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The FSC Risk Assessment Methodology & Issues Arising from Current Reviews

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Aims of presentation

- Why the need for change
- The objectives of the new methodology
- Outline of the revised methodology
- The on-site work
- Re-defining the risk mitigation stage
- Revised service level standards
- Areas of concern from current reviews of the insurance industry





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The speed trap analogy



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Objectives of New methodology

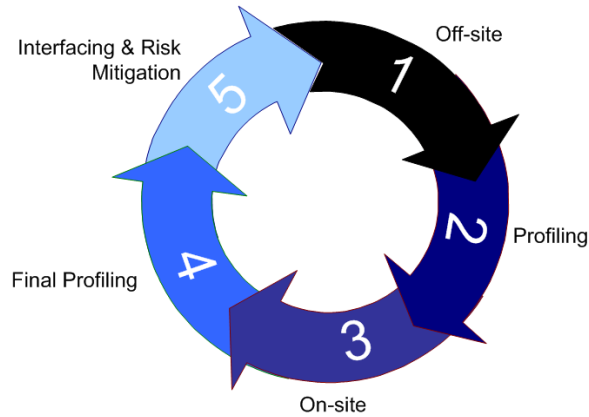
- Focus FSC resources from the beginning on a risk-based approach where they are most needed
- Reduce the amount of time spent on detailed work carried out by the divisions
- Increase quality of risk information held on firms
- Eliminate use of checklists and other on-site questionnaires
- Reduce turn-around time of risk-assessments
- Focus on high level risks not regulatory compliance work
- Increase number of risk assessments each division carries out in a year.





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Outline of new methodology



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Offsite

- To gather as much information as possible about a firm from sources that are already at the FSC's reach.

- Planning

- To ensure that a risk assessment is adequately resourced, that responsibility for the assessment has been identified, and that timings for completion of the assessment are established

- Review of existing documentation

- To ensure that the FSC is properly informed of the risks facing the firm and that it does not ask for information which has already been supplied.





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Customised pre-assessment questionnaire

- To determine the minimum amount of additional information that is required to complete the initial risk profiling of a firm.
 - Redesigned questionnaire.
 - Full menu which will be reduced.
 - Customised down for each firm.
- Documents to supplement;
 - Current staff organisation chart including reporting lines.
 - Current group and ownership structure.
 - Copy of the last MLRO's Annual Report to the Board
 - Copy of the completed Compliance Report against the 109 AML/CFT Requirements
 - Copy of the latest letter of Representation/Management letter issued with audited financial statements.
 - Copy of any internal audit or quality assurance audits issued in the previous 18 months.
- Pro forma letter to be issued with pre-assessment questionnaire



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Initial Profiling

- To obtain a preliminary assessment of the risk profile of a firm in order to obtain an early indication of the intensity of the assessment.
 - **Financial Soundness & Capital** - To determine the adequacy of the capital, funding and insurance cover in light of the current and future business plans of the firm.
 - **Environment** - To determine what operational and other market risks the firm is subjecting itself in carrying out its business plan.
 - **Business Plan** - To determine where the current and future risks lie in a firm's business plan, products and strategy.
 - **Controls** - To determine the control environment of a firm and management's ability to put into place proper oversight procedures.
 - **Organisation** - To determine if the legal ownership structure and/or Passporting of services of the firm provides any impediments to the supervision of the firm.
 - **Management** - To determine if the firm's corporate governance arrangements and management are adequate for the nature, size and complexity of the firm.





