GUIDELINE NO. #/2022

CONSULTATION PAPER

DOMESTIC NON-BANK SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS GUIDELINE

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GUIDELINE ON DOMESTIC NON-BANK SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

(This Guideline is issued pursuant to Section 53 of the Financial Services Commission Act, 2010 and comes into effect on _____________, 2022)

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PURPOSE

The purpose of this Guideline is to outline the standards and requirements that apply to financial institutions designated as Domestic Non-bank Systemically Important Financial Institutions (DNB-SIFIs).

These measures are intended to mitigate the risk posed by such entities to the financial system and wider economy. DNB-SIFIs are expected to adopt and implement among other things robust risk-based capital, liquidity, risk management, governance, business continuity, and resolution standards. DNB-SIFIs will be subject to enhanced disclosure and reporting requirements to enable timely and effective actions to be taken in response to emerging risks.

Responding to the consultation

Financial Institutions are invited to submit comments regarding the Guideline by **May 26, 2023**, via the following link at https://bit.ly/41S0fQV.

1. CRITERIA FOR DETERMINING SYSTEMIC IMPORTANCE

Consistent with criteria established by the Basel Committee on Banking Supervision (2012)[1], the Financial Services Commission (Commission) defines a Domestic Non-Bank Systemically Important Financial Institution (DNB-SIFI) as a non-bank financial institution whose distress or disorderly failure would cause significant disruption to the wider financial system and economic activity because of its size, substitutability, and systemic interconnectedness.

1.1 Size

The ability of a financial institution to impact the financial system and wider economy in the event of its failure is directly correlated with its size. A large financial institution whose activities comprise a significant share of the domestic system and economy will have a significant negative impact on the system and economy if it fails.

The Commission considers a number of factors in evaluating the size of a financial institution and potential impact, including but not limited to the following:

- Total assets of the financial entity relative to other similar entities in the market,
- Total assets relative to the overall financial sector
- Size of off-balance sheet exposures.

1.2 Substitutability

Substitutability is determined by the extent to which a financial institution can be replaced by another market participant and financial services provider. The greater a FI's role as a market participant and a financial services provider, the greater the risk of a significant disruption following its failure given the limited capacity and ability of other FIs to address the service gaps in a timely manner.

The Commission employs the following indicators to assess the substitutability of a FI;

- Total funds held in a fiduciary capacity,
- Total deposits accepted from non-FI customers,
- Total loans extended to non-FI customers
- The number of institutions providing the registered activity or capable of providing the registered activity.
- The importance of the entity as a financial marketplace (settlements facilitator).
- The volume and value of premiums written relative to the life market.

[1] In document titled "A Framework for Dealing with Domestic Systemically Important Banks", published in October 2012.

1.3 Interconnectedness

The financial institution has significant interconnectedness to other financial institutions. The higher the level of interconnectedness, the greater the risk that the financial institution's failure will spread to other financial institutions and the wider economy.

The Commission utilises the following indicators to capture the interconnectedness of an FI:

- Total intra-financial assets and intra-off-balance sheet exposures held by the FI,
- Total intra-financial assets and off-balance sheet exposures held by the FI relative to total financial sector assets.
- The extent to which there are assets in the FI or group (including off-balance sheet assets) that are highly integrated with the key aspects of the real sector such that the loss of the facilities/assets will cause significant economic stress to the system.

2. REGULATORY AND SUPERVISORY REQUIREMENTS FOR DNB-SIFIs

FIs which have been designated as DNB-SIFIs are subject to enhanced regulatory and supervisory measures and mechanisms which are intended to monitor, assess and respond to emerging risks and developments within and in respect of the institution.

The requirements for a designated DNB-SIFI are as follows:

2.1 Capital

A designated DNB-SIFI is required to:

i. maintain such capital as may be determined by the Commission. This may include additional capital buffers, limitations on the type of instruments that may be accepted as capital, limitations on the jurisdiction in which the capital may be held, etc.

ii. create, implement and maintain a capital management plan that outlines among other things the FI's capital adequacy assessment process including the frequency of internal capital assessment reviews; capital buffers that are in excess of minimum regulatory capital requirements; and a capital restoration plan. Where the financial intuition is a part of a group, it is required to have an enterprise-wide capital plan in addition to its individual plan.

iii. illustrate in clear, documented terms that the FI's capital levels and its capital targets are aligned with the board's risk appetite, strategic plans and initiatives and are adequate to support the complexity of the FI's business and risk exposure.

iv. assess and update its capital management plan on an annual basis at a minimum and at such other times as may be necessary.

2.2 Liquidity and Large Exposures

i. A DNB-SIFI is required to establish and monitor its liquidity risk tolerance and maintain a contingency funding plan and liquidity buffers to manage liquidity stress events when normal sources of funding may not be available. A DNB-SIFI must ensure its ongoing ability meet its short-term (thirty days) obligations by maintaining a liquidity coverage ratio such that its assets can sufficiently fund cash outflows for a thirty-day period. Additionally, a DNB-SIFI is expected to maintain its capacity to meet its obligations in the long-term (twelve months) by maintaining a net stable funding ratio such that the structure of its funding is deemed sustainable.

