedures regarding loan loss provisions are adequate;
 - (b) determine if officers and employees are operating according to established guidelines;
 - (c) determine compliance with laws and regulations; and
 - (d) initiate corrective action when policies, practices and procedures are deficient or where there are violations of laws or regulations.

Relevant Considerations

352. Management's determination of the amount of the provision is an estimate, and the inspection team should evaluate its adequacy. It is the responsibility of the inspection team to determine that management has exercised reasonable judgment, based on reliable information to arrive at an appropriate reserve. The bank's management should determine that there is sufficient information in credit files and other documentation to support its judgment regarding provisions. The inspection team should review the appropriateness of the procedures employed by management in determining the amount of provisions as well as the conclusions reached.

353. Historical data are often the foundation on which the bank builds an estimate of the losses existing in the portfolio. Such data may include

- (a) the value of loans and contingent accounts at the most recent review date and at comparable dates in prior years;
- (b) the level of provisions for credit losses for the past several years;
- (c) the credit loss experience, charge-offs and recoveries, in the past several years in total and by major loan categories; and
- (d) the ratio of provisions for credit losses to average credits outstanding for several years.

354. Historical data, however, whether expressed as amounts or ratios, or formulas based on such data, provide only a portion of the information necessary to evaluate the adequacy of the provisions. An assessment of the effectiveness of the bank's lending policies, practices and procedures is equally important. The inspection team should combine this with periodic comprehensive reviews of the credit portfolio, and an assessment of the effect of current economic conditions.

355. The level of provisions should be at least adequate to cover those credits classified as loss in the inspection report. There should also be provisions to cover some applicable percentage of other "weak loans" and ideally an additional percentage, a general provision, to cover unidentified potential losses.

356. The inspection team should understand the bank's accounting for the provisions for credit losses and the related capital accounts. It may be appropriate for the inspection team to discuss the matter with management and the bank's external auditors.

357. There are different methodologies used by banks in analysing the adequacy of the loan loss provisions. This may entail

- (a) individual loan allocation method;
- (b) specific amounts allocated for individual credits with "identified weaknesses" based on the potential for loss;
- (c) historical loss ratio analysis based on historical loss rates for specific segments of the portfolio, for example, personal loans. Banks sometimes weight current loss experience more heavily to account for trends; or

- (d) unspecified allocation. This provides a "cushion" for portfolio credit risk not factored into the first two components.

358. Banks often estimate losses on consumer loans, small commercial loans, and other similar types of credits on a percentage of the amounts that are past due. Such percentages will vary, depending on collateral, the definition of "past due", experience, and an assessment of current economic conditions.

359. The inspection team must evaluate management's estimate of losses, existing in the portfolio as well as the procedures used in making such estimate. That evaluation provides the basis for determining the adequacy of the loan loss provisions.

Inspection Essentials

360. The inspection team should

- (a) obtain a description of the methods and procedures used by management to determine the adequacy of the allowance for loan loss, and the supporting records;
- (b) obtain a list of any deficiencies noted by the internal or external auditors and determine whether appropriate corrections have been made;
- (c) obtain the beginning and ending balances for the most recent financial year and review the appropriateness of changes;
- (d) obtain a list of credits as of the inspection date that are not fully collectible, possess more than the normal degree of risk, are past due, or require more than the normal management supervision;
- (e) determine whether the loan loss reserve has been adjusted in the most recent quarter, and, if not, suggest that management make such adjustment;
- (f) evaluate management's estimate of the amount necessary to adequately provide for possible loan losses by considering
 - (i) probable losses as determined by a review of problem loans and other pertinent information;
 - (ii) historical losses as a percentage of loans outstanding and other relevant factors; and

- (iii) a comparison of the allowance for loan losses to that of other peer group banks;
- (g) review the following items with management:
 - (i) internal control deficiencies or non-compliance with written policies, practices and procedures;
 - (ii) un-corrected audit deficiencies; and
 - (iii) inadequate allowance for possible loan losses, if any; and
- (h) request management to prepare the appropriate adjustments to the loan loss provision accounts and:
 - (i) determine the materiality of the change ; and
 - (ii) prepare comments for the inspection report regarding the adequacy of the loan loss provision, and include any deficiencies reviewed with management and any remedial actions recommended.

INDEPENDENT INSPECTORS

361. From time to time the Commission may find it necessary to engage the services of a third person to function in the capacity of independent inspector and thus lead an inspection of a licensee. Where such an engagement occurs, the Commission will outline the specific duties that the independent inspector is expected to perform. The provisions of this Procedures Manual shall have effect; the Inspections Coordinator will continue to have responsibility for coordinating the inspection concerned, detail necessary Commission personnel to the inspection process to assist as necessary and render such advice to the independent inspector as may be considered fit.

would be appreciated if they are all available for consultation during the entire period of the compliance inspection.

Objectives of the Visit

This inspection will be carried out for the purpose of regulatory and prudential supervision of financial services business carried on by the licensee in or from within the Territory. Accordingly, all records, books and/or other documents in your possession, custody or control relating to the business of the company/licensee and its subsidiaries should be made available for inspection.

Areas to be Examined

The main areas of discussion will include, but not be limited to anti-money laundering and combating terrorist financing related issues, governance and know-your-client procedures, management, business plan and development, compliance with the FSCA, applicable financial services legislation and guidelines and codes issued by the Commission, capital and earnings, general business activities, internal controls, directorships, staff training, number and status of inquiries made of the company/licensee by the Financial Investigations Agency, and fund administration processes, (i.e. valuations, fund accounting, shareholder communication, shareholder complaints)* *[insert for fund inspections only]*, and lending activities and liquidity management *[insert for banks only]*.

Pre-Inspection Material Required

Please submit the following in respect of the company/licensee (all licence-holders)* to the Commission no later than the day of , *[insert date: at least two weeks prior to the inspection date]* at 4:30pm.

- (a) A completed pre-inspection questionnaire (attached);
- (b) Register of shareholders;
- (c) Register of directors;
- (d) Confirmation of authorized signatories and their respective signing powers;
- (e) Affidavit confirming the particulars of the Licensees (i.e. registered office, solicitors, auditors, authorized agents (and authorized representative, where applicable) and financial year-end);
- (f) Copy of the most recent audit engagement letter;
- (g) Copy of latest business plan;
- (h) Organizational chart which provides full particulars of the senior officers, other key members of staff and their respective roles, responsibilities and reporting lines (please include updated résumés for these persons, where applicable);
- (i) Operating policies and procedures, including anti-money laundering and terrorist financing measures (i.e. internal procedures manual);
- (j) Know-your-customer policies (i.e. compliance manual);
- (k) Due diligence checklists; and
- (l) Internal audit/testing and management reports produced in the last two years or as of the last inspection, whichever is later.

(NOTE: If the licensee to be inspected is a bank, the following additional information is to be provided):

- (m) Details of group structure (if the bank is part of a group , please provide a diagram which clearly outlines the bank's structure and shareholdings);
- (n) List of committees, including each committee's terms of reference;
- (o) Board and committee minutes, and any presentations to the Board or its committees;
- (p) Provisioning policies;

- (q) List of restructured loans, including customer name, amount, loan type and last payment date;
- (r) Statement of assets and liabilities (specify a recent date);
- (s) Policies and procedures manuals for the major risk areas, including credit and provisioning policies, liquidity policies, investment policies, policies governing the bank's information systems, etc;
- (t) A list of the 10 largest loans including the name(s) of the creditor(s), amount outstanding, term of loan, and security description.
- (u) A list of all loans and advances where interest and/or principal is 90 days or more overdue, together with the applicable loan loss provisions;
- (v) A list of all loans and advances to related parties;
- (w) A list of all loans and advances made to directors, officers, or major shareholders;
- (x) A list of the 20 largest depositors that shows the names, amounts of deposit, and maturity;
- (y) Defalcations involving significant sums (the regulators must specify the threshold) which occurred during the past two years, indicating the amount, approximate date, nature of defalcation, and action taken; and
- (z) Business continuity plan.

(NOTE: If the licensee to be inspected relates to a mutual fund, the following additional information is to be provided and sequentially numbered):

- (aa) Schedule of funds administered as at *[insert the date of the last calendar quarter]* (this should include name of fund, type of fund, jurisdiction of domicile, total assets, net asset value, frequency of valuations, number of investors and details of specific functions carried out in respect of each fund);
- (bb) Details of any investor complaints;

(cc) A copy of the licence-holder's fund administration and management procedures manuals; (dd) A copy of the licence-holder's business continuity and disaster recovery plan;

- A copy of a standard administration agreement between the licence-holder and a fund it administers;
- A copy of a standard management agreement between the licence-holder and a fund it manages;
- Copies of the relevant sub-delegation agreements between the licence-holder and other entities.
- A copy of a recent offering document in respect of a fund that the licence-holder administers;
- A copy of a recent offering document in respect of a fund that the licence-holder manages;
- Copies of the minutes of the licence-holder's Board of Directors' Meetings since inception.

Client Confidentiality

Section 49(1) of the FSCA places restrictions on the Commission from disclosure of information which it requires in the course of exercising functions under the FSCA and other financial services legislation. Such information is to be treated by the Commission as protected information and may only be disclosed pursuant to gateways that are set out in section 49A of the FSCA. The information which is obtained in the course of a compliance inspection is protected information within the meaning of section 49 of the FSCA and would be treated as such by the Commission.

Areas of Concern/Feedback

The Commission invites you to use the opportunity of the inspection to raise any areas of concern you may have regarding your obligations under the relevant legislation. Following completion of the inspection, you will be provided with a written inspection report in due course identifying the findings of the areas reviewed. You will, if considered necessary, also be required to effect relevant corrective measures.

Length of Stay

As mentioned in the first paragraph above, the inspection will last for the period stated; however, following a review of the pre-inspection material we may require additional time onsite, at which time you will be immediately notified. Our provisional timetable for the first week is as follows:

Day 1	Introductory meeting	AM - PM
	Business plan and internal control issues	
Day 2	Interviews and Anti-Money Laundering and Combating Terrorist Financing issues	AM - PM
Day 3	Review of Business Activities and File/Case Review	AM - PM
Day 4	File/Case Review	AM - PM
Day 5	Discussions with Management/Close out Meeting	AM - PM

[NOTE: For the inspection of a licensed bank, the following provisional timetable is to be substituted.]

Day 1	Introductory meeting	
	Business Plan and Strategy	AM
	Management Meeting	
	Management and Internal Control issues	PM

Day 2	Credit Administration, Earnings, Liquidity, Investments and Market Risk	AM - PM
Day 3	Lending Review	AM - PM
Day 4	Account Opening and AML/CFT	AM - PM
Day 5	Governance (Internal audit, Management Information Systems and Reporting and Workings of Committees) Meeting with Bank's Senior Management/Close out Meeting	AM PM

At the end of the first week (where the inspection is to be carried out beyond a week) a provisional timetable will be given for the remainder of the compliance inspection visit.

A wrap up session/closing meeting will be scheduled for *[state day]*, the *[state day]* day of *[insert month]* at *[insert time]* am/pm.* This session is intended to provide a useful opportunity for the clarification of any matter that may have arisen during the course of the inspection.

We look forward to your cooperation.

Yours sincerely,

Deputy Managing Director, Regulation

Encl: Pre-Inspection Questionnaire

**Please select/omit as necessary*

SAMPLE

APPENDIX 2

Focused Inspections (General)

Please note that this is a sample questionnaire utilized for a prior focused onsite inspection. For future focused inspections the questionnaire would have to be appropriately modified to reflect the intended focus of the planned inspection.

Inspection Team: [Name of Commission's staff attending]

Date: [Insert date]

Completed by: _____

Purpose: This inspection visit is being carried out for *[indicate the purpose of the inspection]*.

Questions/Confirmations for Management:

1. Management staff interviewed:

2. Please confirm your willingness to participate and cooperate in this inspection process.

Yes ____ No ____

3. Please confirm whether *[indicate type of product]* is an optional or mandatory requirement of the company?

Optional ____ Mandatory ____

4. If optional, does the company give *[details of the type of product]*.

Yes ____ No ____

5. Please confirm whether *[indicate type of product]* is offered to.... *[provide name]* and indicate which products or services:

6. Please provide the time period over which the company offered such products to its customers or potential customers.

From: _____ To: _____

7. Please describe the procedures that staff members are required to follow when dealing with or arranging the purchase of these products.

8. If the company no longer offers these products to its customers, does the company still require its customers to obtain the products elsewhere?