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New basis for scoring risk

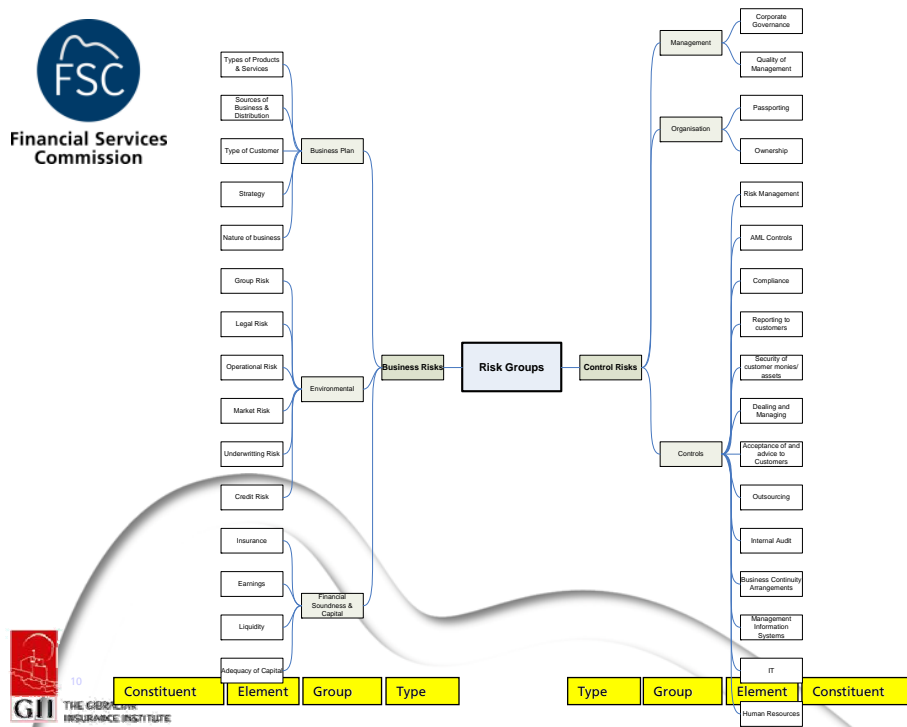
Previous Methodology



2009 Methodology

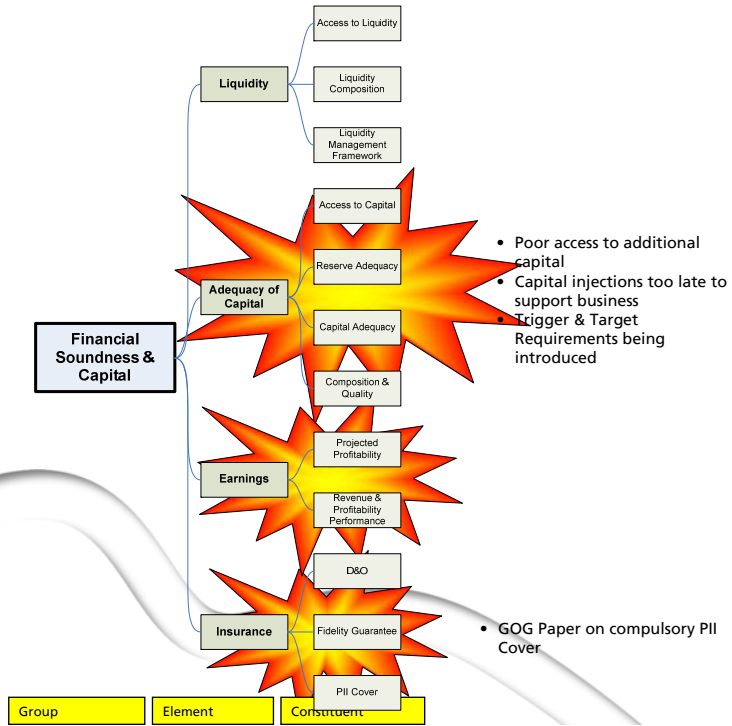


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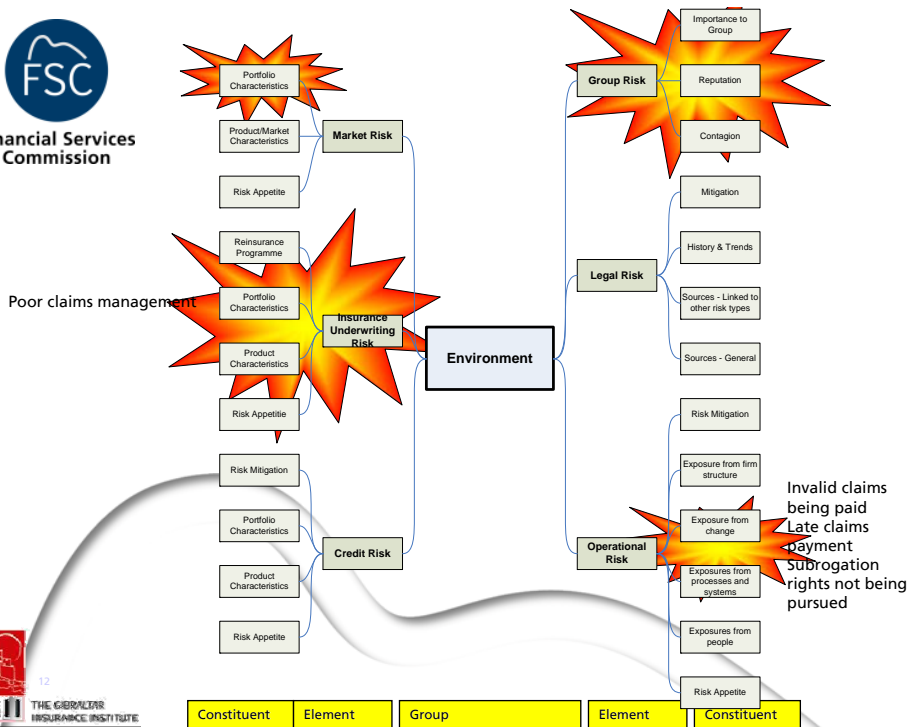


