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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Jersey—Financial System Stability Assessment—Update**

Attached for the **information** of the Executive Directors is an update on the Financial System Stability Assessment for Jersey. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Jersey indicating whether or not they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Hardy, MCM (ext. 38490).

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INTERNATIONAL MONETARY FUND

JERSEY

Financial System Stability Assessment Update

Prepared by the Monetary and Capital Markets Department

Approved by José Viñals

September 1, 2009

This report presents the conclusions of the Financial Sector Assessment Program (FSAP) Update mission that visited Jersey, November 11-21, 2008. The mission comprised Daniel Hardy (mission chief), Andrea Maechler, Ian Tower (all MCM/IMF), Jürgen Dreymann (BaFin, banking supervision expert), and Keith Bell (banking supervision expert). The mission worked closely with the overlapping LEG mission (led by Terence Donovan) that conducted an assessment of the anti-money laundering and combating the financing of terrorism (AML/CFT) provisions. The mission received excellent cooperation and support from the authorities.

The main findings of the FSAP update are:

- Financial sector regulation and supervision are of a high standard, and processes and resourcing have been significantly enhanced since a 2003 assessment under the Offshore Financial Center (OFC) program. The Jersey Financial Services Commission (JFSC) operates with considerable independence as well as accountability, and has broadly adequate resources.
- The financial crisis has highlighted the vulnerability of Jersey's banks to events in major financial centers. While Jersey supervisors cannot feasibly analyze in depth the soundness of the financial groups to which their Jersey operations provide extensive funding, it should be able to detect and react to intensified risks stemming from parent institutions.
- Jersey has experienced some effects from the global crisis, but financial soundness indicators (FSIs) for institutions licensed on the island have been satisfactory, and stress tests confirm that the system is resilient to a range of shocks. However, there is high concentration risk and spill-over risk from parent banks.
- The authorities are making contingency plans, a key element of which will be cooperation with home supervisors. Experience elsewhere suggests the usefulness of a dedicated bank insolvency regime.
- Possible introduction of a bank depositor compensation scheme would require careful study. In any case, all depositors must receive clear information on who is responsible for safeguarding their claims and the scheme's coverage, if any.

The main authors of this report are Daniel Hardy and Ian Tower with input from other members of the FSAP Update team.

FSAP assessments are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAP assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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Glossary

AG	Attorney General
AML	Anti-money laundering
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
Banking Codes	Codes of Practice for Deposit-taking Business
BCP	Basel Core Principles for Effective Banking Supervision
CAR	Capital adequacy ratio
CDD	Customer due diligence
CFT	Combating the financing of terrorism
CIF Law	Collective Investment Funds (Jersey) Law 1988
CIS	Collective Investment Scheme
COBO	Control of Borrowing (Jersey) Order 1958
Commission Law	Financial Services Commission (Jersey) Law 1998
Companies Law	Companies (Jersey) Law 1991
DCS	Deposit Compensation Scheme
DNFBP	Designated Non-Financial Businesses and Professional
DTOL	Drug Trafficking Offenses (Jersey) Law 1988
EU	European Union
FATF	Financial Action Task Force
FIU	Financial intelligence unit
FSAP	Financial Sector Assessment Program
FSC(J)L	Financial Services Commission (Jersey) Law 1998
FSIs	Financial soundness indicators
FSSA	Financial System Stability Assessment
GAD	UK Government Actuary Department
GBP	Great Britain Pounds
GNI	Gross national income
JFCU	Joint Financial Crimes Unit
JFSC	Jersey Financial Services Commission
GAAP	Generally Accepted Accounting Principles
GVA	Gross value added
IAIS ICP	International Association of Insurance Supervisors Insurance Core Principles
IB (J)L	Insurance Business (Jersey) Law 1996
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOM	Isle of Man
IOSCO	International Organization of Securities Commissions
Insurance Codes	Codes of Practice for Insurance Business
LLP	Limited liability partnerships
LOLR	Lender of last resort
MLA	Mutual legal assistance
MLO	Money Laundering (Jersey) Order 2008
MOU	Memorandum of understanding

NAV	Net asset value
NBFIs	Nonbank financial institutions
OEM	Other enforceable means
OFC	Offshore Financial Center
OGBS	Offshore Group of Banking Supervisors
PEPs	Politically exposed persons
POCL	Proceeds of Crime (Jersey) Law 1999
ROSC	Reports on Observance of Standards and Code
SARs	Suspicious activity reports
SIV	Structured investment vehicle
SPV	Special purpose vehicle
TCBs	Trusts company businesses
The States	Jersey’s legislature
TIEAs	Tax Information Exchange Agreements
TL	Terrorism (Jersey) Law 2002
UK	United Kingdom
US	United States

EXECUTIVE SUMMARY AND POLICY AGENDA

This report updates the findings of the 2003 assessment under the OFC program, while concentrating on priorities going forward. The analysis is based mainly on information available at the time of the November 2008 mission; developments since then are taken into account but also confirm the importance of the identified underlying issues.