Yes ____ No ____

If yes, indicate if any remuneration is received? Yes ____ No ____

9. Please confirm whether the work of staff members who deal or used to deal with product matters is/was reviewed by a senior staff member and by whom:

10. Please provide the Commission with a copy of relative procedures.

11. Other questions and/or remarks:

SAMPLE

2. Is the licence-holder authorized to conduct business in any other jurisdiction? If so, please identify the jurisdiction(s) and the type(s) of business being conducted.
3. What are the arrangements for raising additional capital/liquidity from existing shareholder(s)?
4. When was the last time that the licence-holder's operations were independently assessed, either by its internal audit department or an external party, on its (a) compliance procedures, (b) internal controls, (c) credit administration and (d) deposit taking policies?
5. Have reports outlining the findings been produced and obtained? If so, please provide a copy to the Commission.
6. Have the reports been made available to the directors, partners or others involved with the management of the licence-holder?
7. Outline how the findings of these reports have been addressed.
8. Name of professional indemnity insurance provider, the policy limits/excess and areas covered.
9. Please provide details of where the licence-holder obtains its main borrowings and the terms of repayment of loan capital and interest, including whether these are secured sources of borrowing.
10. Have the IT systems been assessed in terms of:
 - (a) threats to the confidentiality, integrity and availability of key information?
 - (b) Adequacy and viability of the IT strategy for the planned business initiatives?

5. Proportion of customer-client base (check one or more if applicable):

Introducer _____ % EUC²⁹ _____ %

6. Types of introducer and proportion:

7. Main geographic location (please enter percentage data where relevant):

	North America	South America	Western Europe	Eastern Europe	Hong Kong	Asia	Other
Introducer							
EUC							

Other (provide further details):

8. Details of group structure (if the licence-holder is part of a group, please provide a diagram which clearly outlines the structure and the shareholdings).

²⁹ End User client.

9. Volume and type of inter group business:

10. Does the licence-holder administer companies registered in other jurisdictions? ____
If yes, how many are there and in which location(s)?

11. Are any foreign administered companies registered in a non-cooperative country/territory? If yes, please list the country(ies)/territory(ies).

12. Does the licence-holder have any overseas interests? (i.e. subsidiary, branch, agency or representative office): If yes, please identify the jurisdiction(s).

13. What makes up the capital of the licence-holder (e.g. called up shares, redeemable preference shares, subordinated loans)?

14. Does the licence-holder have the ability to raise additional capital from existing shareholder(s)?

15. Does the licence-holder assess the effectiveness of its compliance procedures?

16. When was an internal assessment of the licence-holder last undertaken?

17. Has a report outlining the findings of the internal assessment been produced and obtained? If yes, please provide a copy to the Commission.

18. Has the report been made available to the directors, partners or others involved with the management of the licence-holder?

19. What issues (if any) have been identified in the report?

20. Have the issues identified in the report been addressed? If yes, please provide evidence of this.

21. Name of professional indemnity insurance provider and the policy limits.

APPENDIX 3C

Pre-inspection Questionnaire (Insurance Manager for Captives)

1. Number of BVI insurers managed.

2. Main lines of business:

General

- Property
- Liability
- Workers Compensation
- Other (please specify): _____

Long-Term

- Life
- Health
- Other (please specify): _____

3. Main geographic location (please enter percentage data where relevant):

	Central & Caribbean	South America	Europe	Canada	USA	Asia	Other
Captive							
Credit Life							

Other (provide further details):

4. Details of group structure (if the Insurance Manager is part of a group, please provide a diagram which clearly outlines the structure and the shareholdings).

5. Volume and type of inter-group business:

6. Does the Insurance Manager administer companies registered in other jurisdictions?
If yes, how many are there and in which location(s)?

7. Are any foreign administered companies registered in a non-cooperative country/
territory? If yes, please list the country(ies)/territory(ies).

8. Does the Insurance Manager have any overseas interests? (i.e. subsidiary, branch,
agency or representative office): If yes, please identify the country(ies).

9. What makes up the capital of the Insurance Manager (e.g. called up shares,
redeemable preference shares, voting shares, non-voting shares)?

10. Does the Insurance Manager assess the effectiveness of its compliance procedures?

11. When was an internal assessment of the licensee last undertaken?

12. Has a report outlining the findings of the internal assessment been produced and obtained? If yes, please provide a copy to the Commission.

13. Has the report been made available to the directors, partners or others involved with the management of the Insurance Manager?

14. What issues (if any) have been identified in the report?

15. Have the issues identified in the report been addressed? If yes, please provide evidence of this.

16. Name of professional indemnity insurance provider and the policy limits.

APPENDIX 3D

Pre-inspection Questionnaire (Insurance Intermediary)

1. Please provide details of the company's/licensee's corporate structure (if the Intermediary is part of a group, please provide a diagram which clearly outlines the structure and the shareholdings).

2. Number of insurers through which the company/licensee places domestic insurance business.

3. Please list insurers through which the company/licensee places domestic insurance business:

4. Please list lines of business underwritten by each insurer (attach a separate schedule if necessary):

Insurer: _____ Home

Jurisdiction: _____

General

- Auto
- Property
- Marine

Long-Term

- Life
- Health
- Other (please specify) _____

- Liability
- Workers Compensation
- Other _____

Relationship: Agent___ Agency Agreement – Yes___ No___

Broker _____

Insurer: _____

Home Jurisdiction: _____

General

- Auto
- Property
- Marine
- Liability
- Workers Compensation
- Other (please specify) _____

Long-Term

- Life
- Health
- Other (please specify) _____

Relationship: Agent___ Agency Agreement – Yes___ No___

Broker _____

Insurer: _____

Home Jurisdiction: _____

General

- Auto
- Property

Long-Term

- Life
- Health

- Marine Other (please specify) _____
- Liability
- Workers Compensation
- Other (please specify) _____

Relationship: Agent ___ Agency Agreement – Yes ___ No ___

Broker _____

Insurer: _____

Home Jurisdiction: _____

General

- Auto
- Property
- Marine
- Liability
- Workers Compensation
- Other (please specify) _____

Long-Term

- Life
- Health
- Other (please specify) _____

Relationship: Agent ___ Agency Agreement – Yes ___ No ___

Broker _____

5. Volume of business Gross Premiums by Class/Insurer:

6. Does the company/licensee have any overseas interests (i.e. subsidiary, branch, agency or representative office)? If yes, please identify the country(ies).

7. What makes up the capital of the company/licensee (e.g. called up shares, redeemable preference shares, voting shares, non-voting shares)?

8. Does the company/licensee assess and test the effectiveness of its internal operating procedures?

9. When was an internal assessment of the company/licensee last undertaken?

10. Does the company/licensee assess and test the effectiveness of its compliance procedures?

11. When was an assessment of the company's/licensee's compliance procedures last undertaken?

12. Does the company/licensee assess the effectiveness of its claims handling procedures?
-
13. When was an assessment of the company's/licensee's claims handling procedures last undertaken?
-
14. Does the company/licensee assess and test the effectiveness of its complaints handling procedures?
-
15. When was an assessment of the company's/licensee's complaints handling procedures last undertaken?
16. Does the company/licensee assess and test the effectiveness of its AML/CFT procedures?
-
17. When was an assessment of the company's/licensee's AML/CFT procedures last undertaken?
-
18. Does the company/licensee assess and test the effectiveness of its business continuity procedures?
-
19. When was an assessment of the company's/licensee's business continuity procedures last undertaken?
-
20. Has a report outlining the findings of each assessment been produced and obtained? If yes, please provide copies to the Commission.

21. Has each report been made available to the directors, partners or others involved with the management of the company/licensee?

22. What issues (if any) have been identified in the reports?

23. Have the issues identified in the reports been addressed? If yes, please provide evidence of this.

24. Does the company/licensee disclose relevant information to its customers, including but not limited to the product being purchased?

Initially (when policy(ies) is/are issued)

- On renewal of policy(ies)
- When a claim is submitted
- Other (please explain)

25. Name of professional indemnity insurance provider, the policy period and limits:

Signed: _____

PrintName: _____

Title: _____

Date: _____

SAMPLE

APPENDIX 3E

Pre-Inspection Questionnaire (Mutual Funds)

<p>To be completed by the Financial Services Commission</p> <p>Licence-holder (s): _____</p> <p>Reference Number: _____</p> <p>Type of Licence: _____</p>

1. Schedule of funds administered and/or managed:

Name	Type ³⁰	Jurisdiction of Incorporation	Total Assets	Net Assets Value	Frequency of Valuation	Number of Investors

2. Describe services typically provided to a fund.³¹

³⁰ Private, professional or public

³¹ Services may include full administration, responsibility for customer due diligence, NAV calculations and registrar and transfer agency services.

3. Total assets under administration/management in US\$:

4. Primary lines of business:

- Fund Administration
- Registrar and Transfer Agency
- Shareholder services
- Other (please specify) _____
- Fund Management
- Nominee Director Services

5. Details of group structure (if the licence-holder is part of a group, please provide a diagram which clearly outlines the structure and the shareholdings).

6. Volume and type of inter group business:

7. Does the licence-holder engage in customer identification on behalf of an applicant for business?³² If yes, please provide a detailed explanation of the relevant procedures:

8. Does the licence-holder provide fund management and/or administration services to any foreign companies registered in a non-cooperative country/jurisdiction? If yes, please list the country(ies)/territory(ies).

9. Does the licence-holder have any overseas interests (i.e. subsidiary, branch, agency or representative office)? If yes, please identify the country(ies).

³² For example, has the Licence-holder been contracted by the fund to perform all function relative to the fund's AML/CFT requirements including customer due diligence requirements.

10. What makes up the capital of the licence-holder (e.g. called up shares, redeemable preference shares, subordinated loans)?

11. Does the licence-holder have the ability to raise additional capital from existing shareholder(s)?: _____

12. Does the licence-holder assess and test the effectiveness of its compliance procedures in relation to AML/CFT risk, including assessment of customer base, customer due diligence?

13. When was an assessment of the licensee's AML/CFT procedures last undertaken?

14. Does the licence-holder assess and test the effectiveness of its complaint handling procedures? :

15. When was an assessment of the complaints handling procedures last undertaken?

16. Has the licence-holder received any investor/client complaints? _____ If yes, please provide details of the complaints as well as how such complaints have been handled.³³

17. Has a report outlining the findings of each assessment been produced and obtained? If yes, please provide a copy to the Commission.

18. Has the report(s) been made available to the directors, partners or others involved with the management of the licensee?

19. What issues (if any) have been identified in the reports?

20. Have the issues identified in the reports been addressed? If yes, please provide evidence of this.

³³ An indication must be provided on whether the complaint had been resolved.

21. Name of professional indemnity insurance provider, the policy period and the policy limits:

22. Does the licence-holder provide appropriate training to its employees? If yes, how often, and provide evidence in the form of appropriate training register.

23. Has the licence-holder been the subject to any court proceedings in any jurisdiction? If yes, provide details.

In addition to providing responses to the above questions, the licence-holder must also provide the following information for inspection during the inspection period, unless otherwise required in advance of the inspection:

- (a) Copies of the management agreements between the licensee and relevant group counterparts.
- (b) Copies of the employee contracts for employees of different ranks.
- (c) A copy of the training register of the licensee.
- (d) Copies of all documentation underlying processes of TFS (i.e. guidelines as regards service standards, guidelines for handling complaints, etc.).

APPENDIX 3F

Pre-Inspection Questionnaire (Insolvency Services)

Name of licensed insolvency practitioner:	
Licence Number:	
Firm:	
Date of Review:	

Please provide the requested information in the space provided, using supplementary pages if necessary, or by attaching supporting documents, as indicated.

1. INSOLVENCY CASES

- 1.1 Please complete the attached Form, which provides a list, and other details, of all Insolvency Act 2003 cases (i.e. insolvency cases commenced since the Insolvency Act, 2003 came into force on 16 August, 2004) to which you have been appointed.
- 1.2 Please state your fee income from insolvency work in the last twelve month period and in your firm's last complete financial year.

2. PII COVER, COMPLAINTS AND CLAIMS

2.1 Have there been any changes to your professional indemnity insurance cover (including the insurer, policy limits and any deductibles) from those provided in your last annual return? If so, please provide details.

2.2 Do you have a procedure for handling complaints? If so, please provide details and a copy of the procedure.

2.3 Have any written complaints been received in relation to an insolvency case to which you have been appointed? If so, please provide details.

2.4 Have any claims been made against you or your staff in relation to an insolvency case to which you have been appointed, or are any potential claims known to you? If so, please provide details, including whether the claim, or potential claim, has been reported to your PI insurer.

2.5 Has any disciplinary action been taken by your firm against any member of staff who has been involved in insolvency work (whether or not the alleged conduct relates to insolvency work)? If so, please provide details.

3. STAFFING OF INSOLVENCY WORK

3.1 Please provide details of the number, names and experience levels of staff performing insolvency work in your office. Please attach an organisational chart.