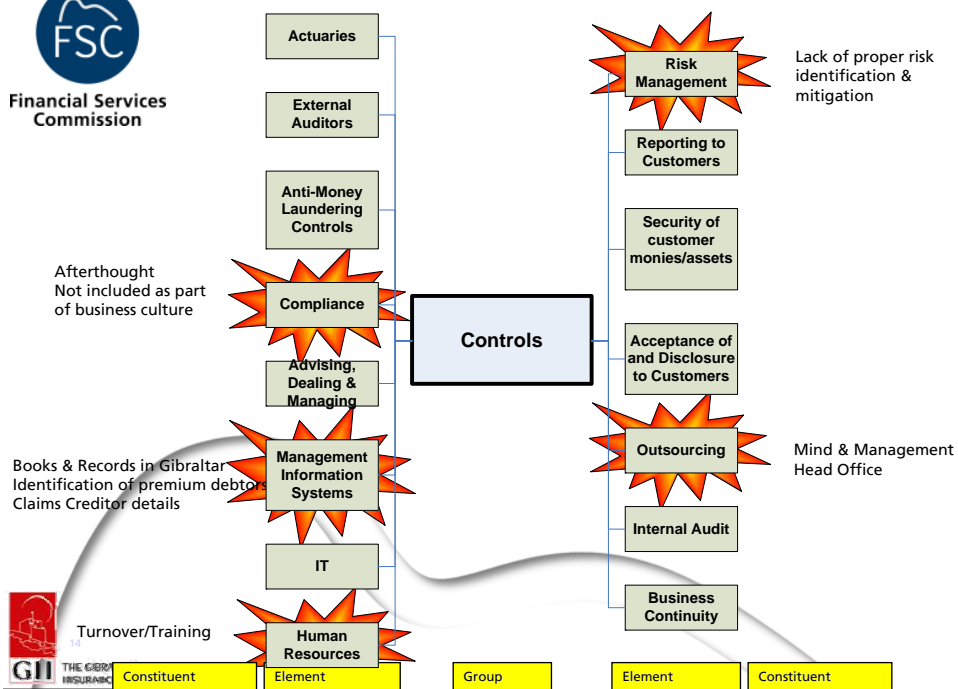
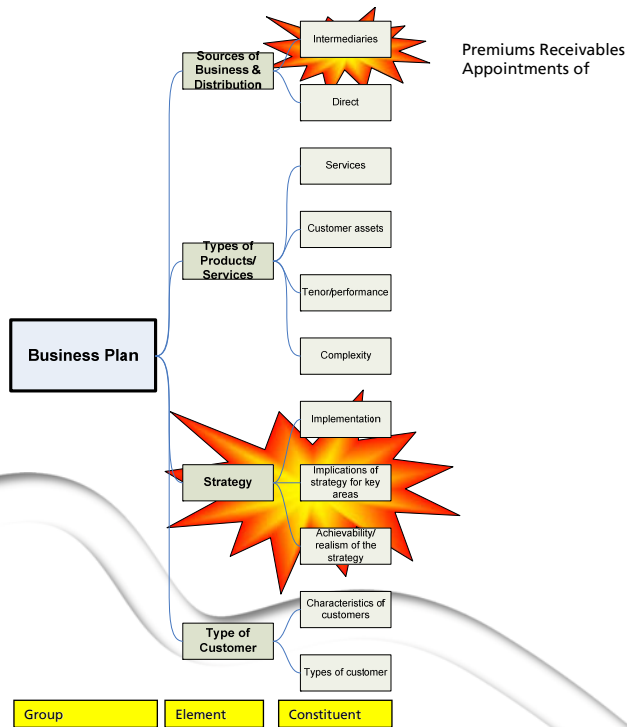


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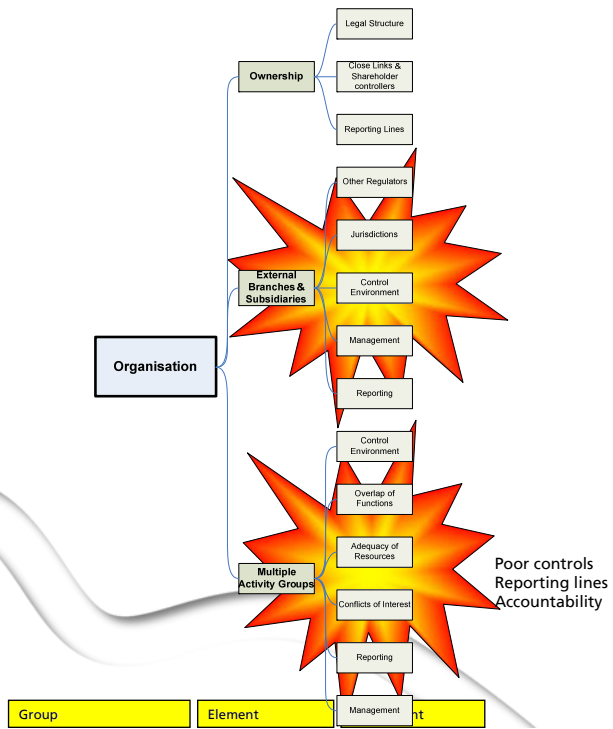
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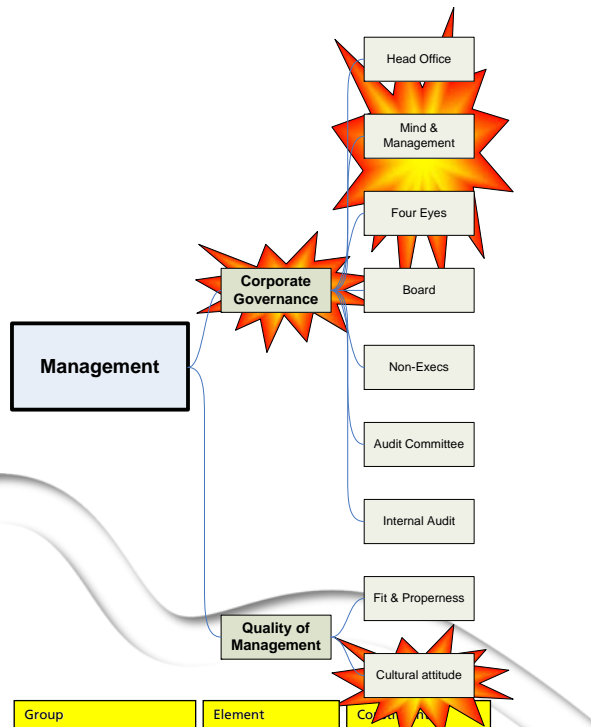