The financial sector has continued to expand since 2003. Jersey's comparative advantage has shifted, for example, toward investment funds aimed at expert investors.

Financial sector regulation and supervision comply well with international standards, and both processes and resourcing have been enhanced in recent years. Detailed assessments were undertaken of observance of the Basel Committee Core Principles for Effective Banking Supervision (BCP), the International Association of Insurance Supervisors Insurance Core Principles (IAIS ICP), and the Financial Action Task Force (FATF) 40+9 recommendations on AML/CFT. The recommendations of the 2003 OFC assessment in these and on the International Organization of Securities Commissions (IOSCO) Principles have largely been implemented. Related reports on observance of standards and codes (ROSCs) are attached.

The JFSC operates with considerable independence, and mechanisms are in place to ensure its accountability. Its resources are broadly adequate, and its staff are well-regarded by the industry. Over the past five years, it has developed an extensive program of on- and off-site supervision of banks and other financial institutions. Jersey has continued to maintain an open and cooperative relationship with regulatory authorities overseas.

The current global financial crisis highlights the vulnerability of Jersey institutions to events in major financial centers. Most banks on Jersey are branches or subsidiaries of large international groups, to which they provide financing. This close relationship reduces risk in normal times, given the groups' ability to support their Jersey operations. However, it is also a powerful risk transmittal mechanism in case the health of the group deteriorates. In the event of extreme stress, a large share of Jersey banks' balance sheets could be at risk, as well as their core business model. The JFSC thus faces a conundrum. It cannot feasibly analyze in depth the soundness of major international banking groups, but it should be able to detect and react to intensified spill-over risks. The JFSC also needs to further develop its capacity to look at the strength of the banking system as a whole, for example by performing stress tests.

Regulation and supervision in the collective investment schemes (CISs) sector now largely incorporate the 2003 OFC recommendations. The JFSC has significantly reformed the regulatory framework of funds, mainly to make Jersey funds more attractive to institutional investors. In parallel, it has enhanced regulation of fund services providers. As the authorities recognize, continued strict supervision of service providers is necessary to offset the potential reputational risks attached to the light regulation of certain categories of funds. A small number of special purpose vehicles (SPVs) are registered on the island; in current circumstances the authorities could usefully survey their activities and situation.

A key challenge in insurance supervision is to maintain effective and proportionate regulation of a small sector with limited insurance risk. While regulation is mostly sound, there are some gaps, for example regarding risk management, which should be filled as opportunities arise.

The trust and company services business sector enjoys a comprehensive regulatory and supervisory framework. The implementation of the regulatory regime has been a major catalyst for sectoral consolidation in recent years.

Jersey has felt some effects from the turmoil in global financial markets. There have been some outflows from banks and CISs, and profitability is expected to decline. No bank has failed, but the crisis should reinforce awareness that even the largest parent groups are not immune to major disruption. Available FSIs for institutions licensed on the island are satisfactory. Stress tests confirm that, while the system is resilient to a range of shocks, concentration risk and spillovers from parent banks are the main potential areas of concern, and that credit risk is of significance for the local economy.

The authorities rightly recognize the need to plan for contingencies, and preparations have begun. An essential element will be cooperation with home supervisors—and with the domestic authorities. Experience elsewhere suggests that it is useful to have a dedicated bank insolvency regime.

The authorities are considering the introduction of a bank depositor compensation scheme (DCS). The potential financial and other costs of a DCS (and those of compensation schemes in other sectors) are large and resources are constrained, and Jersey has developed its banking system without a DCS. Hence, introducing even a limited DCS would require very careful assessment of the net benefit. In any case, all depositors must receive clear information on who is responsible for safeguarding their claims and the DCS coverage, if any.

Jersey has put in place a comprehensive and robust AML/CFT framework and has achieved a high level of compliance with almost all aspects of the FATF Recommendations. Jersey's financial institutions and trust company businesses are well supervised for AML/CFT purposes. The Joint Financial Crime Unit (JFCU) carries out its role as financial intelligence unit effectively and its resource limitations are being addressed. The Jersey authorities are active in international cooperation and in a position to share information subject to appropriate safeguards.

A list of main recommendations is attached. The recommendations are generally not time sensitive, but many could be implemented within 6 to 12 months. The ROSCs contain numerous specific recommendations.

Main Recommendations

High priority	
General	• Continue to develop contingency planning, including through a clear allocation of roles between the JFSC, the Treasury, and other institutions.
General	• Seek to develop mechanisms to receive early information on financial strains, including from home supervisors.
Banking	• Replace the general exemption for inter-bank exposures from risk concentration provisions by a defined and transparent procedure under which the JFSC renews such permissions on a regular basis following a review of risks and risk mitigants.
Banking	• Develop capacity to assess overall financial system soundness, including through stress testing.
Medium priority	
General	• Study the design of a possible DCS based on explicit objectives and recognizing constraints.
General	• Continue to ensure that creditors receive clear information on counterparty risk and compensation scheme coverage, if any.
General	• Strengthen powers to impose fines for breach of JFSC regulations.
Banking	• Supervise more actively loan classification and provisioning by banks, and maintain up-to-date expertise in evaluating risk models.
Banking	• More regularly discuss individual banks with auditors.
Other	• Survey activities of SPVs registered on the island.