[Empty response box for question 3.1]

3.2 What (if any) additional resources are available to you from affiliated overseas offices, or elsewhere, to perform insolvency work?

[Empty response box for question 3.2]

3.3 Have any sub-contractors or temporary staff been utilized to perform insolvency work? If so, please provide details and advise what control mechanisms are in place to supervise their work. Please also advise whether estate funds or other assets pass through their control.

[Empty response box for question 3.3]

3.4 Has an anti-money laundering officer been appointed by your firm? If so, please provide

his/her name and job title.

3.5 Please outline the system for conducting staff appraisals and/or performance reviews.

3.6 Please outline the provisions made to train staff in insolvency related matters.

3.7 Do you have a continuity plan (or agreement) in place, in the event that you become incapacitated for any reason: If so, please provide details.

4. SYSTEMS AND INTERNAL CONTROLS

4.1 Do you have an insolvency procedures manual (or equivalent)? If so, please provide a copy.

4.2 Please list any checklists used by your firm in support of insolvency work and advise the date on which each checklist was introduced. All checklists should be disclosed, including (for example) any used for different types of insolvency cases, new case acceptance procedures, investigations and review of directors' conduct. Please provide copies of checklists used.

4.3 Do you have a diary system to flag statutory reporting or other deadlines? If so, please provide details.

4.4 Do you apply a standardised filing index or filing system for insolvency cases? If so, please provide details and copies.

SAMPLE

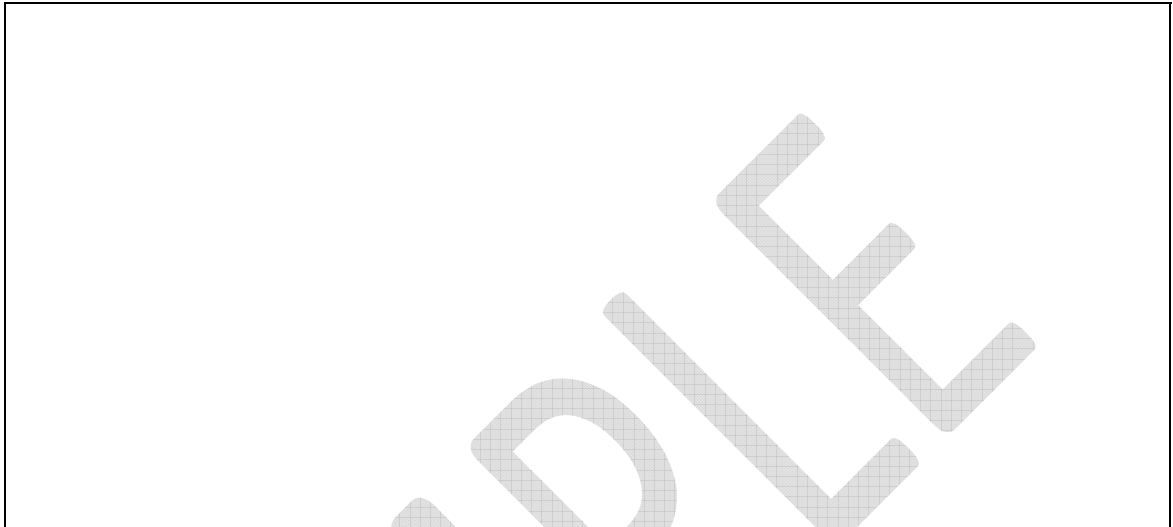
4.5 Do you have a system of periodic case reviews or apply any other controls to monitor the progression of insolvency cases and the standard of work carried out by staff?
Please provide details.



4.6 Please outline the system for handling incoming correspondence (including mail, fax and emails) relating to insolvency work.

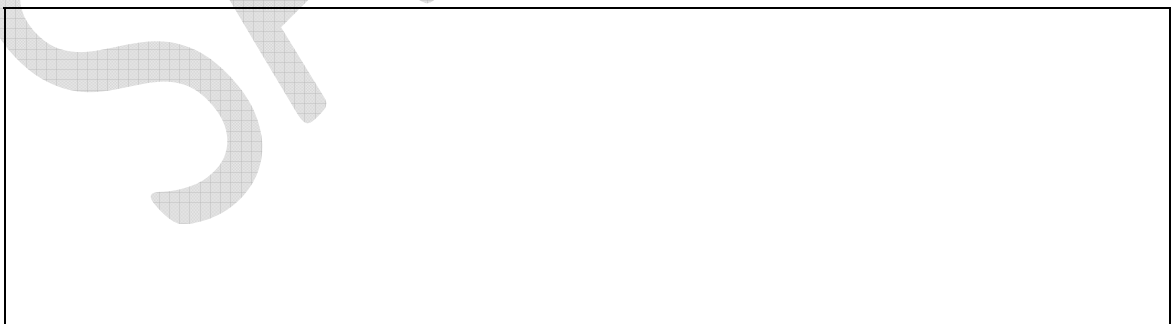


4.7 Please outline the system for handling outgoing correspondence (including mail, faxes and emails) relating to insolvency work, including details of delegated signing rights for correspondence, reports and other documents.



A large empty rectangular box with a thin black border, intended for the user to provide details on the system for handling outgoing correspondence. A large, light gray 'SAMPLE' watermark is overlaid diagonally across the page, passing through this box.

4.8 Has any internal assessment been completed regarding the effectiveness of your systems and internal controls? If so, please advise the date of the assessment and provide brief details of the findings.



A large empty rectangular box with a thin black border, intended for the user to provide details on internal assessments regarding the effectiveness of systems and internal controls. A large, light gray 'SAMPLE' watermark is overlaid diagonally across the page, passing through this box.

5. **INSOLVENCY CASHIERING PROCEDURES**

5.1 Do you use any proprietary software for maintaining insolvency case bank accounts? If so, please provide details.

[Empty response box for question 5.1]

5.2 Please outline the authorisation procedures and signing rights for cash payments and receipts, and provide a list of authorised signatories showing their respective signing powers.

[Empty response box for question 5.2]

5.3 Are separate bank accounts maintained for each insolvency case?

[Empty response box for question 5.3]

5.4 Are any client or office bank accounts used in connection with insolvency work? If so, please state the number of accounts and the uses of each.

5.5 How frequently are insolvency case bank accounts and, if applicable, client/office accounts, reconciled and reviewed?

Completed by: _____

Signature: _____

Date: _____

The following documents are attached:

Question

Yes/No

- 1.1 Completed Form
- 3.1 Organisational chart
- 4.1 Insolvency procedures manual
- 4.2 Checklists
- 4.4 Standard filing index
- 5.2 List of authorised signatories
- Other (please list)

SAMPLE

APPENDIX 4A

BVI Insurer File Review (General)

The file reviews should essentially be aimed at establishing the following matters (which may in some respects duplicate some of the essential elements outlined in the body of this Procedures Manual):

Management Agreement

Section 19(1) of the Insurance Act, 2008 (“the “Act”) states that a BVI Insurer shall not appoint a director or senior officer without the prior written approval of the Commission.

Section 25(1) of the Act states that a BVI Insurer shall at all times have at least two directors.

Section 16(2) of the Act states that a BVI Insurer shall not enter into an agreement to reinsure any of its risk with a person, unless (a) that person satisfies the prescribed criteria for an approved reinsurer; or (b) the Commission, on the application of the BVI insurer, approves that person as a reinsurer for the liabilities specified in the application.

Section 17(1) of the Act states that a BVI insurer shall not invest or trade in a derivative without the prior written approval of the Commission, unless the derivative concerned (a) is prescribed as an admissible asset; or (b) is a derivative that the Regulatory Code, 2009 (“the “Code”) otherwise permits insurers, or specified categories or description of insurers, to invest or trade in.

Section 19 of the Act states that a BVI insurer shall not appoint a director or senior officer without the prior written approval of the Commission.

Section 20(1)(a) of the Act states that a BVI insurer shall not, without the prior written approval of the Commission, (a) open, maintain or carry on business through a branch or a representative or contract office outside of the Virgin Islands.

Section 21 (1) of the Act states that a person owning or holding a significant interest in a BVI insurer shall not sell, transfer, charge or otherwise dispose of his interest in the insurer, or any part of his interest, unless the prior written approval of the Commission has been obtained.

Section 21(2) of the Act states that a person shall not, whether directly or indirectly, acquire a significant interest in a BVI insurer, unless the prior written approval of the Commission has been obtained.

Section 21(3) of the Act states that a BVI insurer shall not, unless the prior written approval of the Commission has been obtained,

- (a) cause, permit or acquiesce in a sale, transfer, charge or other disposition referred to in subsection (1); or
- (b) issue or allot any shares or cause, permit or acquiesce in any other reorganisation, including of its share structure, that results in
 - (i) a person acquiring a significant interest in the insurer; or
 - (ii) a person who already owns or holds a significant interest in the insurer, increasing or decreasing the size of his interest.

Section 33(1) of the Act states that subject to section 35, no part of the business of a BVI insurer may be

- (a) transferred to another person, or
- (b) merged with the business of another person,

except under a scheme of transfer or merger complying with the Code that, in the case of a general insurer, has the prior written approval of the Commission and, in the case of a long term insurer, has been approved by the Court.

The Inspection Team should:

- ascertain whether the BVI insurer has a management agreement in place with the Insurance Manager;
- ascertain whether the management agreement contains:
 - the provision to notify the Commission as required by sections 19(1) and 25(1) of the Act;
 - provision for the prior written approval of the Commission as required by sections 16(2), 17(1), 19, 20(1)(a), 21(3) and 33(1) of the Act; and
- ascertain whether the management agreement provides for the maintenance of records in accordance with section 52 the Act.

Business Plan

Section 18(1) of the Act states that subject to subsection (2), a BVI insurer shall not carry on any business or activities, whether in the Virgin Islands or elsewhere, otherwise than in connection with or for the purposes of the insurance business that it is authorised by its licence to carry on.

Section 18(4) of the Act states that a licensed insurer may, at any time, submit an amended business plan to the Commission.

Section 72(3) of the Code states that a licensee shall not, without giving the Commission reasonable prior notice, (a) cause or permit a change in (i) its name or any business under which it carries on regulated business; (ii) the address of its principal office or place of business, whether in or outside the Virgin Islands; or (iii) the address of its

registered office; or (b) carry on business in a manner materially different to its most recent business plan.

The Inspection Team should:

- ascertain whether business plans held on file for each BVI insurer is as required in section 18(1) and (4) of the Act and 72(3) of the Code.
- review the business plan and ensure that it accords with the Commission records.

Outsourced Functionaries

The Inspection Team should:

- review the BVI Insurer's file to ensure that it contains a copy of the contract agreements for the individual responsible for:
 - Underwriting risks and issuing policies
 - Settling premiums/prices for business written
 - Settling claims and other technical reserves
 - Investment/asset management
 - Reinsurance;
- ensure that the outsourcing responsibility is in accordance with Division 5 of the Code;
- review the BVI insurer's file to ensure that there is a signed contract/agreement between the BVI Insurer and the outsourced individual;
- ensure that the individual responsible for the outsourced function accords with the Commission's records; and

- ascertain whether both parties abide by the terms of the outsourcing agreement.

Policy Documents

The Inspection Team should:

- conduct a review of the policy documents to ensure that copies of all policy documents/policy schedules are maintained for each BVI Insurer; in reviewing policy documents, ensure that the policy documents/policy schedule include the name of the insured, type of coverage, policy period, policy sums insured/limits and premiums; and
- ascertain whether the policy documents are prepared and signed by the Manager. If not indicate by whom.

Claims Documents

The Inspection Team should:

- ensure that copies of all claim documents/claims schedules are maintained for each BVI insurer;
 - in reviewing claims documents ensure that claim documents/claims schedules include a list of all claims paid including policy details, date of loss, cause of loss, amount paid and the payee;
 - in reviewing claims documents ensure that claim documents/claims schedules include a list of all claims outstanding including policy details, date of loss, cause of loss, amount of reserve and the payee; and
- ascertain whether claims documents are prepared and signed by the Manager. If not, indicate by whom.

Financial Statements

Section 56(1) of the Act states that a relevant licensee shall prepare financial statements for each financial year that comply with the Code and with such accounting standards as may be prescribed.

Section 56(2) of the Act states that if, in complying with the accounting standards in accordance with which they are prepared, the financial statements do not give a true and fair view of the matters to which they relate, the notes to the financial statements shall contain such information and explanations as will give a true and fair view of those matters.

Section 56(3) of the Act states that the financial statements prepared under subsection (1) shall

- (a) be approved by the directors of the relevant licensee; and
- (b) following approval under paragraph (a), be signed by at least one director on behalf of all the directors.

