

THE LICENSEES(CAPITAL ADEQUACY) RULES and GUIDANCE, 2021

The Licensees (Capital Adequacy) Rules, made in accordance with the Protection of Investors (Bailiwick of Guernsey) Law, 2020 (“the Law”), are set out in this document.

Further guidance, provided by the Guernsey Financial Services Commission (“the Commission”), is set out in blue boxes.

This draft version has been annotated to demonstrate the alterations, which have been made, to the previous version of these Rules.

Annotations, including previous rule numbering where appropriate, are set out in red and will be removed in the final, published, versions.

Earlier Rules combined Rules and Guidance in a way which, in some cases, made it difficult to distinguish between the two. In the re-issued versions the numbering, and the placement of relevant guidance, follows a standard format – providing harmony across the Commission’s rulebook.

Language has been modernised and, in some cases, a provision has been completely redrafted, in plain English, to make the Rules user friendly. Where a Rule has been redrafted, in this way, it is marked ‘REDRAFTED’.

These Rules have also been drafted to ensure gender neutrality.

A table of contents will be included, at this point in the final version.

PART 1 INTRODUCTION

Following standardisation, 'The Legislative Framework', has been removed and the introductory section on the principles behind the Rules, have been integrated into guidance boxes within the document

Definitions and standard provisions, e.g. Citation and Commencement, become the final 'Part'.

1.1 Application

- (1) The Licensees (Capital Adequacy) Rules 2021 replace The Licensees (Capital Adequacy) Rules, 2010¹.
- (2) The Commission may in its absolute discretion, by written notice, exclude or modify the application of any provision of these Rules.
- (3) The Commission may issue supplementary guidance regarding the standards of conduct and practice expected in relation to any aspect of the regulatory framework. Such guidance will not constitute rules of the Commission.

Guidance Note: This document takes a two-level approach –

- the Rules set out the standards to be met; and
- guidance notes present suggested ways of showing compliance with the Rules.

Licensees may adopt alternative measures to those set out in the guidance so long as it is possible to demonstrate that such measures achieve compliance.

The text contained in shaded boxes contains guidance from the Commission and does not form part of the Rules.

¹ G.S.I. No. 29 of 2010.

Guidance Note

The Capital Adequacy Rules recognise that there will be some occasions where the Rules for financial resources requirements and liquidity requirements will not take into account the nature and complexity of the licensee's business. Such an occasion might be, for example, due to foreign exchange risk, risk of counterparty default, off-balance sheet assets or liabilities (including contingent liabilities) or principal positions which the licensee has taken. Accordingly the Board of the licensee should consider an appropriate level above that required in these Rules and evidence that consideration. In assessing the above, as a minimum, the Board should consider the calculations laid out in Schedule 1. These calculations are intended to be a framework.

In addition, the Commission will consider adjustments or modifying the Rules to allow mechanisms to the financial resources requirement and liquidity requirement calculation. However, the Commission will not consider such amendments or adjustments where they would permit the licensee to not meet the solvency test defined in the Companies (Guernsey) Law, 2008.

PART 2 FINANCIAL RESOURCES

2.1 Financial resources requirement [2.2] REDRAFTED

- (1) A licensee must, at all times, maintain financial resources of not less than –
 - (a) for the designated trustee or designated custodian of an open-ended collective investment scheme –
 - (i) net assets of £4,000,000; and
 - (ii) minimum professional indemnity insurance cover of either £300,000, or three times the total revenue, whichever is greater, the excess of which must not exceed 20% of the total insured;
 - (b) for the designated administrator of a collective investment scheme –
 - (i) net assets of £100,000, or net assets equal to the expenditure-based requirement as shown by the latest annual financial statements submitted to the Commission, whichever is greater; and
 - (ii) minimum professional indemnity insurance cover of either £300,000, or three times the total revenue, whichever is greater, the excess of which must not exceed 20% of the total insured;
 - (c) in the case of an entity which is licensed, authorised, or registered under –
 - (i) The Banking Supervision Law;
 - (ii) The Insurance Managers and Insurance Intermediaries Law;
 - (iii) The Insurance Business Law; or

(iv) The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. Law,

and does not fall under (a) or (b), written confirmation, from the Commission, that one of the laws set out above takes precedence;

(d) in the case of a licensee with no physical presence, meaning either premises or staff, in the Bailiwick who does not fall under (a), (b) or (c), the higher of –

(i) £10,000; or

(ii) net assets and professional indemnity insurance cover which is, in the opinion of its directors, sufficient to meet its commitments and to withstand the risks to its business;

(e) in all other cases –

(i) net assets of £25,000 or net assets equal to the expenditure-based requirement, whichever is greater; and

(ii) minimum professional indemnity insurance cover of £250,000, or three times total revenue, whichever is the greater, the excess of which must not exceed 20% of the total insured.

(2) Licensees must follow the framework for the calculation of financial resources requirements as set out at Schedule 1.

This is a new section, to the Rule, reflecting the fact that the financial resources requirements can now be found in Schedule 1.

PART 3 LIQUIDITY RESOURCES

3.1 Liquidity resources rule REDRAFTED

- (1) This rule does not apply to licensees who follow the financial resources requirements set out in rule 2.1 (1)(c).
- (2) The licensee must maintain, at all times, a liquidity requirement which is the greater of either –
 - (a) £10,000; or
 - (b) 10% of annual audited expenditure.