I. INTRODUCTION

A. Purpose of the FSAP Update

1. **The on-going refinement of the Jersey regulatory framework and the growth in the financial sector warrant an update of the assessment that was conducted in 2002 under the Fund's OFC program and finalized in 2003.** Furthermore, the integration of the OFC program into the FSAP (see BUFF/08/78, 06/04/08) has widened the scope of the assessment to include stability-related issues. This report, therefore, covers both the regulatory and supervisory system and matters relating to the soundness of the financial system and its ability to cope with stress. The assessment is based on information available at the time of the November 2008 mission, updated to reflect documented regulatory and economic developments since then.

B. Context

2. **Jersey is one of the three British Crown Dependencies, the others being Guernsey and the Isle of Man (IOM).** It is not part of the United Kingdom (UK) and has its own parliament (the States), legal and regulatory system, and tax regime. However, its economy is highly oriented toward that of the UK and uses the pound Sterling as its currency. Jersey is in a customs union with the European Union (EU) for trade in goods.

3. **Jersey's economy, which is dominated by financial services, is expected to suffer a slowdown in the context of global financial turmoil and the slowing of the British economy.**[1] The basis of the economy is the financial sector. The main activities are banking, fund management, and fiduciary services. The sector contributes over half of gross value added (GVA).[2]

4. **Banking is the dominant component of the financial sector (Table 1).** Banks' principal business is the collection of retail deposits from overseas and from trusts managed on the island (Tables 2-4). These funds are mainly placed with parent banks. Many banks also offer fund management and fiduciary services. Banks have limited real estate exposure and most do not operate trading books or independent treasury functions (Table 5).

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[1] Appendix I describes the economy and financial sector in more detail.

[2] GVA equals GDP less net taxes on products.

Table 1. Jersey: Financial System Structure, 2003-2008

	December 2003			December 2007			December 2008		
	Number	Assets (GBP million)	Percent of total assets	Number	Assets (GBP million)	Percent of total assets	Number	Assets (GBP million)	Percent of total assets
Banking Sector	52	191,760	99.7	47	317,836	99.8	47	319,090	99.7
Joint stock and private banks	34	59,984	31.2	25	96,905	30.4	23	103,608	32.4
of which: Subsidiaries of UK banks	14	47,368	24.6	8	74,028	23.2	7	80,902	25.3
of which: Subsidiaries of other EU banks	11	9,507	4.9	11	20,240	6.4	10	19,985	6.2
Bank branches	18	131,776	68.5	18	220,931	69.4	21	215,481	67.3
of which: UK	7	11,206	5.8	6	24,089	7.6	7	20,147	6.3
of which: Other EU	3	14,730	7.7	2	16,449	5.2	4	24,354	7.6
Other	0	...	...	4	...	...	3	…	...
Insurance sector - Cat B	17	536	0.3	12	713	0.2	13	897	0.3
Life insurance companies	5	347	0.2	3	198	0.1	3	161	0.1
Non-life companies	6	105	0.1	6	481	0.2	8	721	0.2
Reinsurance	2	36	0.0	2	31	0.0	1	10	0.0
Capitives	4	48	0.0	1	3	0.0	1	5	0.0
Total banking and insurance sectors	69	192,297	100.0	59	318,549	100.0	60	319,987	100.0
Memo items:			Percent of total employees			Percent of total employees			Percent of total employees
Investment Business	136	...	...	113	...	...	113	...	...
General Insurance Mediation Business	...	...	...	117	...	...	123	...	...
Number of employees in the financial sector	11,150	...	22.5	12,480	...	23.5	13,400	...	25.0
of which : Banking	5,220	...	10.5	5,590	...	10.5	6,040	...	11.3
Financial sector contribution to GVA 1/	...	1,584	50.4	...	2,177	53.2	...	...	...
Total GVA 1/	...	3,141	...	...	4,089	...	...	...	...

Source: Jersey Financial Services Commission.

1/ In GBP millions. Figures for Gross Value Added presented, since this is considered to be the best measure of economic activity in Jersey.

Table 2. Jersey: Balance Sheet of Banking System, end-2008

	GBP millions	Percent of total assets	Percent of 2007 GVA
Assets	319,090	100.0	7,803.6
Cash	413	0.1	10.1
Loans to Banks	266,363	83.5	6,514.1
Loans to Parent	248,572	77.9	6,079.0
Loans to fellow banking subsidiaries	12,125	3.8	296.5
Loans to other banks	5,666	1.8	138.6
Marketable Assets	10,718	3.4	262.1
Loans and Advances	34,650	10.9	847.4
Group non-banking entities	22	0.0	0.5
Sovereigns	2,179	0.7	53.3
Public sector entreprises	69	0.0	1.7
Corporate Lending	18,171	5.7	444.4
Retail Lending	7,624	2.4	186.4
Residential Mortgages	6,538	2.0	159.9
Capital Connected Lending	48	0.0	1.2
Investments	1,397	0.4	34.2
Other Financial	5,271	1.7	128.9
Other	277	0.1	6.8
Liabilities	319,090	100.0	7,803.6
Deposits due to:	209,792	65.7	5,130.6
Parent/Holding Company or Group	62,261	19.5	1,522.7
Associated Banking Companies	2,856	0.9	69.8
Fellow Subsidiaries	19,761	6.2	483.3
Other Deposit Takers	4,310	1.4	105.4
Retail Accounts	55,582	17.4	1,359.3
Corporate / Trust / Fiduciary	58,924	18.5	1,441.0
All Other Depositors	6,098	1.9	149.1
CDs and Other Debt	87,072	27.3	2,129.4
Creditors & Accruals etc	6,434	2.0	157.4
Capital	15,792	4.9	386.2