Section 56(4) of the Act states that the director signing the financial statements shall state the date when the financial statements were approved by the directors and the date when he signs the financial statements.

Section 57(1) of the Act states that the financial statements of a relevant licensee signed by a director in accordance with section 56 shall be submitted to the Commission within six months of the end of the financial year to which they relate accompanied by

- (a) a directors' certificate in the approved form;
- (b) an auditor's report;

- (c) any report on the affairs of the licensee made to the members of the licensee in respect of the relevant financial year; and
- (d) such other documents as may be prescribed.

The Inspection Team should:

- ensure that there are copies of the BVI insurer's financial statements maintained on file in accordance with sections 56 and 57 of the Act;
- conduct a review of the BVI insurer's financial statements to ensure that the financial statements agree with the Commission's records; and
- ensure that all the filings of financial statements for the BVI insurer are up-to-date.

Investment

The Inspection Team should:

- ascertain whether there is a list of all investments held by the BVI insurer;
- ascertain whether copies of investment statements are maintained for the BVI insurer;
- conduct a review to ascertain whether the investment manager and the custodian have been clearly identified; and
- ascertain whether the custodian is affiliated with the owner of the BVI insurer.

Bank Accounts

The Inspection Team should ascertain whether:

- there is a list of all bank accounts held by the BVI insurer; and
- copies of bank statements are maintained for each BVI insurer.

Checklists

The Inspection Team should:

- ascertain whether the Insurance Manager conducts reviews of the BVI insurer, i.e. monthly, quarterly, annually, etc.; and
- conduct a review of the forms used to ascertain the adequacy.

APPENDIX 4B

BVI Insurer File Review (Insurance Intermediary)

Subsidiaries, Joint Ventures and Branches

The Inspection Team should:

- ascertain whether the BVI Insurance Intermediary has any other subsidiaries, joint ventures or branches in other jurisdictions; and
- request information on how the subsidiaries, joint ventures or branches operate in relation to the BVI Insurance Intermediary.

Other Regulatory Consents

The Inspection Team should:

- ascertain whether the BVI Insurance Intermediary has any other companies in other jurisdictions;
 - If there is a company in another jurisdiction, ascertain how they operate in conjunction with the BVI Insurance Intermediary and BVI Insurer; and
- request and review a copy of the licence of the company from the other jurisdiction.

Professional Indemnity Insurance

Section 50(1) of the Act states that a licensed insurance intermediary and a licensed insurance manager shall at all times maintain such professional indemnity and other insurance as may be prescribed.

The Inspection Team should ensure that the BVI Insurance Intermediary has professional indemnity insurance in accordance with section 50(1) of the Act.

Advertising, including internet marketing

Section 70(1) of the Act states that a licensee shall not issue, or cause or permit to be issued, any advertisement, statement, brochure or other similar document which is misleading or which contains an incorrect statement of fact.

The Inspection Team should:

- review the BVI Insurance Intermediary's marketing material/samples to ascertain what kind of marketing the company undertakes; and
- ensure that the marketing material/samples are not misleading – section 70(1) of the Act.

Insurers through which BVI Insurance Intermediary places insurance business

The Inspection Team should:

- ensure that the BVI Insurance Intermediary is placing business with licensed BVI insurers pursuant to sections 4 and 5 of the Act; and
- if the insurer is a Lloyds member and syndicate, ensure that the member and syndicate are complying with regulations 10, 11 and 12 of the Insurance Regulations.

Business Continuity

The Inspection Team should:

- ensure that the BVI Insurance Intermediary and BVI Insurer have a business continuity plan in place;
- review the business continuity plan to ensure suitability and to ascertain whether the business continuity plan is BVI specific or on a group-wide basis; and
- ascertain whether the business continuity plan has been tried and tested.

Accounts and Business Information

The Inspection Team should:

- ensure that the BVI Insurance Intermediary has the ability to meet its financial obligations to its creditors, i.e. the insurers through which business is placed, general business creditors, investors and its clients/customers; and
- ensure that the BVI Insurance Intermediary is complying with section 57 of the Act.

Agency Agreements

The Inspection Team should:

- ascertain whether there are agency agreements in place with each BVI Insurer; and
- ascertain whether the BVI Insurance Intermediary is complying with the terms and conditions of the agency agreement.

New Business Files, Existing Files, Adjustments and Endorsements and Renewal Files

The Inspection Team should ascertain whether:

- the files indicate evidence:
 - that policy documents have been submitted to the client
 - that proposals are signed by the client
 - that changes have been initialed
 - of the policy delivery date/receipt
 - of a copy of policy documents on file
 - of method of payment, i.e. cash, check, credit card, etc.
 - of a compliance checklist having been completed
- the files indicate evidence of return premium in the event of over-payment.

Claim Files

The Inspection Team should ascertain whether:

- the files indicate evidence:
 - of claim status.
 - of claim settlement.
 - of proof of loss.
 - of claims having been settled in a timely manner.
 - that changes have been initialed.
 - of follow-up with respect to open claims.
 - of circumstances surrounding the refusal of claims, if any.

Handling Client Money

The Inspection Team should:

- ascertain whether the Insurance Intermediary is complying with International Association of Insurance Supervisors International Core Principle 24 (“ICP”); ascertain whether the Insurance Intermediary has sufficient safeguards in place to protect client money;
- request confirmation of the safeguards in place to protect client money;
- review the manner in which client money is stored; and
- ascertain whether the Insurance Intermediary co-mingles client money. If so, request confirmation of why this is done.

Status of Intermediary

The Inspection Team should:

- ascertain whether the Insurance Intermediary is complying with ICP 24 in relation to status of Intermediary;
- ascertain whether the Insurance Intermediary provides customers with information on its status, specifically whether they are independent or associated with particular insurance companies and whether they are authorized to conclude contracts on behalf of an insurer or not;
- ascertain whether the application forms clearly differentiate between the Insurance Intermediary and the BVI Insurer; and
- ascertain whether the application clearly states that the Insurance Intermediary is representing a BVI Insurer.

Customer Needs

The Inspection Team should ascertain whether the Insurance Intermediary:

- is complying with ICP 25 in relation to customer needs;
- assesses customer needs in accordance with ICP 25;
- handles clients with due skill, care and diligence; and

- obtains information on customer needs.

Customer Information

The Inspection Team should ascertain whether the Insurance Intermediary:

- is complying with ICP 25 in relation to customer information; and
- provides customers with information regarding:
 - the policy summary
 - the policy documents
 - the claims handling process
 - policy cancellation rights.

Complaints

The Inspection Team should:

- ascertain whether the Insurance Intermediary is complying with ICP 25 in relation to complaints;
- ascertain whether the Insurance Intermediary has procedures in place to deal with complaints;
- conduct a review of how the Insurance Intermediary deals with claims:
 - effectively
 - Fairly
 - in a simple, easily accessible and equitable process;
- request confirmation of the average number of complaints handled by the Insurance Intermediary.

Fraud

The Inspection Team should ascertain:

- whether the Insurance Intermediary is complying with ICP 27 in relation to fraud;
- whether the Insurance Intermediary has procedures in place to detect, deter, record, report and remedy fraud; and
- the actions taken to prevent financial fraud.

APPENDIX 4C

Compliance Inspection File Review Checklist (Insurance)

Company:

Date of Incorporation:

Most Recent Written Premium:

Claims Paid:

[to be completed before the Inspection] Claims Outstanding:

Investment Income:

Cash and Cash Equivalents:

Equities:

<i>Does the file contain:</i>	<i>Yes/No</i>	<i>Last date</i>
a Register of shareholders?		
a Register of directors and officers?		
minutes of Board meetings held in the last three years?		
a signed copy of the Management Agreement between the manager and the insurer?		
➤ Does the Agreement require records required to be maintained at the Principal Office?		
➤ Does the Agreement require the insurer to seek the relevant prior approval for or notify all changes specified in the Insurance Act, 2008?		
a Business Plan?		
copies of contract agreements with and evidence of who is responsible for:		
<i>Activity</i>	<i>Responsibility</i>	

➤ underwriting risks and issuing policies?			
➤ setting premiums/prices for business written?			
➤ settling claims?			
➤ setting claims and other technical reserves?			
➤ investment/asset management?			
➤ producing the insurer accounts?			
➤ acting as approved auditor?			
➤ acting as approved actuary?			
➤ acting as legal counsel?			

the following books and records:			
➤ copies of all policy documents, or at least a copy of the standard policy?			
➤ list of all issued policies showing			
○ name of insured?			
○ type of coverage?			
○ policy period?			
○ policy sums insured / limits?			
○ premium, and do the premiums reconcile with the accounts?			
➤ list of all claims paid showing			
○ policy details			
○ date of loss?			
○ cause of loss?			
○ amount of payment and do the payments reconcile with the accounts?			
○ payee?			

➤ list of all claims outstanding		
○ policy details?		
○ date of loss?		
○ cause of loss?		
○ amount of reserve, and do the reserves reconcile with the accounts?		
○ payee?		
➤ inwards reinsurance agreements?		
➤ inwards reinsurance accounts?		
➤ outwards reinsurance agreements?		
➤ outwards reinsurance accounts?		
➤ a list of all bank accounts held by the insurer, and do the amounts reconcile with the accounts?		
○ are the bank records/statements complete?		
➤ a list of all investments, and do the amounts reconcile with the accounts?		
○ Where an investment/asset manager is employed, are complete copies of investment statements maintained?		
➤ copies of all letters of credit?		
➤ copies of all loan agreements with connected parties?		
➤ audited financial statements?		
➤ General Ledger?		
➤ management accounts (state frequency – monthly, quarterly or annual)?		
<i>Does the file contain evidence of:</i>		
➤ Monthly, quarterly or annual reviews by the insurance manager?		
➤ Input of service providers:		

○ Underwriter?		
○ Price/premium setters?		
○ Reserve setters?		
○ Loss adjusters?		
○ Accountants?		
○ Investment Manager?		
○ Auditors?		
➤ Gazette Listing?		

APPENDIX 5A

Investment Business File Review (General)

Administering Mutual Funds

Prudential standards and good practice, which the Commission considers relevant and applicable with respect to the functions of Investors Services, Valuation and Accounting and that are taken into account in its evaluation process, include the following:

AIMA's- Guide to Sound Practices for Hedge Fund Administrators
IOSCO's- Principles for the Valuation of Hedge Fund Portfolios
MFA's- Sound Practices for Hedge Fund Managers
Principles and Best Practice for Hedge Fund Investors
Best Practices for the Hedge Fund Industry

Depending on the size, nature and complexity of the business, a number of the issues would not be relevant. Therefore, the Inspection Team must be mindful of the particular circumstances of each licensee being inspected.

A licensee should ensure that it does the following:

- establish comprehensive written procedures and policies for effective performance of their duties as they relates to shareholder services;
- where responsible, conduct AML/CFT and CDD on potential investors into the fund;
- send deal receipts including subscription and redemption notes to investors within a timely manner;

- engage in regular communication with fund manager in relation to investors' dealing requests, subscriptions and redemptions, as well as liquidation issues, and other relevant matters;
- communicate timely and accurately with investors on matters such as queries, dealing and fund reporting; and
- implement a system of control to ensure adherence with established procedures.

Therefore, the Inspection Team should ensure that issues relevant to Investor Services, Valuation and Accounting are appropriately addressed.

Investor Services

The licensee should ensure that the services it is mandated to provide are carried out in a manner that is consistent with industry best practice as well as with all binding agreements that it has entered into.

The Inspection Team should

- examine the licensee's written procedures and policies to ensure that the licensee is adhering to them in the discharge of its daily functions;
- review samples of daily work to establish whether the licensee utilizes the four eyes principle in the provision of its day-to-day functions;
- review worksheets/checklists utilized in the provision of the licensee's day-to-day work to establish if protocol is being followed on a consistent basis;
- review the licensee's agreements with the funds to ensure that they are fulfilling all the responsibilities as set out in the agreements;
- review the offering documents of the funds to ascertain whether the licensee is meeting the requirements of the fund on a consistent basis;

- review the licensee’s daily work with a view to determining whether or not they meet their established service standards;
- assess the quality of the work, both from the perspective of timeliness and accuracy;
- ascertain whether the licensee has procedures for handling subscriptions and redemptions;
- ascertain what types forms of subscriptions and redemptions are accepted ;
- examine whether the licensee verifies bank payment details for redemptions proceeds; and
- determine whether the licensee experiences any delays regarding timing of requests and processing.