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Basis of scoring

- Each risk element is scored as;
 - Negligible 1.0
 - Possible 1.75
 - Probable 3.0
 - Perceptible 5.0
- Each risk element is weighted in accordance with importance to that risk group
- Each risk group is weighted as follows;
 - Business Risks
 - Financial Soundness & Capital 40%
 - Environment 30%
 - Business Plan 30%
 - Control Risks
 - Controls 45%
 - Organisation 10%
 - Management 45%



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What to cover at an on-site?

- On-site objective:
 - To identify the areas of biggest concern in respect of perceived risks of a firm that require validation or additional information from the firm.
- On-site issues
 - Only risk elements scored with “Probable” or “Perceptible” initial scores may be raised at on-site
 - Generally will be limited to 5 issues
 - Should be less than 5 issues





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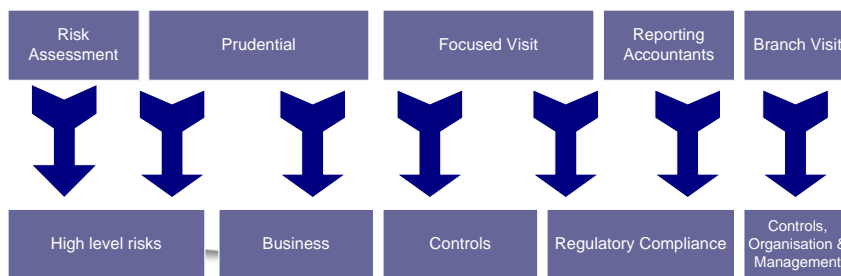
On site notification & close-out

- Formal agenda and letter to be sent to firm at least one week before arrival of team
- Close out happens as part of on-site, no rearranging for later date
- Mainly opportunity for firm to feedback on process



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New processes for risk mitigation





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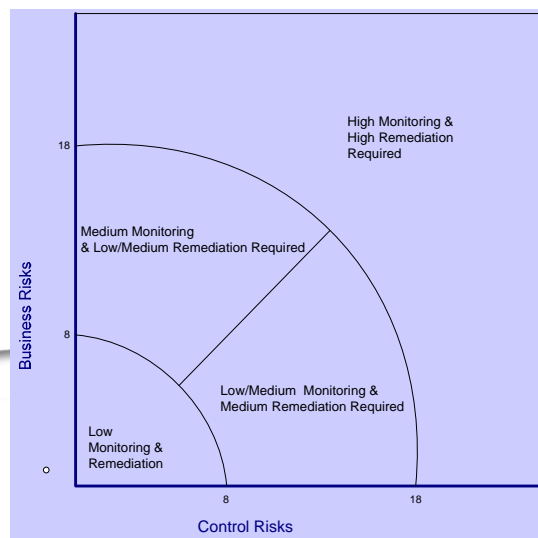
Risk mitigation programme

- The whole programme is now inclusive of other types on-site work
 - Prudentials
 - Focused Visits
 - Reporting Accountants
- Duration of risk mitigation programme dependent on risk-profile of firm
 - No specifics or guidance given to divisions
 - Should not be more than 48 months in any case



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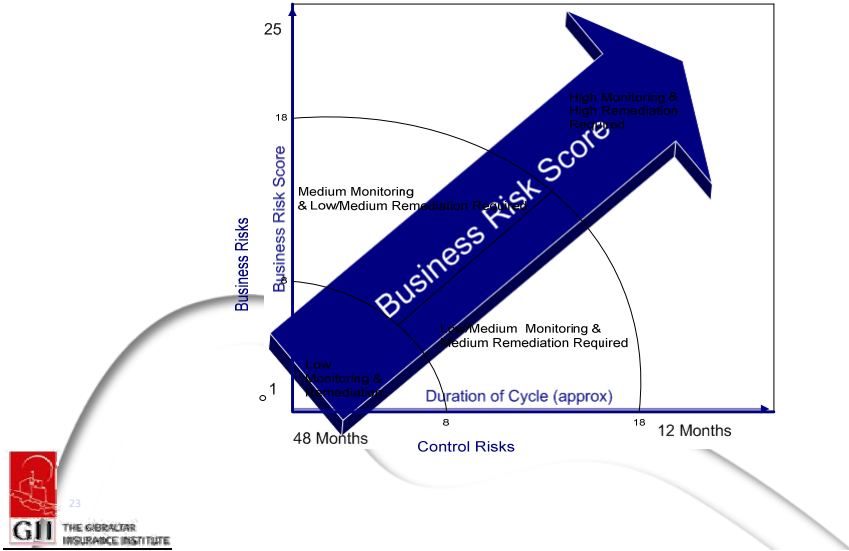
Risk Profile