Sources: JFSC, and staff estimates.

Table 3. Jersey: Structure of Total Deposits, By Region

	December 2007			September 2008		
	Sterling	Other	Total	Sterling	Other	Total
	(in GBP millions)					
By Residence	69,402	142,919	212,320	69,392	127,584	196,975
Channel Island and U.K.	46,441	38,363	84,803	47,243	31,131	78,373
Jersey resident depositors	9,921	5,819	15,740	8,568	4,596	13,164
Jersey financial intermediaries, etc	7,040	8,285	15,325	6,979	8,829	15,808
U.K., Guernsey & I.O.M.	29,480	24,259	53,738	31,695	17,706	49,401
Other	22,961	104,556	127,517	22,149	96,453	118,602
Other EU Members	3,621	13,480	17,100	3,749	13,754	17,503
European Non EU Members	7,536	57,194	64,730	6,685	49,860	56,546
Middle East	1,422	10,904	12,326	1,551	15,573	17,125
Far East	2,777	5,818	8,595	2,732	5,006	7,738
North America	2,777	12,408	15,185	2,613	6,708	9,321
Others	4,828	4,751	9,579	4,818	5,552	10,370
	(in percent)					
By Residence	100.0	100.0	100.0	100.0	100.0	100.0
Channel Island and U.K.	66.9	26.8	39.9	68.1	24.4	39.8
Jersey resident depositors	14.3	4.1	7.4	12.3	3.6	6.7
Jersey financial intermediaries, etc	10.1	5.8	7.2	10.1	6.9	8.0
U.K., Guernsey & I.O.M.	42.5	17.0	25.3	45.7	13.9	25.1
Other	33.1	73.2	60.1	31.9	75.6	60.2
Other EU Members	5.2	9.4	8.1	5.4	10.8	8.9
European Non EU Members	10.9	40.0	30.5	9.6	39.1	28.7
Middle East	2.0	7.6	5.8	2.2	12.2	8.7
Far East	4.0	4.1	4.0	3.9	3.9	3.9
North America	4.0	8.7	7.2	3.8	5.3	4.7
Others	7.0	3.3	4.5	6.9	4.4	5.3

Source: JFSC.

Table 4. Jersey: Structure of Deposits, by Size and Residence 1/
(end-October 2008)

	GBP millions	Percent
Total balance	33,934	100.0
Balances < £50k	3,676	10.8
Resident	605	1.8
Non-resident	3,067	9.0
Balances > £50k	30,258	89.2
Resident	2,729	8.0
Non-resident	27,525	81.1
Number of deposits		
Balances < £50k	516,545	82.1
Resident	125,312	19.9
Non-resident	390,233	62.0
Balances > £50k	112,484	17.9
Resident	11,995	1.9
Non-resident	100,489	16.0

Sources: JFSC, and staff estimates.
1/ Based on a 2008 partial survey covering only accounts of individuals.

Table 5. Jersey: Structure of Non-Interbank Loans, by Type
(end-June, 2008)

	GBP millions	Percent of total credit	Percent of total assets	Percent of 2007 GVA
Total credit	34,590	100.0	10.8	845.9
Agriculture	84	0.2	0.0	2.1
Energy	428	1.2	0.1	10.5
Manufacturing	4,986	14.4	1.6	121.9
Construction	1,893	5.5	0.6	46.3
Garages & Tourism	194	0.6	0.1	4.7
Financial	5,176	15.0	1.6	126.6
Business & Other Services	5,575	16.1	1.7	136.3
of which : Property Companies	2,868	8.3	0.9	70.1
Persons	15,702	45.4	4.9	384.0
of which : House Purchase	6,301	18.2	2.0	154.1
Other	553	1.6	0.2	13.5
Jersey-related credit	5,904	17.1	1.9	144.4
Agriculture	1	0.0	0.0	0.0
Energy	15	0.0	0.0	0.4
Manufacturing	34	0.1	0.0	0.8
Construction	6	0.0	0.0	0.1
Garages & Tourism	121	0.4	0.0	3.0
Financial	1,953	5.6	0.6	47.8
Business & Other Services	1,115	3.2	0.3	27.3
of which : Property Companies	782	2.3	0.2	19.1
Persons	2,626	7.6	0.8	64.2
of which : House Purchase	2,193	6.3	0.7	53.6
Other	33	0.1	0.0	0.8

Sources: JFSC, and staff estimates.