2.3 Reporting and Disclosure

i. A DNB-SIFI is required to file reports and make disclosures related to, among other things, its business, financial condition, internal controls and risk management when requested by the Commission.

ii. A DNB-SIFI is required to file the reports outlined in **Appendix 1** with the Commission in accordance with stated periods or such other times as the Commission may require.

2.4 Corporate Governance

i. The Board of Directors (the Board) of a DNB-SIFI is an oversight role. It has ultimate responsibility for promoting and approving the FI's business and strategic objectives, governance, risk management and compliance frameworks, control functions and corporate culture. The Board is required to ensure management has effectively implemented the policies and standards set. The Board may delegate some of its functions, though not its responsibilities, to board committees where appropriate, subject to effective board oversight and ratification of key decisions that materially impact the FI's operations. The Board of a DNB-SIFI shall NOT be an executive Board and shall not be engaged in the day-to-day operations of the FI. As provided for in the Corporate Governance guideline, SIFIs are required to adopt the higher standards and are expected to have an Asset Liability Committee (ALCO), subcommittee of the Board.

ii. The Board must be sufficiently large based on the size, risk profile and complexity of the FI to ensure that it can adequately and effectively oversee the FI but should not be so large as to make oversight challenging. It is recommended that the Board of a SIFI be between 7-13 members and comprise members with sufficient experience and expertise to facilitate effective oversight. Board qualification is an ongoing requirement and members should be and remain qualified, individually and collectively, with a sufficient breadth of understanding of the FI's business for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the FI.

iii. The Board must develop, document, and regularly review the criteria and skill sets required of its members, both individually and collectively.

iv. The Board should comprise individuals with a diversity of skills, backgrounds, experience and expertise, who collectively possess the necessary qualifications commensurate with the size, complexity, and risk profile of the FI. Their skills and expertise should include, inter alia, capital markets, financial analysis, financial stability issues, financial reporting, information technology, strategic planning, risk management, compensation, regulation, corporate governance and management. Take note that this list is not intended to be exhaustive.

v. The Board should collectively have a reasonable understanding of local, regional and global economic and market forces and of the legal and regulatory environment.

2.5 Fitness and Propriety

i. All candidates for the Board of Directors, elected committees, committees to whom the Board has delegated authority and Senior Management/Officers including acting appointees, or any person responsible for executing major policy decisions of the Board, must be vetted and approved by the Commission before assuming office. Where this requirement has been contravened, the Commission may exercise its power to remove that person.

ii. The Board should have a clear, rigorous, and documented process for identifying, assessing and selecting Board candidates. The selection process should include reviewing whether Board candidates:

a) possess the knowledge, skills, experience, and independence of mind (for independent directors) given their responsibilities on the Board and in light of the FI's business and risk profile,
b) if the skill set of the individual, when seen in combination with the skills of the existing Board Members, serves to enhance the overall skill set of the Board,
c) are fit and proper,
d) have sufficient time to fully carry out their responsibilities; and
e) have the ability to promote smooth interaction between Board Members.

iii. When a regulated entity seeks to appoint or engage a person to perform a regulated function, it is the responsibility of the regulated entity to satisfy the Commission that the person is fit and proper, consistent with the FSC Fit and Proper Guideline, to perform the function for which they are being appointed or engaged.

iv. It is expected that the assessment conducted by the FI will take place at the recruitment stage, and on an ongoing basis, and that the regulated entity will make every effort to verify qualifications, experience, references and membership in professional bodies. It is also expected that the regulated entity will conduct probity checks on criminal history, sanctions, legal proceedings, and other similar matters. The regulated entity should be able to satisfy the Commission that the person acting or proposed to act in a regulated function possesses good character, integrity, competence and capability for the particular function and is financially sound.

v. Assessments conducted by the regulated entity to determine the fitness and propriety of persons seeking to conduct a regulated function must be documented to evidence what was done to determine the suitability of the applicant for the position. Such internal assessments must be made available to the Commission upon request.

vi. The Commission expects that where a third party is submitting the fit and proper documentation on behalf of a regulated entity or person (for e.g., in the case of a licensing application when an attorney or other representative is submitting the application), that the third party shall obtain and submit all relevant information as required and ensure that only complete applications are submitted to the Commission.

vii. The responsibilities of the Board of a regulated entity with respect to fitness and propriety are as follows:

- Ensuring that the regulated entity develops and implements fit and proper person policies and procedures, including assessment process, and such policies, procedures and processes shall be approved by the Boards and reviewed at least annually.
- Either alone or through its Nominating Committee, conducting fit and proper assessments of directors, the CEO and the company secretary and subject to regulatory requirements, making decisions on their appointments.