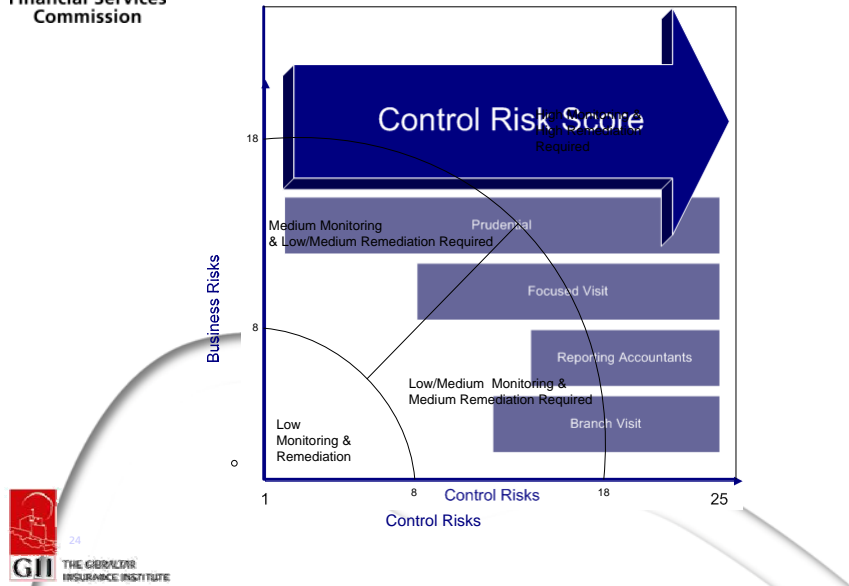
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Length of Risk Assessment Cycle



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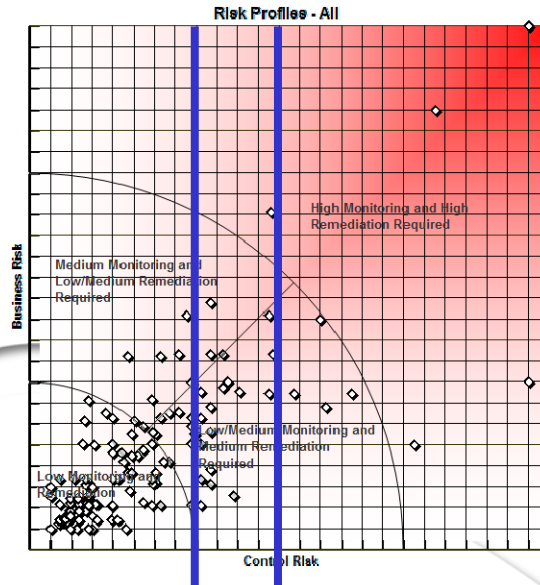
Interfacing Programme





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Current risk profiles of firms (all sectors)



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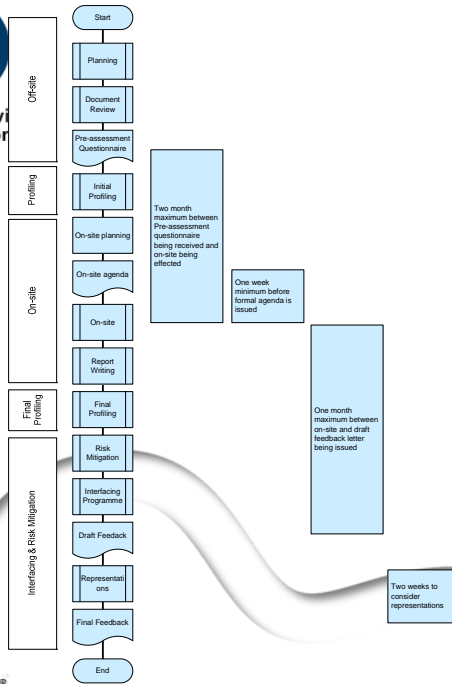
Feedback to firm

- Risk profile of firm
 - You are prohibited from sharing this risk-profile outside the senior management, board, controllers and auditors of the firm and it may never be used to imply FSC endorsement of any aspect of the firm's business or practices.
 - The risk profile may not be used in communications with prospective, current or past customers of the firm nor used in any marketing context.
 - Failure to comply by this restriction may result in the withdrawal of your authorisation.
- Risk mitigation programme
 - What needs to be corrected
 - What the FSC expects the outcomes to achieve
 - By when and how the FSC will monitor it
- Interfacing programme
 - Type of visit
 - To look at what
 - When