5. **Fund management and associated services are the other main component of the financial sector, while the insurance sector is small.** The numbers of CISs and the value of their assets have been growing strongly in the past decade. The sector is increasingly dominated by schemes aimed at institutional and high net worth individuals, many of them specialist funds such as hedge fund/alternative investments. Fund services, such as management and administration, are offered by many groups. Numerous trust and company service providers operate on the island. Jersey hosts a small but diverse group of SPVs and a few Structured Investment Vehicles (SIVs) used, for example, for securitization purposes. There are only 14 insurance companies firms incorporated on the island, although many more firms incorporated overseas are licensed to write Jersey business. A wide range of legal and accountancy services are available in the island.

II. Regulatory and Supervisory System

6. **The 2003 OFC assessment noted that Jersey's financial regulatory and supervisory system complies well with international standards.** The JFSC was assessed to have made progress in international standards for banking, insurance, securities, and AML/CFT. The framework for trust and company service provider regulation was largely consistent with international best practice. In addition to several specific recommendations in relation to individual principles, the assessment emphasized as areas for improvement:

(i) Enhancing the independence of the JFSC.

(ii) Increasing its resources and improving its processes, especially with respect to on-site supervision.

(iii) Formalizing supervisory guidance for credit policies, loan evaluation, and loan-loss provisioning.

(iv) Introducing prudential requirements for market risk.

7. **Since 2003, the authorities have made considerable efforts to enhance regulation and supervision, in particular through more on-site supervision (see below, Appendix II, and the Annex with ROSCs).** The JFSC has become more risk-oriented, for example in its use of a risk model for assessing regulated firms, and conducts extensive on- and off-site supervision across the financial sector. Legislation has been updated and initial steps taken toward the long-term objective of a single legislative framework applying to all sectors. Regulatory principles have been elucidated in new codes of practice and regulations.

A. Institutional Structure

8. **The JFSC, as the integrated regulator, has as its main responsibility the supervision and development of financial services on the island.** In exercising its functions, the JFSC must have regard to reducing the risk to the public of financial loss due to the dishonesty, incompetence or malpractice by or the financial unsoundness of financial institutions; protecting and enhancing the island's reputation and integrity; protecting the best economic interests of Jersey; and countering financial crime. The JFSC also operates the companies registry, and has certain related functions, such as advising the government on financial sector matters. The responsibility for both supervision and development could lead to conflicting objectives, although the authorities haves publicly recognized that stability is a precondition for attaining the other objectives. Nonetheless, an explicit ranking, giving highest priority to financial stability, might facilitate consistent policy-making and accountability.

9. **The JFSC enjoys considerable independence, and is subject to suitable accountability provisions.** The foundation of this independence is the clear statement in law

of the JFSC's responsibilities. Moreover, commissioners cannot be dismissed without good cause; the JFSC approves (and if need be terminates) the appointment of a Director General. However, the government may give the JFSC "guidance" or "general direction." A memorandum of understanding (MOU) between the JFSC and the responsible minister has clarified that the minister would exercise this power to guide or direct only in exceptional circumstances where it believed that the well-being of the island is at stake, and with respect to general policy, not individual cases. Any "direction" would have to be explained to the States and the public. The minister has never exercised this power. Hence, this legal possibility does not seem to limit independence in practice. Accountability provisions include a requirement to publish annual reports, regular meetings with the government and the States and a practice of consulting widely when formulating policy.

10. **The JFSC now sets the detailed regulatory framework for the financial sector largely through codes of practice.** The JFSC has wide scope to obtain information, especially from supervised entities, and arrangements are in place to share that information with other domestic and overseas authorities, subject to assurances on the maintenance of confidentiality.

11. **Concerning enforcement, the JFSC has numerous and effective powers, although the scope for imposing fines is limited.** The JFSC can issue binding directions, publish warnings and advice, appoint managers or co-signatories when management has been demonstrably inadequate, revoke licenses, or request that a court start bankruptcy or winding-up proceedings. Fines can be imposed by the JFSC mostly for administrative matters, such as late submission of supervisory returns; and the court may impose fines on regulated firms that commit a criminal offence such as providing misleading information. While the JFSC can and does use other means to enforce compliant behavior, the restricted availability of fines as a sanction mechanism limits possible responses to misconduct. It may be useful to have in addition a fining power to ensure that breach of JFSC regulations is damaging not only to a regulated firm's reputation, but also to the profitability of the activities in question. The JFSC and its staff enjoy legal protection.

12. **The authorities cooperate pro-actively with the home supervisors of foreign institutions.** Numerous MOUs with supervisors abroad have been signed to address both ongoing supervision and information exchange. Relevant information is in fact exchanged, and regular visits to and from home supervisors are undertaken, including for on-site supervision. In the current financial turmoil, the authorities have found themselves able to communicate effectively with relevant home authorities, although the initiative generally has come from Jersey.