2.6 Risk Management

i. A DNB-SIFI is required to establish a risk committee that has the responsibility for approving and periodically reviewing the risk management policies of the financial institution. Where the DNB-SIFI is part of a group, the committee should be responsible for overseeing the enterprise-wide risk management framework.

ii. A DNB-SIFI is required to create and maintain an enterprise-wide risk management framework that is commensurate with its size, activities, structure, risk profile, and complexity.

iii. The framework should address at a minimum:
  - the policies and procedures for determining its risk management governance,
  - processes and infrastructure to identify, mitigate and report risk management deficiencies and failures, as well as emerging risks,
  - processes and infrastructure to ensure timely, effective action is taken to address emerging risks and risk management failures/deficiencies,
  - outline the responsibilities of the board, management and employees in the risk management process and framework,
  - policies, processes and infrastructure in place to safeguard the independence of the risk management function.

2.7 Business Recovery Planning

i. Each SIFI should have a robust and credible recovery plan which is approved by the board.

ii. The recovery plan serves as a guide to the recovery of a distressed DNB-SIFI. In the recovery phase, the financial institution has not yet met the conditions for resolution or entered the resolution regime. There should be a reasonable prospect of recovery if appropriate recovery measures are taken. The recovery plan should include measures to reduce the risk profile of the institution and conserve capital, as well as strategic options, such as the divestiture of business lines and balance sheet restructuring.

iii. The recovery plan should take account of the specific circumstances of the institution and reflect its nature, complexity, interconnectedness, level of substitutability and size.

iv. The underlying assumptions of the recovery plan and stress scenarios should be sufficiently severe. Both organisation (group) specific stress scenarios, inclusive of idiosyncratic and market-wide risk, and system-wide stress scenarios should be considered. The stress scenarios should take into account the potential impact of contagion in crisis scenarios, as well as simultaneous stress situations. Upon request, a DNB-SIFI is required to provide strategy and scenario analysis.

v. The recovery plan should serve as guidance to the DNB-SIFI and the Commission in a recovery or resolution scenario. They do not in any way imply that the Commission would be obliged to implement them or be prevented from implementing a different strategy in the event that the organisation needs to be resolved.

vi. The responsibility for developing and maintaining, and where necessary, executing the recovery plan lies with the institution’s senior management. This includes periodic simulation of scenario exercises to assess whether the recovery plans are feasible and credible. The Commission will review the recovery plan as part of the overall supervisory process, assessing its credibility and ability to be effectively implemented.

vii. DNB-SIFI are required to update the recovery plan at regular intervals, and upon the occurrence of events that materially change the organisation's structure or operations, its strategy or aggregated risk exposure. They are expected to regularly review the assumptions informing the recovery plans and assess on an ongoing basis the relevance and applicability of the plans. If necessary, DNB-SIFI should adapt their recovery plan accordingly.

viii. DNB-SIFI are required to have a robust governance structure in place and sufficient resources to support the recovery planning process. This includes clear responsibilities of business units, senior managers up to and including board members. This also includes identifying a senior level executive responsible for ensuring the organization is and remains in compliance with recovery plan requirements; and for ensuring that recovery planning is integrated into the organization's overall governance processes.

ix. DNB-SIFI are expected to have systems in place to generate timely information required to support the recovery planning process, to enable both the institution and the Commission to effectively carry out recovery and resolution planning, and where necessary, implement the recovery plan or the resolution plan.

2.8 Resolution Planning

i. Each designated SIFI must develop and the Board must approve resolution plans, also known as "living wills," which detail how the entity will resolve itself in an orderly manner if it is no longer able to continue as a "going concern", so as to minimize the impact of the failure on customers, stakeholders, other FI and the wider economy. These plans must be reviewed at least annually and updated to consider changes in the entity's circumstances or operating environment.

2.9 Expert Reviews and Reports

A DNB-SIFI is required to have reviews conducted and reports provided by experts such as actuaries, accountants and members of other professional bodies, as the Commission may require.

3. SANCTIONS

Failure to comply with this guideline is a breach of the FSCA and can result in the imposition of sanctions and penalties inclusive of limitations of the licence and allowed activities.

4. APPENDIX 1

Domestic Non-bank Systemically Important Financial Institutions
Reports to be filed

Frequency	Filing deadline	Report type
Annual		• Corporate Structure • Annual business plan and objectives • Bi-annual stress testing reports • Internal Audit Reports • Reports on Internal control failures • Auditor’s management letter
Quarterly	Within 30 days of the end of each quarter	• Liquidity report • Large exposures report • Cash flow statements • Loan report • Delinquency report • Report regarding affiliated entities including its parent or holding company, and subsidiaries
Monthly	Within 15 days of the end of each month	Board minutes and related board papers and packages,