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Service Level Standards

- Two months to process pre-assessment questionnaire and arrange on-site
- One week before on-site, formal agenda sent
- One month after on-site draft feedback letter sent
- Two weeks after representations received, final feedback letter sent



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Corporate Governance



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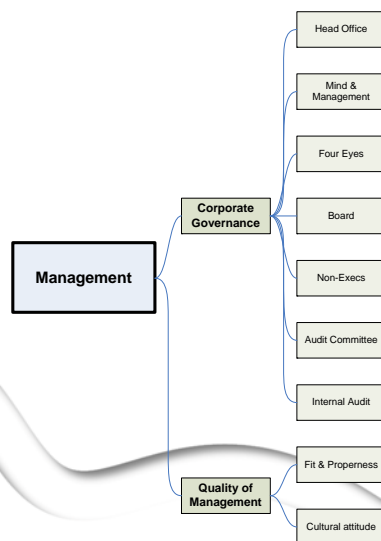
Splitting the issues

- Head Office
- Mind & Management
- Four Eyes
- The Board
 - Chairperson
 - Non-Exec Appointments
- Subsidiaries and Group
- Audit Committee
 - Internal Audit



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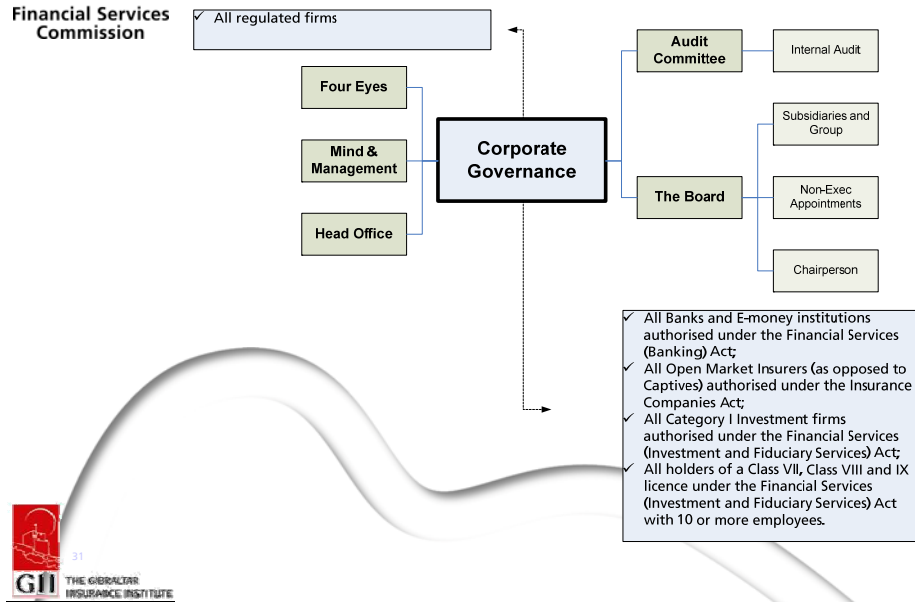
Link to our risk assessment





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Application of requirements



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Head office

- **Statutory Requirement**
 - Must be located in Gibraltar
 - Different to “in or from within” concept
- **Primary Considerations**
 - That the firm is incorporated or established in Gibraltar.
 - The location of
 - routine Board meetings
 - day-to-day management decisions
 - decisions taken concerning the firm’s strategy
 - the staff and management responsible for central management and control matters.
 - the compliance function.



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Head Office (contd.)

- Secondary Considerations
 - significant meetings
 - non-resident executive directors
 - the number of directors who are employees of the parent
 - influence which any non-resident executive directors have on the conduct of the firm
 - the Board's ability to make decisions
 - acting under the influence of particular dominant non-resident individuals or corporations
 - Whether members of the board have the qualities to stand up to outside pressure



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Mind & Management

- financial and other records of the firm are kept
- parameters set by the parent company
- hiring and firing of staff
- reporting lines to the parent
- management functions conducted outside the jurisdiction
- Where is the business booked
- parent company approval
- parent committing the subsidiary to business it would not otherwise undertake





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Four Eyes

- To be met on a **continual basis** and that individuals, so assigned to fulfil these roles, do so **over the entire operations** of the firm.
 - It is not therefore possible to satisfy this criterion when different sets of eyes look over different parts of a firm's operations.
- They must have **sufficient experience and knowledge** of the business and the necessary authority to detect and deal with any imprudence, dishonesty or other irregularities in the firm.
- In determining whether a firm meets the four eyes criterion the FSC will consider:
 - The **seniority and authorities** of the persons.
 - Whether the individuals are conducting their roles on a day-to-day basis **within Gibraltar**.
- The four eyes criterion does not extend to the concept that systems of internal controls of a firm should require that two persons oversee the work being conducted.