13. **The JFSC appears to be adequately resourced, although some technical skills are limited.** It is funded by fees payable by the industry, which it adjusts periodically such that fees from a particular sector substantively cover the costs of regulating that sector plus a share of the JFSC's overheads. Fee levels appear reasonable and have allowed the JFSC to

build a reserve to deal with contingencies, such as exceptional legal fees. The JFSC currently has over 100 staff, representing an increase of about 40 over the last five years. Most work in regulatory and supervisory functions. However, it can be difficult to retain good staff, and expertise in some areas (such as the assessment of risk models) is in short supply. Representatives from the regulated sector generally felt that the JFSC functions with rigor and expertise; it consults with the industry but is viewed as not beholden to it.

14. **The JFSC will be challenged to react to the changes in supervisory standards coming out of the global financial turmoil, and implement them proportionately to the risks on the island.** Especially relevant may be changes to standards on bank liquidity management and capitalization requirements, and an expansion of the regulatory perimeter, which may affect the CIS and companies registry sectors.

B. Banking Sector

15. **The BCP assessment undertaken by the mission confirms the high standard of prudential regulation and supervision described in the 2003 assessment, and issues identified at that time have largely been addressed.** Most importantly, the JFSC now conducts a large program of on-site supervision, supported by off-site analysis. The JFSC follows up on visits with detailed recommendations. In addition, a framework of minimum prudential standards is provided by the Banking Business (Jersey) Law 1991 and other legislation.

16. **Pillars 1 and 2 of the Basel II capital requirements were introduced in 2008.** Most banks adopt the standardized approaches. The JFSC has set a minimum risk-weighted capital adequacy requirement (CAR) of 10 percent, and in some cases banks have additional capital requirements under Pillar 2. Moreover, if a bank's capital approaches the minimum, consultations on remedial action are triggered. The JFSC has reviewed banks' Internal Capital Adequacy Assessment Processes (ICAAP). Since banks' internal models are complex and evolving rapidly, the JFSC will need to take care to ensure that it maintains up-to-date expertise in this area.

17. **The authorities complement regulation and supervision by an express policy of limiting entry to banks with strong parents.** Only groups that are among the global top 500 in terms of Tier I capital and meet certain other requirements are permitted to open on the island. These banks are presumed able and willing to provide their Jersey affiliates with support in case of local difficulties, and are likely to be viewed as too big to fail in their home jurisdictions. Furthermore, these banks tend to have centralized risk management and internal controls procedures, which are imposed on their Jersey affiliates, as well as central treasury, trading and risk modeling functions, so Jersey operations are relatively straightforward.

18. **Banks' intra-group claims on their parents represent the major risk to the system (see below).** However, The JFSC exempts these claims from limits on exposures to related parties and large exposures. Specifically, inter-group exposures with a maturity of one

year or less are exempted from risk concentration provisions. Jersey banks are highly vulnerable to concentration risk with respect to their groups. Recent experience has demonstrated that even the largest banks can come under extreme stress, in which eventuality a Jersey affiliate could lose access to almost all of its assets, at least temporarily. If a parent is suspected to be in difficulties, the JFSC may attempt to require the Jersey subsidiary to move assets elsewhere, as would be consistent with the duties of the subsidiary's management, but such action may be damaging to the parent, to the home country authorities, and ultimately to Jersey banks' business model.[3] While some flexibility is required for banks to fulfill their business model of "upstreaming" deposits, a permanent and blanket exemption from single counterparty limits is inconsistent with the BCP, which requires setting a prudent limit.

19. **While this conundrum cannot be fully resolved, it is recommended that the authorities make the exemptions less automatic.** The JFSC could confirm on a regular basis that the parent continues to have the will and capacity to support its subsidiary, and try to ensure that local banks develop more autonomous risk management capacity. In addition, the JFSC could seek more frequent updates from home supervisors of their assessment of group soundness.[4] This approach would recognize that the full development of local treasury and risk management capacity would be uneconomic and bring with it other risks, such as operational risk.

20. **The supervision of credit other than to parent groups is adequate but should not be neglected.** Such credits form a small portion of most banks' assets, but the exposure is significant in percent of GVA, and in current circumstances vulnerabilities might be emerge suddenly. The JFSC relies largely on banks' internal controls and auditors to ensure adequate loan classification and provisioning, but it does not engage in intensive dialogue with auditors on individual banks. More frequent discussions between supervisors and auditors on individual banks would give the JFSC access to an important information source.

21. **The JFSC should develop more capacity to assess overall financial sector stability and banks' risk models.** The JFSC could engage in more discussions with banks' risk managers and modelers, and foreign supervisors, if it had more ability to quantify risks and simulate scenarios, including scenarios that allow for comparisons of vulnerability across banks. In this connection, the JFSC should consider publishing more statistics on banks and other financial institutions, such as aggregate balance sheets and the mean and distribution of FSIs. Publishing these indicators would further contribute to Jersey's reputation for stability

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[3] A branch is in this regard less problematic.