PART 4 NOTIFICATIONS

4.1 Immediate notification REDRAFTED

- (1) A licensee must notify the Commission, immediately, where –
 - (a) it is in breach of its financial resources requirement or liquidity requirement, including setting out in writing, the steps that it is taking, or has taken, to remedy the breach;
 - (b) it anticipates being in breach of its financial resources requirement within one month, including setting out in writing the steps that it proposes to take to avoid the breach;
 - (c) it's auditor intends to qualify the accounts;
 - (d) the liabilities of a subsidiary of the licensee exceed the subsidiary's assets;
 - (e) the liabilities of the parent company of the licensee exceed the parent company's assets.

PART 5 GENERAL PROVISION

Previously, definitions were placed before the Rules. The definitions have been redrafted to follow standard drafting convention.

5.1 Interpretation

- (1) In these Rules terms have their ordinary meaning unless specifically defined in the Law or in these Rules.
- (2) In these Rules the following definitions should be followed -

“accounting reference date” means the date to which the licensee’s accounts are prepared;

“adjustments” means –

- (a) deductions for non-current assets, which includes any investment in a subsidiary, debtors arising from sales or other transactions to associates, any deficiencies where the liabilities of a subsidiary of a licensee exceed its assets, and any other assets specified, in writing, by the Commission; and
- (b) additions for creditors arising from purchases or other transactions from associates and other liabilities specifically permitted in both cases, in writing, by the Commission;

“annual audited expenditure” means either –

- (a) an estimate of budgeted expenditure for the first twelve months which is submitted to the Commission, in the case of a licensee which has not yet commenced its controlled investment business; or
- (b) the expenditure as stated in the reported results in the immediately preceding period’s audited financial statements,

and, in either case, excluding any remuneration to directors whether through salary, bonuses, or other benefits; this should exclude fees and commissions payable which are directly attributable to fees and commissions receivable and should also exclude depreciation and amortisation of non-current assets;

“carry value” is the value of the item carried in the balance sheet, determined by reference to GAAP;

“client” means any person with, or for whom, the licensee carries on, or intends to carry on, controlled investment business;

“current assets” means assets falling to be realised within one year of the accounting reference date;

“current liabilities” mean liabilities due to be realised within one year from the accounting reference date;

“expenditure-based requirement” means a figure equal to 25% of the licensee’s annual audited expenditure;

“generally accepted accounting principles (“GAAP”)” includes those accepted in –

- (a) the UK;
- (b) the United States; or
- (c) any other country approved in writing by the Commission;

“liquidity requirement” means the value of current assets minus current liabilities less and loans to group companies, which must be at least equal to 10 per cent of annual audited expenditure, or £10,000, whichever is the greater as per rule 3.1;

“margin requirement” means the margin required by the exchange or clearing house over which the derivative is being traded;

“net assets” means total assets less total liabilities after adjustments of the licensee and calculations required by Schedule 1;

“total assets” means assets of any type, which will include non-current assets, and current assets, including debtors;

“total liabilities” means liabilities of any type, which will include creditors and provisions for liabilities and charges;

“total revenue” means revenue of any type, which will include commissions, investment management fees, advisory fees, interest and dividends.

PART 6 TRANSITIONAL ARRANGEMENTS, REVOCATIONS, CITATION AND COMMENCEMENT

Previously Rule 6 “Transitional Provisions”. This Part has been standardised across the Commission’s Rules

6.1 Transitional Arrangements

- (1) Any notification, issued by the Commission under rule 2.2.3 of The Licensees (Capital Adequacy) Rules, 2010, will be accepted as having been issued under these Rules.

6.2 Revocations

6.2.1 Revocation of The Licensees (Capital Adequacy) Rules, 2010

- (1) The Licensees (Capital Adequacy) Rules, 2010 are revoked.

6.3 Citation and commencement

- (1) These rules may be cited as the Capital Adequacy Rules, 2021.
- (2) These rules come into force on *****.

SCHEDULE 1
FRAMEWORK FOR THE CALCULATION OF FINANCIAL RESOURCES
REQUIREMENT

Previously rule 5. This has been separated out from the body of the Rules for ease of use

Net Assets

Net assets after adjustments		X
Less: <i>Contingent liabilities that require disclosure or provision under GAAP</i>		X
<i>Position risk</i>		X
<i>Counterparty risk</i>		X
Net assets after adjustments, contingent liabilities and risks		X

Position Risk

Sovereign Debt	5% of carry value	X
Daily-dealing Money Market		
Open-ended CIS	5% of carry value	X
Other Marketable Debt	10% of carry value	X
Listed/Publicly Traded Equities	25% of carry value	X
Open-ended and Closed-ended CIS (excluding daily-dealing CIS, as above)	25% of carry value	X
Other derivative products (as referred to in Sch. 1 to the Law)	25% of carry value <i>or</i> 4 times initial margin requirement, <i>whichever is greater</i>	X
Illiquid current assets (defined as being more than 90 days)		X
Position Risk		X

Counterparty Risk

Exposure to any one counterparty is at least 25% of financial resources req.	15% of excess over 25%	X
Exposure to any one counterparty is at least 50% of financial resources req.	40% of excess over 25%	X
Counterparty Risk		X

Guidance Note:

Margin Requirement

The margin requirement may only be used as a measure for calculating the position of risk of derivative products if it is considered, by the board of the licensee, to appropriately reflect that risk.

Counterparty Risk

For the purposes of calculating the counterparty risk, the Commission recognises that not all unsettled bargains should be included. Accordingly, the provisions above only apply to bargains which are unsettled after 15 days (unless the bargain is subject to a legally enforceable guarantee).

Any money held at a bank with terms of less than 90 days should also be excluded from the counterparty risk.