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The Role of the Board

- entrepreneurial leadership
- strategic aims
- financial and human resources are in place
- sets the company's values and standards
- balanced and understandable assessment of the company's position and prospects.
- sound system of internal controls





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Composition of Boards

- the appointment of new directors to the Board
- based on merit and against objective criteria.
- That appointees have enough time available to devote to the job.
- succession for appointments to the Board and to senior management
- mix of executive and non-executive directors (and in particular at least one independent non-executive director).
- no individual or small group of individuals can dominate the Board's decision making.



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Chairperson

- Chairman and Chief Executive should not be exercised by the same individual.
- The division of responsibilities between the Chairman and Chief Executive should be clearly established.
- Role of Chairman;
 - Providing strong leadership of the Board
 - Ensuring that the directors receive accurate, timely and clear information.
 - Providing effective communication with shareholders.
 - Facilitating the effective contribution of non-executive directors
 - Holding meetings with the non-executive directors without the executives present.





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Non-exec directors

- The FSC requires that at least one member of the Board should be an independent non-executive director (which may include a non-executive Chairman).
- Role of non-executive directors;
 - Constructively challenge and help to develop proposals on strategy.
 - Scrutinise the performance of Management
 - Satisfy themselves about the integrity of financial information and that financial controls and systems of risk management are robust and defensible.
 - Determine appropriate levels of remuneration of executive directors
 - On resignation, provided a written statement to the Chairman, for circulation to the Board, if they have any such concerns.



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Independence of Directors

- A director's independence may be compromised for a variety of reasons including if he/she:
 - Is an employee of the company or group within the last five years;
 - Has material business relationship with the company
 - has received or receives additional material remuneration from the company
 - has close personal relationships
 - holds cross-directorships
 - represents a significant shareholder; or
 - has served on the Board for more than nine years from the date of his first appointment.
- The Board should be aware of these circumstances and make a conscious decision to record where any of these, or other reasons, may lead to the director not being considered to be independent.





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Audit Committee

- Board should;
 - at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so.
 - establish formal and transparent arrangements for considering how it should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.
 - establish an audit committee comprised of at least one non-executive director. In smaller companies the company Chairman may be a member of, but not chair, the committee in addition to the non-executive directors, provided he or she was considered independent on appointment as chairman.
 - satisfy itself that at least one member of the audit committee has recent and relevant financial experience.



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Role of the Audit Committee

- to monitor the integrity of the financial statements
- to review the company's internal financial controls
- to monitor and review the effectiveness of the company's internal audit function where such a function exists;
- to make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence
- to develop and implement policy on the engagement of the external auditor to supply non-audit services
- to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.





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Consultation Process & Beyond

- Replies required by 31st March
- Response paper will be published with all representations received
- Amended Guidance to be issued
- Firms must comply or explain why not
- Guidance Note will be benchmark against which firms will be measured, alternative arrangements for corporate governance may be suitable to individual firms



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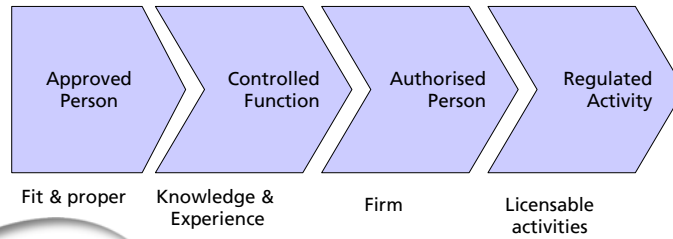
Approved Persons Regime





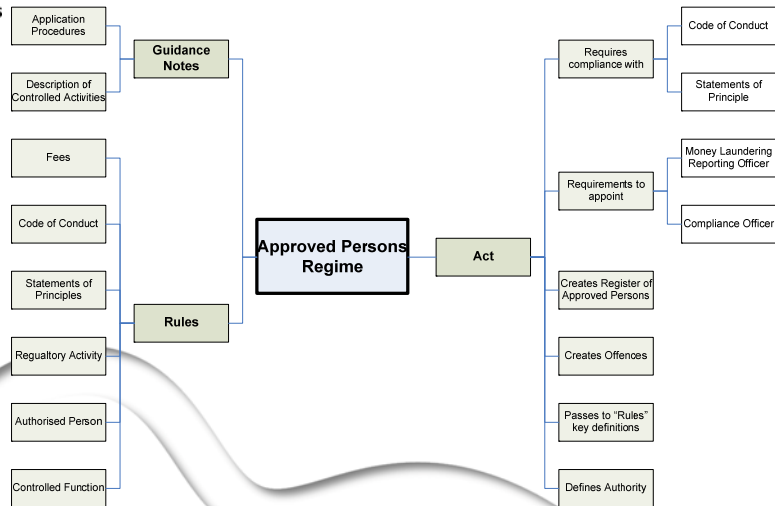
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What is the APR?