Valuation Services

The licensee should ensure that its valuation process is independent, transparent and is carried out in a manner that is consistent with established policies and procedures. Accordingly, the Inspection Team should

- evaluate whether or not the licensee has established comprehensive documented policies and procedures for the valuation of the funds;
- examine whether subscriptions and redemptions are being priced correctly;
- examine whether the licensee’s actual practices are consistent with the operational manual and/or fund prospectus;
- ascertain whether or not the licensee has a system to update and reconcile fund manager’s trades to the fund administration/accounting system;
- ascertain whether or not trades from the broker statements are being reconciled to administration/accounting system;
- establish whether or not the licensee has a pricing policy;
- establish whether or not the licensee has independent pricing sources/vendors;

- establish whether the licensee utilizes automated pricing sources;
- establish whether the licensee utilizes manual pricing sources, such as brokers;
- ascertain whether or not the licensee has tolerance levels for price movements for each type of security. Do the tolerance breaks instigate additional pricing procedures?
- ascertain whether or not the licensee has a mechanism for resolving difficult-to-price securities;
- ascertain whether the licensee has a written policy on, and system for, processing corporate actions. Does it include a calendar of corporate events?
- ascertain if corporate actions are reconciled to an external source (such as Bloomberg);
- ascertain if corporate actions are notified to and reconciled with the custodian;
- ascertain if the licensee has an effective governance mechanism, such as a valuation committee;
- ascertain whether or not the licensee engages external valuation services; and
- examine whether or not the licensee has adequate segregation of valuation duties.

Operational Review

In addition to the review of various documents independently, the Inspection Team should also cross reference various items across documents to ensure that the licensee is conducting the requisite checks and matching to ensure consistency and accuracy. In this regard, the Inspection Team should

- consider shares in issue per trial balance to share register;
- ascertain whether all subscriptions/redemptions for the relevant day are included;
- ascertain whether the bank statements match the licensee's records;

- ascertain whether all transactions to custodian bank have been posted to the administration system and, where this has not occurred, investigate discrepancies;
- investigate the circumstances surrounding any overdrawn balances if discovered;
- ascertain whether transactions are being settled to custodian bank account in a timely manner;
- reconcile accounts against brokerage statements;
- conduct a dividend receivable reconciliation, interest reconciliation and fee reconciliation;
- review investment gains/losses, investment exchange gains/losses and liquidity gains losses;
- ascertain the level of seniority required based on the level of the price movement; and
- ascertain if movements found in investments are consistent with market.

Accounting

The licensee should ensure that it maintains adequate accounting records in respect of each client fund in order to adequately construct financial statements that accurately present the financial position and performance of the fund. Such records should clearly demonstrate each transaction. Where statements are provided to each respective client, such statements must be complete, accurate and reflective of the transactions carried out.

Analysis

The Inspection Team should

- Ascertain whether the licensee, amongst other things, has records which relate to:
 - the purchase and sale of client assets
 - receipts and payments of client monies
 - fees and expenses
 - other transactions which may affect the value of the fund
 - the assets and liabilities of the funds
- ascertain whether there is a provision for Senior Accountant review of accounts;
- examine how actively the licensee liaises with the auditor; and
- ascertain if the licensee has an arrangement whereby both the director and auditor must sign off on statements.

Error Reporting Policy

A licensee should develop a comprehensive policy or programme for error reporting. Among other things, the policy should provide a systematic process for detecting, reporting, investigating and resolving errors. This policy should give due regards to corrective and, where applicable, compensating mechanisms. Accordingly, the Inspection Team should

- ascertain whether or not the licensee has an error reporting policy in place;
- ascertain whether or not the licensee maintains an error reporting log;
- ascertain whether or not the errors are being reporting to appropriate personnel;

- examine the licensee's tolerance levels with respect to reporting valuation errors;
- ascertain whether or not the licensee has a compensation policy for errors;
- assess the seriousness or materiality of the errors as well as frequency with which they reoccur; and
- assess from a qualitative perspective how well errors are dealt with and resolved (i.e. did the client appear satisfied with end result, was the error resolved in a timely manner, etc.).

APPENDIX 5B

Managing Mutual Funds File Review

The MFA's "Sound Practices for Hedge Fund Managers" is considered relevant and applicable with respect to the function of managing mutual funds and is taken into account in the evaluation process. Depending on the size, nature and complexity of the business, a number of the issues would not be relevant. Therefore, the Inspection Team must be mindful of the particular circumstances of each licensee being inspected. Accordingly, the Inspection Team should

- ascertain whether or not the licensee's management policies and practices are appropriate, given its size and complexity;
- assess whether or not licensee is acting in accordance with its management policies;
- ascertain whether the licensee reviews its policies at least annually (the review should include examination of changes in structure, effects of any extraordinary market events and effects of new regulations);
- ascertain whether or not the licensee acts in accordance with all agreements and offering documents for the funds;
- ascertain whether or not the licensee has procedures for dealing with conflicts of interest;
- ascertain whether the licensee has a code of ethics in place (this should include, amongst other things, blackout periods, confidentiality issues, policy on gifts and entertainment, prohibition of certain trades, etc.);
- examine the licensee's procedures for entering into relationships with counterparties;
- ascertain whether the licensee has procedures in place to ensure best execution;
- ascertain whether the licensee has policies and procedures in place for dealing with soft dollar arrangements;

- ascertain if trading parameters and risk limits are consistent with trading strategy;
- ascertain if investments which fall outside the general profile of strategy are reported and approved by relevant senior staff;
- evaluate the licensee's mechanism for monitoring trading activity;
- ascertain whether or not the licensee has agreements in place with sub-advisors. If so, the Inspection Team should assess whether the agreements explicitly cover all areas of the arrangement, including investment restrictions, etc.;
- ascertain whether or not the licensee reviews the performance of third party service providers;
- ascertain whether or not the licensee disseminates performance data to investors in accordance with established requirements;
- examine the licensee's level of transparency with respect to side letter arrangements;
- ascertain if the licensee conducts its own Net Asset Value calculations;
- ascertain if the Net Asset Value calculated by the licensee is subject to independent verification by a reputable fund administrator;
- ascertain whether the licensee has an independent valuation pricing committee;
- examine if the licensee has its various duties adequately segregated;
- ascertain how frequently the licensee reconciles third party trades;
- ascertain whether or not the licensee has special provisions for dealing with Over the Counter trades;
- examine whether the licensee utilizes fair value in its valuation process;
- ascertain whether the licensee has specific procedures for dealing with hard-to-provide or illiquid assets;
- ascertain how many sources the licensee utilizes for pricing securities;
- examine the processes the licensee has in place for investigating differences in prices;

- examine whether the licensee documents its rationale when executing price overrides, etc.;
- examine the licensee's risk metric system;
- examine whether the licensee compares its risk metric system to its return profile;
- examine whether the licensee updates its risk metric system in accordance with its findings on a periodic basis; and
- examine whether the licensee conducts stress tests on its portfolio.

APPENDIX 6A

Compliance Inspection File Review Checklist, Including Fact Cover Sheet (Banks)

Name of Bank:

Period of Inspection:

File Review Checklist:

Things to be Reviewed and/or Collected				
Inspection Checklist Items	Yes	No	Not Required	Comments/Examiner
Credit Committee Minutes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Branch Credit Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Audit Committee Minutes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Investment Committee Minutes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
ALCO Committee Minutes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Non-Accrual loans list	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
30-89 days past due loans list	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
90 days and more past due loans list	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Complaints Log/Records	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Significant Complaints Log/Records (those that cannot be settled quickly)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Training Log/Records and Handouts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Register of Enquiries (from FIA)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Vacation schedule for (last 3 years)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Register of Reports made (with FIA)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Nominal ledger print out with balance Including suspense accounts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Internal Audit Report.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

APPENDIX 6B

Compliance Inspection File Review Checklist (Fiduciary Services)

PSC File

Active

Licensee's Name: _____

Jurisdiction: _____

Inspection Checklist Items	Photo				Comments
	Yes	No	Copy	Blank	
Name, Address and Contact	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Notarized Passport page(s)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Letters of Reference	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Name & Addresses of Directors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Terms of Business Agreement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
PSC Due Diligence Procedures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Nature of Business	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Corporate Brochures/Promotional	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Notes:

APPENDIX 7A

Systems and Internal Controls File Review (Insolvency Services)

[Note: A shaded box indicates that information may be completed from details provided on the Pre-Visit Questionnaire.]

		<i>RESPONSE</i>	<i>COMMENT</i>
1.	Professional indemnity insurance		
1.1	Is current professional indemnity insurance ("PII") cover in place?		
1.2	Level of PII cover	\$	
1.3	Fee income from insolvency work;		
	- in the last 12 months		
	- in the firm's last complete financial year	\$	
		\$	
1.4	Gross assets under the control of the IP.	\$	
1.5	Does the level of the PII cover appear adequate in view of the volume of insolvency and gross assets under the control of the IP?		
1.6	Is there a complaints handling procedure?		
1.7	How many complaints have been received in relation to Insolvency Act 2003 cases?		
1.8	Have any claims been received and are there any potential claims known to the IP? If so, how many?		

RESPONSE

COMMENT

1.9 Have all such claims or potential claims been notified to the insurer in accordance with the terms of the policy?

2. New case acceptance procedures

2.1 Is there a checklist or other documentation to demonstrate that ethical and anti-money laundering considerations have been addressed prior to the acceptance of new cases?

2.2 Does the checklist or other documentation include adequate steps to ensure that;

- (a) potential conflicts of interest are identified?
- (b) the IP has the skills and resources necessary to handle the case effectively?
- (c) the Insolvency Code of Practice is adhered to?
- (d) the identity of a new client is verified and evidence of verification retained?

2.3 Has an AMLRO been appointed by the company/firm? If so, state who.

3. Staff

3.1 Record staffing levels below:

The PVQ does not provide the roll by

		RESPONSE	COMMENT
	<ul style="list-style-type: none"> - Licensed appointment takers - Licence holders who do not take appointments - Other staff with a professional qualification - Managers - Administrators - Cashiers - Secretarial and support - Other (specify) - Total 		<p>each member of the firm in insolvency works. Who is the case office?</p>
3.2	What is the total number of cases currently being administered by these staff?		
3.3	Specify any additional support available from affiliated offices in the BVI and overseas, or from elsewhere (if applicable)		
3.4	Do staff appear to be adequate in numbers and competence to deal effectively with the case load?		

RESPONSE

COMMENT

3.5 Are staff adequately trained? (See AMLTFCOP, Chapter V, 3.1)

3.6 Has any member of staff or temporary worker been disciplined or dismissed for any misdemeanor? (See AMLTFCOP, Chapter V, 3.1)

3.7 If so, provide brief details

3.8 Are staff regularly appraised?

3.9 Have any sub-contractors or temporary staff been engaged in insolvency work?

3.10 If so, are the control mechanisms imposed over them adequate?

3.11 Does the IP have a contingency plan (or agreement) in place, in the event of his becoming incapacitated?

4. Technical support systems

4.1 Is there an insolvency procedures manual?

insolvency cases?

- 4.8 Are procedures in place to monitor the progression of cases and assess the quality of work done? If so, how frequently are cases monitored?

5. Office systems and signatories

- 5.1 Does the incoming mail system provide for
- (a) mail to be opened independently from case handlers or, failing that, by more than one case handler at any one time?
 - (b) incoming cheques to be separated (and recorded) from incoming mail passed to case handlers?
 - (c) all incoming correspondence (mail and fax) to be date stamped?
 - (d) all incoming correspondence to be reviewed by the office holder?
 - (e) the office holders and case handlers to evidence their review of incoming correspondence in some way (i.e. by initialing the document)?

RESPONSE

COMMENT

5.2 Are correspondence and other signing rights clearly set out and communicated to staff?

5.3 Are there procedures to ensure that all outgoing correspondence (including mail and faxes) is seen by the office holder?

5.4 Is there a standard filing system and index?

Review performed by:

Signature:

Date of completion:

APPENDIX 7B

Fund Handling and Cashiering Systems Review (Insolvency Services)

[Note: A shaded box indicates that information may be completed from details provided on the Pre-Visit Questionnaire.]

	<i>RESPONSE</i>	<i>COMMENT</i>
1.	Client accounts and office accounts	
1.1	Are any client and/or office accounts operated by the company/firm in connection with insolvency work?	
1.2	If yes, specify the accounts.	
1.3	Review the insolvency related transactions in the client/office accounts; (a) are the posted transactions reasonable in the circumstances? (b) are monies transferred onwards to insolvency estate accounts or other appropriate accounts on a timely basis?	
1.4	Are any longstanding balances contained in client/office accounts adequately explained?	
2.	Insolvency case accounts	
2.1	Is a separate case account operated for each appointment?	

RESPONSE

COMMENT

2.2 Detail the standard signatory/mandate and authorization levels for banking transactions.

2.3 Are signatures appropriate?

2.4 Are cash receipts and payment vouchers used to detail and authorize all cash transactions?

2.5 If yes, detail the authorization requirements.

3. General

3.1 Are all bank accounts reconciled regularly? If so, state the frequency.

3.2 Is there evidence that the IP has considered whether to pay money over to the Insolvency Surplus Account operated by the Commission, in appropriate situations?