[4] It is worth noting that the JFSC is responsible as "home" supervisor for 12 banks that have activities in other jurisdictions, the majority of which operate in other Crown Dependencies. The JFSC meets its counterparts in host jurisdictions to discuss supervisory issues and conducts regular on-site inspections of overseas branches.

and transparency, and facilitate peer group comparisons. In addition, the authorities could usefully gather more comprehensive information on the overall indebtedness of Jersey households and the corporate sector by accounting for credit from abroad and from local non-bank lenders. This will help banks and the authorities better assess borrowers' ability to absorb shocks, and the possible spillover effects to the rest of the economy in the event of a credit crunch.

22. **Jersey could benefit from an enhanced framework for macroprudential analysis and decision taking.** With no central bank, there is no authority with an explicit mandate to maintain overall financial stability. Creating a more formal framework for addressing macroprudential issues could enhance the authorities' ability to identify potential problems and take appropriate action. Issues which could be considered include information gaps, for example on the total indebtedness of the domestic economy, stress testing, and contingency planning.

C. Investment Business

23. **The JFSC has significantly reformed the regulation of funds and funds services business, mainly to make Jersey funds more attractive to institutional investors.** Since the 2003 OFC assessment, Jersey has been developing the funds regulatory framework to make it more accommodating to funds aimed at institutional and larger private investors; the authorities consider these to be outside the scope of IOSCO principles relating to CISs. The "expert funds", for investors with $1 million in net worth or making a minimum $100,000 investment, have proved particularly popular. Regulation of such funds is light. This is also the case for funds that are offered to fewer than 50 investors, which are not regulated under the Collective Investment Funds (Jersey) Law 1988 (CIF Law) but instead under the Control of Borrowing (Jersey) Law 1947 (this simply requires the JFSC's consent). Specialist funds are generally permitted unlimited leverage, subject to disclosure of their approach in offer documents and to the approval of the JFSC where leverage in excess of 200 percent of net asset value (NAV) is proposed. Since February 2008, legislation has been further amended, at the request of the industry, to allow for "Unregulated Funds" which require only notification to the JFSC. They have a minimum initial investment (except where exchange listed) of $1 million, and a risk warning waiver is required from each investor to ensure that the product is restricted to its target market. Twenty nine had been registered at the time of the FSAP discussions.[5]

24. **Parallel to this reform of funds, the JFSC has reformed the regulation of fund services providers.** Until November 2007, managers, administrators, advisers, custodians, and registrars had to be authorized by the JFSC separately for each fund. Now, they can seek

[5] The JFSC does not collect data on the value of these funds and they are therefore not included in official statistics for the total asset values of the funds sector.

a general authorization, under the Financial Services (Jersey) Law 1998 rather than under the CIF Law, to provide services to any fund—including the new unregulated funds (but excluding funds eligible for sale in the UK, where the previous approach remains). Fund service business can also be done through a managed entity, that is, a company whose business in Jersey is managed by another registered fund service provider. All these reforms were aimed at reducing the regulatory burden on fund service providers when creating a CIS, thereby allowing the JFSC to divert resources to supervision of those fund service providers.

25. **The JFSC has significantly strengthened the supervision of fund service providers.** Codes of Practice for Fund Services Business have been introduced setting out the JFSC's expectations in respect of issues such as corporate governance and financial resources. Fund services businesses are now subject to the JFSC's risk assessment model and to on-site visits. The JFSC has put particular emphasis in this sector on "themed" visits—for example, a 2007 program looking at compliance with the requirements for expert funds. One effect has been to align funds services regulation more closely to that of other investment services business, which is often undertaken by the same companies or groups. As the authorities recognize, continued strict supervision of service providers is necessary to offset the potential reputational risks attached to the light regulation of certain categories of funds.

26. **Jersey has continued to maintain a cooperative relationship with regulatory authorities for investment business overseas.** Jersey was an early signatory of the IOSCO Multilateral MOU. It exchanges information regularly with other regulators over the regulatory status of the owners of fund services business in Jersey. It responds to requests for cooperation (including on average 10 enforcement-related requests a year, across all its responsibilities, most from European and U.S. regulators) where an overseas regulator is undertaking an investigation or has other reasons to require information about a Jersey fund or fund services business.

27. **The JFSC has substantially implemented the recommendations of the 2003 OFC assessment of the IOSCO Objectives and Principles of Securities Regulation.** Most significantly, Codes of Practice for Fund Service Business have been completed—and Codes of Practice for Certified Funds themselves are in preparation, which will help with transparency issues, for example, by reducing deadlines for filing financial statements. Suitability of advice issues have been addressed through supervisory work and "mystery shopping" exercises. Advertising requirements have been strengthened. While compliance with IOSCO Principles was not assessed as part of the FSAP Update, it is evident that the regulation of investment business, particularly funds business, has been significantly strengthened since 2003. Going beyond the IOSCO Principles, it would be useful to gather information on the gross balance sheet size and leverage of funds (and other investment vehicles).

D. Insurance Sector

28. **Insurance regulation has been strengthened since the 2003 assessment.** While the sector has been contracting in this period, the JFSC has expanded supervisory resources, applied its general risk assessment model, and undertaken on-site visits to all insurers. To maximize resources, some thematic work is outsourced, typically to international audit firms. Extensive codes of practice have been introduced. One effect has been to align insurance regulation more closely to that of other sectors.