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Legislative Framework





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Register of Approved Persons

- Requirement to establish on-line register
 - Name
 - Person for whom he performs a controlled activity
 - The controlled activities that he performs

- Controlled activities are approved per firm and per person.
- NOT transferable



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Applications

- Use of a single form
- Authority may ask for more information, seek references, etc
- Application fee to accompany applications
- Must determine within 3 months





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Transitional Provisions

- Does not apply to controllers and shareholders!
- Persons conducting controlled function NOW for a firm may continue to do so for a year
- All sections in Supervisory Acts relating to approval of officers, etc to be repealed



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Authorised Persons “the Firm”

- a person who is a licensed institution under the Financial Services (Banking) Act 1992;
- a person who is licensed or authorised to conduct investment business (or a controlled activity) within the meaning of the Financial Services (Investment and Fiduciary Services) Act 1989;
- a licensed insurer within the meaning of the Insurance Companies Act 1987;
- a fund (and other relevant persons) authorised under the Financial Services (Collective Investment Schemes) Act 2005 and an experienced investor fund deemed to be authorised under the Financial Services (Experienced Investor Fund) Regulations, 2005;
- a person authorised under the Financial Services (Markets in Financial Instruments) Act 2006.





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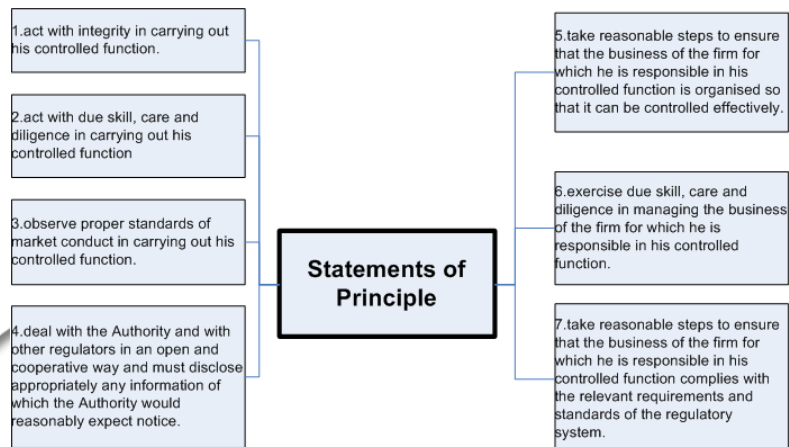
Regulated Activity

- any of the activities in paragraphs 1 to 6 of Schedule 1 of the Financial Services (Banking) Act 1992;
- any of the activities in Schedules 2 or 3 of the Financial Services (Investment and Fiduciary Services) Act 1989;
- the effecting and carrying out of contracts of any of the classes or groups of classes specified in Schedules 1 and 2 of Insurance Companies Act, including reinsurance;
- acting as an authorised director of a fund deemed to be authorised under the Financial Services (Experienced Investor Fund) Regulations, 2005.
- any of the activities in Schedule 1 of the Financial Services (Markets in Financial Instruments) Act 2006.



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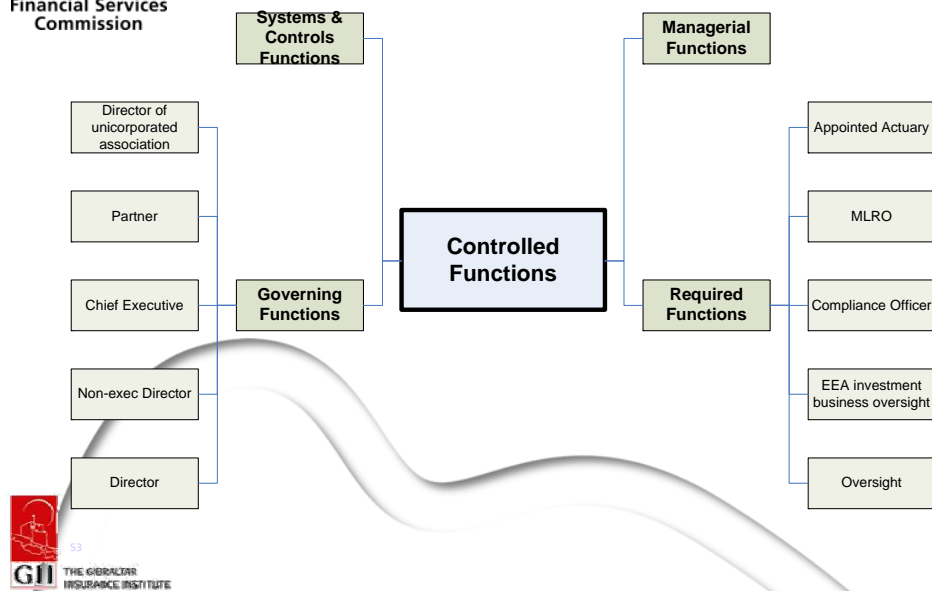
Statements of principle





Controlled Functions

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Application Processes

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- Need to apply for every FIRM that they will conduct a controlled activity - £100.00
- Need to apply for every change in Controlled functions to be carried out within the SAME firm - £25.00
- Need to inform us when they cease to perform such a function - £10.00
- FSC needs to process and make a determination (one way or another) within 3 months of receipt of application
- Use of new Universal Application Form





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What next

- GoG consultation paper – responses up to 31st March
- GoG views will be made known
- Final drafting of legislation
- Publication
- Brought into effect – 2009?



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Questions?