3.3 Did any other matters come to light during the specific funds handling and cashing review which require follow-up or mention in the final report?

Review performed by: _____

Signature: _____

Date of completion: _____

APPENDIX 7C

Funds Handling and Cashiering File Review (Insolvency Services)

Name of Insolvency Case: _____

Case No.: _____

Type of Case: _____

Appointees: _____

		YES ✓ NO ✗	COMMENT
1.	RECEIPTS AND PAYMENTS VOUCHERS		
1.1	Scan through files of cash receipts and payments vouchers. Does it appear that vouchers are properly approved in line with stated procedures?		
1.2	Check the sequence of receipt and payment vouchers. Are any missing?		

		YES ✓ NO ✗	COMMENT
1.3	<p>Select a random sample of 10 cash receipt vouchers and</p> <ul style="list-style-type: none"> (a) check that proper approval is evidenced, pre-dating the banking of the funds; (b) check that the details properly correspond to the supporting documentation (including amount, description of the nature of the receipt and that it relates to the case under review); (c) check that the coding/categorization of the receipt is correct; (d) check the cash book entry to ensure that the details are posted correctly; (e) check that the cash and cheques received were banked promptly. 		
1.4	<p>Select a random sample of 10 cash payment vouchers and</p> <ul style="list-style-type: none"> (a) check that proper approval is evidenced, pre-dating the issue of the cheque; (b) check that the details properly correspond to the supporting documentation (including amount, description of the payment and that it relates to the case); (c) check that the coding/categorization of the payment is correct; (d) check the cash book entry to ensure that the details are posted correctly. 		

		YES ✓ NO ✗	COMMENT
2.	BANK RECONCILIATIONS		
2.1	<p>Review the file of bank reconciliations for this bank account;</p> <p>(a) do bank reconciliations appear to be carried out regularly (how often?) and on a timely basis?</p> <p>(b) are unexplained and outstanding reconciling items followed up?</p> <p>(c) Seek an explanation for any long outstanding items.</p>		
3.	STATUTORY RECEIPTS AND PAYMENTS ACCOUNTS		
3.1	Select one statutory receipts and payments account (unless none are yet due for this case); is there evidence that it has been approved according to stated internal procedures?		
3.2	For the receipts and payments account selected in 3.1, do the details disclosed agree to the underlying cash book?		
4.	GENERAL		
4.1	Have any other matters come to light during this review which require follow-up or mention in the final report?		

Review Performed By: _____

Signature: _____

Date of Completion: _____

APPENDIX 7D

Company Creditors Arrangement File Review – Insolvency Services

Company Name: _____

File No.: _____

Date of Appointment: _____

Date of Completion: _____

Appointees: _____

		YES ✓	COMMENT
		NO X	
1.	STATUTORY COMPLIANCE		
	Are the following documents on file:		
1.1	Acceptance of appointment as interim supervisor (this is done by endorsing in accordance with Rule 92 or 93) a copy of the notice of intention to appoint an interim supervisor issued by the board pursuant to S.21(1)(d) or by an administrator or liquidator pursuant to S.22(2)	S.21(2)	
	Was the endorsed notice delivered to the board within five business days of the resolution or, of applicable, to the administrator or liquidator?	S.21(2), S.22(3)	
	Alternatively if the administrator or liquidator himself is acting as interim supervisor, is there a signed notice of intention to act as interim supervisor?	S.23(2)(b)	
1.2	Notice of appointment	S.24	

YES ✓
NO X

COMMENT

Was the notice, within two business days of appointment,

- filed with the Registrar?
- if the company is a regulated person, filed with the Commission?

1.3	A copy of the proposal for a voluntary arrangement	S.21(b), S.22(b)
-----	--	---------------------

YES ✓
NO X

COMMENT

Does the proposal contain the details required by Rule 86, including:-

- a summary of the proposed arrangement and why creditors are expected to agree to it
- particulars of the assets, and the extent to which they are charged
- particulars of the nature and amount of the company's creditors, including secured creditors and disputed claims, and how creditors will be dealt with under the arrangement
- whether there are any circumstances giving rise to the possibility, in the event that the company should go into liquidation, of claims for voidable transactions under Part VIII of the Act
- the duration of the arrangement
- proposed dates of distribution of assets to creditors and estimated amounts
- remuneration to be paid to the interim supervisor and supervisor
- the business that will be conducted by the company during the course of the arrangement
- the functions to be undertaken by the supervisor

1.4 Notice of a creditors meeting to be held no later than 28 days after appointment as interim supervisor S.27(1)(c)

1.5 Advertisement of the creditors meeting S.27(1)(d)

1.6 Report by the interim supervisor on the proposals for S.27(1)(a)

YES ✓
NO X

COMMENT

an arrangement

Does the report include

R94

- (if the interim supervisor was appointed by the Board) a summary of the affairs of the company and the conduct of its business during the proposal period;

- (unless the company is in administration or liquidation) his opinion as to whether the company is insolvent or likely to become insolvent;
- his opinion as to whether the arrangement which is being proposed has a reasonable prospect of being implemented;
- the costs to the company of his acting as interim supervisor?

1.7 Report on the outcome of the creditors meeting, showing

S.32

- whether the proposal was approved (and, if so, with what modifications), rejected or withdrawn;
- the resolutions put to the meeting and the decision on each one; and
- a list of creditors and their respective values present or represented at the meeting.

		YES ✓ NO X	COMMENT
	If the creditors wished to approve an amended proposal, were the provisions of S.31 complied with?		S.31
	Was the report		S.32(3)
	- sent to every creditor and member of the company?		
	- filed with the Registrar?		
1.8	Notification of appointment of supervisor		S.33
	Was the notification, within two days of the supervisors appointment,		
	- filed with the Registrar?		
	- if the company is a regulated person, filed with the Commission?		
1.9	Supervisor's accounts of receipts and payments, and reports concerning the progress of the arrangement, for		S.37
	- the first 12 months following the Supervisor's appointment;		
	- each subsequent period of 12 months;		
	- the period up to the date of ceasing to act.		
	Were the accounts and reports, within 60 days of the end of the relevant period,		S.37(3)
	- filed with the Registrar?		
	- sent to the company, creditors and members?		
1.10	Notice of completion (or premature termination) of		S.38

YES ✓
NO X

COMMENT

the arrangement.

Was the notice of completion, within 28 days of the arrangement's completion or termination,

- filed with the Registrar?
- sent to the company, creditors and members?

Does the notice of completion explain any material difference between the implementation of the arrangement and the proposal originally approved by the creditors? S.38(2)

2. CASE MANAGEMENT

- 2.1 If the office holder was appointed jointly with another IP based in a different jurisdiction, are the case files maintained in the BVI adequate to ensure that he has adequate oversight of the cases? BP
- 2.2 Do the files contain file notes justifying key decisions made by the office holder? BP
- 2.3 Do the files contain written minutes of important meetings including all creditors and Creditors' Committee meetings? BP
- 2.4 Where applicable, do the case files contain a list or lists recording all assets over which the office holder had responsibility at the commencement of the case, and how each was dealt with? BP
- 2.5 Do the case files contain a list of the Company's books and records over which the office holder has taken control? BP

		YES ✓ NO X	COMMENT
2.6	In general, does incoming correspondence appear to have been answered in a timely and courteous manner?	BP	
2.7	Have the files for this case generally been maintained in good order (are the files tidy and is it possible to find papers in the expected order)?	BP	
2.8	Where applicable, were the Company assets insured on a timely basis after appointment?	BP	
2.9	Where applicable, were major assets sales supported by independent professional valuations?	BP	
2.10	Do the case files contain a list of the Company's creditors, the amount owed to each creditor and their contact addresses?	BP	

3. CASE ACCEPTANCE PROCEDURES

- | | | | |
|-----|--|----------|--|
| 3.1 | Is evidence on file to show that AML/CFT considerations were addressed prior to the acceptance of the appointment?
- are these working papers signed off by the office holder?
- if the firm has a checklist, was the checklist used, signed off and filed prior to acceptance (see Systems and Internal Controls question 2.2)? | AMLTCOP | |
| 3.2 | Were any issues identified from the review under section 2.1 appropriately dealt with? | | |
| 3.3 | If an overseas IP was appointed jointly with the receiver, was the Commission notified prior to the appointment? | S.483(b) | |

		YES ✓ NO X	COMMENT
--	--	---------------	---------

- if so, was the Commission notified in good time, bearing in mind the circumstance of the case?
- was adequate information on the experience/qualifications of the overseas IP and justification for appointing an overseas IP provided to the Commission?

3.4 If this is a joint appointment of IP's based in different jurisdictions, is there any written agreement of the division of responsibilities between appointees? BP

4. COMPLIANCE WITH SYSTEMS AND INTERNAL CONTROLS

4.1 If there is a checklist for this type of appointment, was the checklist used for this case (see Systems and Internal Controls question 4.2)?

Does the checklist appear to be completed on a timely basis? BP

4.2 If procedures are in place to monitor the progression of cases and assess the quality of work done, were those procedures followed in respect of this case (see Systems and Internal Controls question 4.8)? BP

4.3 If there is a standard filing system and index, has it been applied in this case (see Systems and Internal Controls question 5.4)? BP

4.4 Is incoming mail on file typically date stamped and reviewed by the office holder, according to agreed procedures (see Systems and Internal Controls

YES ✓
NO X

COMMENT

question 5.1 (c) and (e))?

- 4.5 Is all outgoing mail on file typically authorized according to agreed procedures (see Systems and Internal Controls question 5.2)? BP

5. REMUNERATION

- 5.1 Detail below the dates and amounts of remuneration taken:

DATE

AMOUNT

- 5.2 Has the office holder provided adequate details to the appointer/ Creditors Committee/ Court to show how the remuneration was calculated and thereby enable the request to be properly evaluated? BP
- 5.3 If remuneration was claimed on a time and hourly rates basis, do the hours stated agree to the firm's time recording system? BP

Review Performed By: _____

Signature: _____

Date of Completion: _____

APPENDIX 7E

Company Creditors Arrangement File Review: Statutory Compliance Summary Worksheet (Insolvency Services)

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		C1	C2	C3	C4	C5	
1	Are the following documents on file?						
1.1	Acceptance of appointment as interim supervisor (this is done by endorsing (in accordance with Rule 92 or 93) a copy of the notice of intention to appoint an interim supervisor issued by the board pursuant to S.21(1)(d) or by an administrator or liquidator pursuant to S.22(2) Was the endorsed notice delivered to the board within five business days of the resolution or, of applicable, to the administrator or liquidator? Alternatively if the administrator or liquidator himself is acting as interim supervisor, is there a signed notice of intention to act as interim supervisor?						
1.2	Notice of appointment Was the notice, within two business days of appointment, <ul style="list-style-type: none">- filed with the Registrar?- if the company is a regulated person, filed with the Commission?						
1.3	A copy of the proposal for a voluntary arrangement Does the proposal contain the details required by Rule 86, including <ul style="list-style-type: none">- a summary of the proposed arrangement and why creditors are expected to agree to it?						

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		C1	C2	C3	C4	C5	
	<ul style="list-style-type: none"> - particulars of the assets, and the extent to which they are charged? - particulars of the nature and amount of the company's creditors, including secured creditors and disputed claims, and how creditors will be dealt with under the arrangement? 						
	<ul style="list-style-type: none"> - whether there are any circumstances giving rise to the possibility, in the event that the company should go into liquidation, of claims for voidable transactions under Part VIII of the Act? - the duration of the arrangement? - proposed dates of distribution of assets to creditors and estimated amounts? - remuneration to be paid to the interim supervisor and supervisor? - the business that will be conducted by the company during the course of the arrangement? - the functions to be undertaken by the supervisor? 						
1.4	Notice of a creditors meeting to be held no later than 28 days after appointment as interim supervisor						
1.5	Advertisement of the creditors meeting						
1.6	Report by the interim supervisor on the proposals for an arrangement						
	Does the report include						
	<ul style="list-style-type: none"> - (if the interim supervisor was appointed by the Board) a summary of the affairs of the company and the conduct of its business during the proposal period? 						

	CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
	C1	C2	C3	C4	C5	
<ul style="list-style-type: none"> - (unless the company is in administration or liquidation) his opinion as to whether the company is insolvent or likely to become insolvent? - his opinion as to whether the arrangement which is being proposed has a reasonable prospect of being implemented? - the costs to the company of his acting as interim supervisor? 						
1.7	Report on the outcome of the creditors meeting, showing					
	<ul style="list-style-type: none"> - whether the proposal was approved (and, if so, with what modifications), rejected or withdrawn; - the resolutions put to the meeting and the decision on each one; and 					
	<ul style="list-style-type: none"> - a list of creditors and their respective values present or represented at the meeting. 					
	<p>If the creditors wished to approve an amended proposal, were the provisions of S.31 complied with?</p> <p>Was the report</p> <ul style="list-style-type: none"> - sent to every creditor and member of the company? - filed with the Registrar? 					
1.8	Notification of appointment of supervisor					

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		C1	C2	C3	C4	C5	
	<p>Was the notification, within two days of the supervisors appointment,</p> <ul style="list-style-type: none"> - filed with the Registrar? - if the company is a regulated person, filed with the Commission? 						
1.9	<p>Supervisor's accounts of receipts and payments, and reports concerning the progress of the arrangement, for</p> <ul style="list-style-type: none"> - the first 12 months following the Supervisor's appointment; - each subsequent period of 12 months; - the period up to the date of ceasing to act. <p>Were the accounts and reports, within 60 days of the end of the relevant period,</p> <ul style="list-style-type: none"> - filed with the Registrar? - sent to the company, creditors and members? 						
1.10	<p>Notice of completion (or premature termination) of the arrangement.</p> <p>Was the notice of completion, within 28 days of the arrangement's completion or termination,</p> <ul style="list-style-type: none"> - filed with the Registrar? - sent to the company, creditors and members? <p>Does the notice of completion explain any material difference between the implementation of the arrangement and the proposal originally approved by the creditors?</p>						

APPENDIX 7F

Receivership File Reviews: Statutory Compliance Summary Worksheet (Insolvency Services)

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		R1	R2	R3	R4	R5	
1	Are the following documents on file?						
1.1	The office holder's written consent to act, in the prescribed form (Form 482(1)(A))						
1.2	Notice of Appointment						
	Was the notice, forthwith on appointment,						
	➤ sent to the company?						
	➤ filed with the Registrar?						
	- filed with the Commission (if the company is a regulated person)?						
	- caused to be advertised in the VI Gazette within 5 business days of appointment?						
	- caused to be advertised in appropriate newspapers within five business days of appointment?						
	- sent to all creditors of the company within 28 days of appointment?						
1.3	Does every public document issued by or on behalf of the company or the Receiver contain a statement that a receiver has been appointed?						
1.4	Does every public document issued by or on behalf of the company that relates to the assets covered by the receivership contain a statement that a receiver has been appointed?						

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		R1	R2	R3	R4	R5	
1.5	Receipts and payment accounts. Were the accounts filed with the Registrar and the Commission (if the company is a regulated person) within 30 days of the following accounting period ends:						
	- the 12 months following appointment?						
	- each subsequent period of six months?						
	- the period up to the date of ceasing to act?						
	- the entire period of receivership from the date of appointment to the date of the ceasing to act?						
	If the receiver was appointed by the Court, have accounts been filed with the Court as ordered by the Court?						
1.6	Notice of completion of receivership Was the notice, forthwith on completion of the receivership,						
	- given to the company?						
	- given to the administrator (if any)?						
	- given to the liquidator (if any)?						
	- given to the creditors' committee (if any)?						
	- given to the Commission (if a regulated person)?						
	- filed with the Registrar?						
1.7	The instrument of appointment of receiver(s)? This must be in writing.						
1.8	Acceptance of appointment as receiver(s). Was acceptance given by the end of the business day following receipt of the written appointment (Note: not applicable to Court appointed receivers)?						

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		R1	R2	R3	R4	R5	
1.9	Director's Statement of Affairs (Form 277(1))						
	Was the Statement of Affairs requested as soon as practicable after the Receiver's appointment?						
1.10	A report to creditors explaining - the events leading up to the appointment;						
	- the disposal or proposed disposal of the company assets and any plans to continue the business of the company;						
	- the principal and interest payable to the appointer;						
	- the amounts payable to preferential creditors;						
	- the amounts likely to be available for the payment of other creditors;						
	- the persons who have submitted statements of affairs;						
	- a summary of the statement of affairs and his comments thereof.						
	Was the report						
	- filed with the Registrar and the Court (if appointed by the Court) within three months of appointment?						
	- sent to the company (or its liquidator, if applicable) within 14 days of filing the report?						
	- sent to the Commission within 14 days of filing the report, if the company was/ is a regulated person?						

		CASE NUMBER (INSERT √ (Yes), X (No) or N/A)					OVERALL
		R1	R2	R3	R4	R5	
	- sent to all creditors or a notice published (Form 147(3)) stating the address from which a report may be obtained?						
1.11	Minutes of a meeting of unsecured creditors called pursuant to S.147(3)(c)?						
	Was the meeting called within 14 business days of filing the S.147(1) report with the Registrar?						
1.12	If a creditors committee was appointed at the S.147(3)(c) creditor's meeting, a Notice of Establishment of a Creditors Committee.						
	Was the notice filed with the Court (if the Receiver was appointed by the Court) or the Registrar (if not appointed by the Court) within five business day of passing the resolution?						
	Does the Creditors Committee consist of between three and five members?						

APPENDIX 7G

Provisional Liquidation File Review (Insolvency Services)

No. PL: _____

Company Name: _____

Date of Appointment: _____

Date of Completion: _____

Appointees: _____

		YES ✓ NO X	COMMENT
1.	STATUTORY COMPLIANCE		
	Are the following documents on file:		
1.1	The office holder's written consent to act, in the prescribed form (Form 482(1)A)	S.482(1)(b)	
1.2	A sealed order appointing a provisional liquidator and setting out his specific functions and powers	S.170, S.171, R.172(1)	
	- was the order, as soon as practicable after appointment, sent to the company?	R.172(3)	
2.	CASE MANAGEMENT		
2.1	If the office holder was appointed jointly with another IP based in a different jurisdiction, are the case files maintained in the BVI adequate to ensure that he has adequate oversight of case?	BP	
2.2	Do the files contain file notes justifying key decisions made by the office holder?	BP	
2.3	Do the files contain written minutes of important meetings including all creditors and Creditors' meetings?	BP	

	YES ✓	NO X	COMMENT
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Committee meetings?

2.4 Where applicable, do the case files contain a list or lists recording all assets over which the office holder had responsibility at the commencement of the case, and how each was dealt with? BP

2.5 Do the case files contain a list of the Company's books and records over which the office holder has taken control? BP

2.6 In general, does incoming correspondence appear to have been answered in a timely and courteous manner? BP

2.7 Have the files for this case generally been maintained in good order (are the files tidy and is it possible to find papers in the expected order)? BP

2.8 Where applicable, were the Company assets insured on a timely basis after appointment? BP

2.9 Where applicable, were major assets sales supported by independent professional valuations? BP

3. CASE ACCEPTANCE PROCEDURES

3.1 Is evidence on file to show that ethical and anti-money laundering considerations were addressed prior to the acceptance of the appointment? BP

- are these working papers signed off by the office holder?
- if the firm has a checklist, was the checklist used, signed off and filed prior to acceptance (see Systems and Internal Controls question

2.2)?

3.2 Were any issues identified from the review under section 2.1 appropriately dealt with?

3.3 If an overseas IP was appointed jointly with the receiver, was the Commission notified prior to the appointment?

S.483(b)

- if so, was the Commission notified in good time, bearing in mind the circumstance of the case?

BP

- was adequate information on the experience/qualifications of the overseas IP and justification for appointing an overseas IP provided to the Commission?

3.4 If this is a joint appointment of IP's based in different jurisdictions, is there any written agreement of the division of responsibilities between appointees?

BP

4. COMPLIANCE WITH SYSTEMS AND INTERNAL CONTROLS

4.1 If there is a checklist for this type of appointment, was the checklist used for this case (see Systems and Internal Controls question 4.2)?

Does the checklist appear to be completed on a timely basis?

BP

4.2 If procedures are in place to monitor the progression of cases and assess the quality of work done, were those procedures followed in respect of this case (see Systems and Internal Controls question 4.8)?

BP

		YES ✓ NO X	COMMENT
--	--	---------------	---------

4.3 If there is a standard filing system and index, has it been applied in this case (see Systems and Internal Controls question 5.4)? BP

4.4 Is incoming mail on file typically date stamped and reviewed by the office holder, according to agreed procedures (see Systems and Internal Controls question 5.1 (c) and (e))? BP

4.5 Is all outgoing mail on file typically authorized according to agreed procedures (see Systems and Internal Controls question 5.2)? BP

5. REMUNERATION

5.1 Detail below the dates and amounts of remuneration taken:

DATE	AMOUNT
------	--------

		YES ✓ NO X	COMMENT
--	--	---------------	---------

5.2 Was remuneration calculated on the basis of time properly spent at normal hourly rates for this kind of work or (alternatively) wholly or partly as a percentage of assets realized and/ or assets distributed? S.172, S.432(3)(4)

5.3 Has the office holder provided adequate details to the Court to show how the remuneration was calculated and thereby enable the request to be properly evaluated? BP

5.4 If remuneration was claimed on a time and hourly rates basis, do the hours stated agree to the firm's time recording system? BP

Review Performed By: _____

Signature: _____

Date of Completion: _____

APPENDIX 7H

Liquidation File Review (Insolvency Services)

No. PL: _____

Company Name: _____

Date of Appointment: _____

Date of Completion: _____

Appointees: _____

		YES ✓ NO ✗	COMMENT
1.	STATUTORY COMPLIANCE		
	Are the following documents on file:		
1.1	The office holder's written consent to act, in the prescribed form (Form 482(1A))	S.482(1)(b)	
1.2	Appointment document If appointed by members; a notice of appointment If appointed by the Court; a Court order	S161(2) S162(1)	
1.3	Notice of appointment Was the notice, within 14 days of appointment, - filed with the Registrar? - sent to the Company? - filed with the Commission (if the Company is a regulated person)?	S178(1) S.178(1)(b) S.178(1)(c) S.178(1)(d)	
1.4	Advertisement of appointment Was the advertisement published in the VI Gazette, a newspaper in the Virgin Islands and a newspaper in the company's principal place of business?	S.178(1)(a) R.32(2)	
1.5	First meeting of creditors	S.179	

		YES ✓ NO X	COMMENT
-	was the meeting held within 21 days of appointment?		S.179(1)
-	did the meeting confirm the appointment of the liquidator?		
-	are minutes of the meeting, signed by the Chairman, on file?		
-	were notices of the meeting sent to creditors giving at least 7 days notice, together with claim forms and proxy forms?		R.184
	NOTE: If appointed by the Court, the liquidator may decide not to call a meeting. If this option was taken, were creditors so informed and advised that a meeting must be called if 10% in value of creditors so require?		S.183
1.6	Preliminary report to creditors, covering		S.226(1)
-	the amount of share capital issued, subscribed and paid up;		
-	the assets and liabilities of the Company;		
-	the causes of failure;		
-	whether further enquiries are desirable with respect to (i) any matter relating to the promotion, formation or insolvency of the company or the conduct of the business or affairs of the company, and (ii) possible claims under Part IX.		

		YES ✓ NO X	COMMENT
	Was the report sent to each creditor of the Company and (if the report states that further enquiries are desirable regarding the conduct of the business or possible claims under Part IX) the Official Receiver?	S.226(1)	
1.7	Director's Statement of Affairs (Form 277(1))	S.225(2)	
	Was the Statement of Affairs filed with the Registrar?	R.204	
	If appointed by the Court, was a copy of the Statement of Affairs filed with the Court?	R.204, S.225(3)	
1.8	If a creditors committee was appointed at the S.179 creditor's meeting, a Notice of Establishment of a Creditors Committee.	S.421(5)	
	Was the notice filed with the Court (if the Liquidator was appointed by the Court) or the Registrar (if appointed by the members) within five business days of passing the resolution?	S.421(5)(b)	
	Was the first meeting of the Creditors Committee held within 28 days of its establishment?	R.72(2)	
	Does the Creditors Committee consist of between three and five members?	S.423(3)	
1.9	Notice of Intended Distribution to creditors (if there are assets available for distribution to creditors)	S.216, R.190	
1.10	Notice of distribution to creditors, including a statement "containing such particulars with respect to the company, and to its assets and affairs, as will enable creditors to understand the calculation of	R.192	

YES ✓
NO X

COMMENT

the amount of the dividend”.

1.11 Final report, sent to every creditor whose claim has been admitted and to every member of the Company. S.234(2)

Did the report contain a statement of realisations and distributions? S.234(2)(a)(i)

Did the report contain a statement that S.234(3)

- all known assets of the Company have been disclaimed, realized or distributed without realization?
- all proceeds of realisation have been distributed?
- there is no reason why, in the liquidator’s opinion, the company should not be struck from the register and dissolved?

Was the report and statement of realisations and distributions filed with the Registrar? S.234(2)(b)

1.12 Certificate of compliance with provisions of S.234(2) (i.e. to send a final report to creditors and members), if applicable. S.232(b)

2. CASE MANAGEMENT

2.1 If the office holder was appointed jointly with another IP based in a different jurisdiction, are the case files maintained in the BVI adequate to ensure that he has adequate oversight of case? BP

		YES ✓ NO X	COMMENT
2.2	Do the files contain file notes justifying key decisions made by the office holder?	BP	
2.3	Do the files contain written minutes of important meetings including all creditors and Creditors' Committee meetings?	BP	
2.4	Where applicable, do the case files contain a list or lists recording all assets over which the office holder had responsibility at the commencement of the case, and how each was dealt with?	BP	
2.5	Do the case files contain a list of the Company's books and records over which the office holder has taken control?	BP	
2.6	In general, does incoming correspondence appear to have been answered in a timely and courteous manner?	BP	
2.7	Have the files for this case generally been maintained in good order (are the files tidy and is it possible to find papers in the expected order)?	BP	
2.8	Where applicable, were the Company assets insured on a timely basis after appointment?	BP	
2.9	Where applicable, were major assets sales supported by independent professional valuations?	BP	
2.10	Do the case files contain a list of the Company's creditors, the amount owed to each creditor and their contact addresses?	BP	

		YES ✓ NO X	COMMENT
--	--	---------------	---------

2.11 If funds were available to pay a dividend to preferential creditors, on what date(s) was the dividend paid? BP

Date: _____

BP

- was the payment made on a reasonably timely basis after the office holder became aware that funds would be available to pay a dividend?

2.12 Have appropriate investigations into pre-insolvency and other transactions been carried out? BP

3. CASE ACCEPTANCE PROCEDURES

3.1 Is evidence on file to show that ethical and anti-money laundering considerations were addressed prior to the acceptance of the appointment? BP

- are these working papers signed off by the office holder?
- if the firm has a checklist, was the checklist used, signed off and filed prior to acceptance (see Systems and Internal Controls question 2.2)?

3.2 Were any issues identified from the review under section 3.1 appropriately dealt with?

3.3 If an overseas IP was appointed jointly with the liquidator, was the Commission notified prior to the appointment? S.483(b)

		YES ✓ NO X	COMMENT
--	--	---------------	---------

- if so, was the Commission notified in good time, bearing in mind the circumstance of the case? BP

- was adequate information on the experience/qualifications of the overseas IP and justification for appointing an overseas IP provided to the Commission?

3.4 If this is a joint appointment of IP's based in different jurisdictions, is there any written agreement of the division of responsibilities between appointees? BP

4. COMPLIANCE WITH SYSTEMS AND INTERNAL CONTROLS

4.1 If there is a checklist for this type of appointment, was the checklist used for this case (see Systems and Internal Controls question 4.2)?

Does the checklist appear to be completed on a timely basis? BP

4.2 If procedures are in place to monitor the progression of cases and assess the quality of work done, were those procedures followed in respect of this case (see Systems and Internal Controls question 4.8)? BP

4.3 If there is a standard filing system and index, has it been applied in this case (see Systems and Internal Controls question 5.4)? BP

4.4 Is incoming mail on file typically date stamped and reviewed by the office holder, according to agreed procedures (see Systems and Internal Controls

YES ✓
NO X

COMMENT

question 5.1 (c) and (e))?

- 4.5 Is all outgoing mail on file typically authorized according to agreed procedures (see Systems and Internal Controls question 5.2)? BP

5. REMUNERATION

- 5.1 Detail below the dates and amounts of remuneration taken:

DATE

AMOUNT

Has the remuneration, in all cases, been sanctioned by the Creditors Committee (if any) or the Court? S.430(1)

- 5.2 If the office holder was appointed by the Court, is remuneration calculated on the basis of time properly spent at normal hourly rates for this kind S.432(3)(4)

	YES ✓ NO X	COMMENT
--	---------------	---------

of work or (alternatively) wholly or partly as a percentage of assets realized and/ or assets distributed?

5.3 Has the office holder provided adequate details to the appointer/ Creditors Committee/ Court to show how the remuneration was calculated and thereby enable the request to be properly evaluated? BP

5.4 If remuneration was claimed on a time and hourly rates basis, do the hours stated agree to the firm's time recording system? BP

6. REPORTING ON DIRECTORS

6.1 Are there any documents on file to evidence whether the office holder has given proper consideration as to whether the conduct of directors (and former directors) makes them unfit to be concerned with the management of companies? S.271(1)

- if a director's conduct checklist is available, was one used for this case (see Systems and Internal Controls question 4.3)? BP
- were the conclusions as to the fitness or otherwise of directors' conduct reasonable in the circumstances?

6.2 If the conclusion was that the conduct of one or more directors was unfit, was a report in the prescribed form (Form 271) sent to the Official S.271(1)

YES ✓
NO X

COMMENT

Receiver?

- if so, was the report sent to the Official Receiver within a reasonable timescale in the circumstances? BP

Review Performed By: _____

Signature: _____

Date of Completion: _____

APPENDIX 7I

Case File Reviews and Funds Handling and Cashiering Reviews Worksheet Summary

Case Number										Overall
Insert v (Yes) X (No) or N/A										

Case File Reviews

1	Statutory compliance See case summaries									
2	Case management									
2.1	Adequacy of documentation within the BVI									
2.2	Documentation of key decisions									
2.3	Minutes of creditors, creditors' committee and other meetings									
2.4	Assets lists									
2.5	Listing of books and records									
2.6	Responding to correspondence									
2.7	Maintenance of files									
2.8	Insurance									
2.9	Independent valuations									

- 2.10 Creditors list
- 2.11 Timely dividends to preferential creditors
- 2.12 Investigations into pre-insolvency transactions
- 2.13 Timely reporting to appointor (AR only)
- 2.14 Reporting unlicensed financial services business (AR only)
- 2.15 Retention of records for 6 years (AR only)

Case Number										Overall
Insert v (Yes) X (No) or N/A										

3. Case acceptance procedures

- 3.1 Consideration of ethical/AML matters
- 3.2 Dealing with ethical AML/issues
- 3.3 Notification of overseas joint appointments
- 3.4 Agreement of responsibilities between joint appointees

4. Compliance with systems and internal controls

- 4.1 Use of checklists
- 4.2 Case progression and quality control reviews
- 4.3 Application of standard filing system
- 4.4 Review of incoming mail

		Case Number										Overall	
		Insert v (Yes) X (No) or N/A											
4.5	Authorisation of outgoing mail												
5.	Remuneration												
5.1	Approval of remuneration												
5.2	Basis of calculation of remuneration												
5.3	Provision of details												
5.4	Agreement to time recording system												
6.	Reporting on directors												
6.1	Documentation of reviews												
6.2	Submission of reports to the Official Receiver												
	Funds Handling & Cashiering Review												
1.	Receipts and payments vouchers												
1.1,1.2	Approval according to stated procedures												
1.3,1.4	Appropriate completion												
2	Bank reconciliations												

2.1 Regularity

Case Number										Overall
Insert v (Yes) X (No) or N/A										

3 **Statutory receipts and payments accounts**

3.1 Approval according to stated procedures

3.2 Corresponds to cash book

SAMPLE

SAMPLE

APPENDIX 8

Guidelines for Preparing Compliance Inspection Reports

The following are guideline for the processing of Compliance Inspection Reports and the subsequent follow up mechanism that should be followed by all Divisions within the FSC.

It is envisioned that a Table of Delegated Authority will be generated indicating to Divisions which issues arising from the Compliance Inspection Reports are to be sent to the Enforcement Committee (EC) and which issues will be delegated to Divisions. It should be noted that all AML/CFT and Management issues should be sent to the EC for deliberation and action as required.

The relevant Division is responsible to report periodically to the EC on the progress of the licence holder to comply with corrective actions.

If during or following the inspection of a licensee the inspection team makes a finding of a serious nature which requires the immediate attention and action of the Commission, the inspection team leader should bring that to the immediate attention of the Managing Director or, in his absence, the Deputy Managing Director (Regulation). Failure to so oblige will be considered a serious lapse of duty and may attract some form of disciplinary action, especially where the finding concerned poses some risk or has the potential for reputational damage.

The guidelines, including the estimated completion time, are set out in the table below.

Task to be Completed	Estimated Time for Completion	Remarks
Finding of a serious nature, such as a breach or non-compliance which poses some immediate risk or has a likely potential for reputational damage.	Immediate to the MD or, in his absence, the DMD, Regulation	
A preliminary findings report is prepared and sent to the MD/CEO	1 to 3 business days	
A factual report should be prepared and sent to LSC.	10 – 14 business days	
<p>After the factual compliance report has been reviewed by LSC, a copy of the report should, unless otherwise approved by the LSC in the absence of a breach, be referred to the EC.</p> <p>In the event that the report is approved by the LSC, it should be transmitted to the licensee concerned under cover of a letter indicating the factual findings of the inspection and inviting comments from the licensee. A deadline of no more than a month should be given for the receipt of comments.</p>	<p>7 days from date of confirmation of LSC minutes in respect of the report</p> <p>3 – 5 business days after LSC approval and following confirmation of LSC minutes in respect of the report</p>	
Where a report is referred to EC and approved, it should be transmitted to the licensee concerned under cover of a letter indicating the factual findings of the inspection and inviting comments from the licensee. A deadline of no more than a month should be given for the receipt of comments.	3 – 5 business days after EC approval and following confirmation of EC minutes in respect of the report	
Inspection Team will set out tentative corrective actions and time frames to govern contraventions discovered. The report is forwarded to the EC for further action after deadline for receipt of comments.	14 business days after the deadline for receipt of comments	

<p>The final report containing ratings in relation to the findings, corrective actions and deadlines for effecting the corrective actions is transmitted to the licensee concerned.</p>	<p>3 – 5 business days after EC approval of final report and following confirmation of EC minutes in respect of the report</p>	
<p>Periodic report should be sent to EC identifying any corrective actions that have been complied /not complied with.</p>	<p>14 business days following deadline for corrective action to be acted upon</p>	
<p>The EC dedicates a special meeting each month to deliberate on Compliance Inspection Reports, subject to the timeframes outlined above.</p>	<p>Ongoing</p>	

APPENDIX 9

Inspection Report (Template)

Name of Licensee: _____

Inspection Period: _____

Background Information

Board of Directors Minutes

Management Responsibilities

Unaudited P&L Management Accounts

Employment Contract (compliance)

Prudential standards require that under their terms and conditions of service employees, officers and directors must undertake to comply with the licensee's written compliance procedures. Ideally, such undertakings should be obtained by means of employment contracts.

Complaints Manual Procedures

Complaints Log

Training Log

Register of Enquires (from FIA)

The register shall contain as a minimum the date and nature of the enquiry, the name and agency of the inquiring officer, the powers being exercised, and details of the accounts or transactions involved.

Register of Reports made (with FIA)

The register shall contain details of the date on which the report is made, the person who makes the report and information sufficient to identify the relevant papers.

Overall Risk Assessments

Areas Reviewed and Ratings Applied

No. **Areas Reviewed**

Ratings Applied

Recommendations/Corrective Measures

Conclusions

SAMPLE

APPENDIX 10

Template for Monitoring Corrective Action

Name of Licence-holder:

Date on which evaluation was undertaken:

Inspection Team:

Date report approved by LSC:

Was report referred to EC? YES/NO

If report referred to EC, date of referral:

Areas reviewed: (Attach separate sheet if necessary)

Rating Applied: Satisfactory Room for Improvement Unsatisfactory

Observation:

Corrective Action(s) Required:

Deadline(s) for effecting Corrective Action: (Must correspond to Corrective Action(s))

Follow-up action taken:

Type of action taken (desk-based review of reports, follow-up onsite visit, off-site inspection, etc.):

Date action taken:

Document submitted: Yes No **Date:**

Finding(s) on compliance with Corrective Actions:

Conclusion(s) and recommendation(s):

Further action required: YES/NO (Please provide reason(s))

If further action required, specify period within which action is to be performed:

(Different periods may be specified for different actions)

If no further action is required, would you recommend removal of licensee from

Monitoring List? YES/NO (Please provide reason(s))

Prepared by: *(Name of Regulator/Reviewer)*

Signature: *(Regulator/Reviewer)*

Reviewed by: *(Name of Regulator/Reviewer)*

Signature: *(Regulator/Reviewer)*

Approved by Inspection Coordinator:

Signature of Inspection Coordinator:

ISSUED by the Financial Services Commission this 1st day of February, 2010.

SIGNED:

Robert Mathavious
Managing Director/CEO
Financial Services Commission