29. **A key challenge going forward is to maintain effective and proportionate regulation of a small sector with limited insurance risk.** With some companies scheduled to close or relocate, and with other centers now likely to attract new international business, the outlook is for further contraction in Jersey. The costs of developing a modern regulatory regime may be disproportionate to the benefits. A better approach, which the JFSC is already adopting with success, is to tailor requirements to the risk profile of each remaining insurance business. It now needs to take the approach further in some areas such as the regulation of closed life insurance funds.

30. **There are also some gaps in the regulatory framework, which should be filled as opportunities arise.** Exemptions to the Insurance Business (Jersey) Law 1996 should be narrowed to bring under the JFSC's regulation, one significant domestic insurer currently subject to a separate statute. New requirements should be introduced in relation to controllers of insurers, risk management (especially operational risk), and groups (though the JFSC has no insurance group responsibilities at present, additional powers to gather information from group companies and a group solvency test could prove valuable in future). The JFSC would benefit from a review of the regime for companies incorporated abroad. This has served Jersey-based insurance consumers well. But the JFSC should ensure that it has a framework for assessing where home state regulation is equivalent to its own approach and should ensure that it is applying appropriate regulation to the small number of companies operating as branches in Jersey rather than merely offering cross-border services.

E. Trust and Company Service Providers

31. **The trust and company service business sector enjoys a comprehensive regulatory and supervisory framework.** Already in the 2003 OFC assessment, Jersey's regulatory and supervisory framework for such business was found to be consistent with all of the practices set out in the Offshore Group of Banking Supervisors (OGBS) Statement of Best Practices. Since then, the States have amended the Trust (Jersey) Law 1984 in October 2006, and the JFSC refined the Codes of Practices for Trust Company Business, most recently in January 2008, in line with the recommendations of the assessment, to further enhance implementation of international standards. In particular, the JFSC completed the transitional licensing process following the introduction of the regulatory regime in 2000,

extended regulatory sanctions and powers to all key persons of registered persons, beyond "principal persons," and introduced explicit record keeping requirements. [6]

32. **The JFSC supervises the trust and company business (TCB) sector on an ongoing basis, with regular follow-ups.** The JFSC conducted over 70 on-site examinations in 2007 and has completed over 50 at end-October 2008. Examinations vary in scope (they can be focused, themed, or narrow) and in coverage (i.e., they can review aspects of AML/CFT, conduct of business, liquidity, corporate governance, risk management processes). Typically, businesses are reviewed under a three-year cycle, although the JFSC will determine a risk-based priority list. Shortcomings found during on-site inspections related mostly to corporate governance issues and, to a more limited extent, liquidity requirements.

33. **The implementation of the regulatory regime has been a catalyst for sectoral consolidation over the last five years.** There has also been a trend toward outsourcing back-office functions to cheaper centers. The new Foundations (Jersey) Law allows trust companies to expand their range of services.

F. Others

34. **The SPVs registered on the island are normally organized as companies established by trusts.** SPVs are registered as public companies, and are therefore subject to relevant regulation (for example, on disclosing financial results) under the Companies (Jersey) Law 1991 (Companies Law), but not supervision. Institutions associated with the SPVs, such as trust service providers, are subject to oversight. The JFSC has sought to ensure that only reputable institutions sponsor the establishment of SPVs. However, little information on their activities is compiled. In recent years only a few score SPVs have been established annually, and only a handful have been used for securitization purposes or to finance relatively risky investments. Of the latter, several are being closed by investors and one is being liquidated following heavy losses. In current circumstances, the JFSC should survey SPVs and SIVs associated with the island in order to achieve a more detailed understanding of their activities.

35. **Arrangements are being made to strengthen the oversight of audit work on the island.** There is no official oversight of the quality of the audit work of Jersey companies, although auditors are subject to reviews by their relevant professional body such as the practice assurance review scheme operated by the Institute of Chartered Accountants in England and Wales. However, legislation to amend the Companies Law is being drafted that, in respect of companies whose shares are admitted to trading on a regulated market, will

[6] Key persons are defined, by regulatory laws, as the compliance officer, money laundering reporting officer, and money laundering compliance officer of a registered person.

result in one or more professional bodies monitoring the quality of audit work and will enable action to be taken against auditors that breach rules on audits work carried out for those companies.

G. AML/CFT

36. **The authorities have put in place a comprehensive and robust AML/CFT legal framework that incorporates almost all aspects of the FATF Recommendations.** The key elements of this framework have been kept up-to-date, most substantially in the last two years in response to the 2003 revision of the FATF Recommendations and in parallel with moves by EU member states to implement the EU Third AML Directive. Substantial resources have been devoted to developing the latest AML/CFT laws and regulations, to consultations between public and private sector regarding implementation issues, and to testing industry compliance. This is evident across the financial institutions and particularly so with regard to trust company business.

37. **Both money laundering (ML) and financing of terrorism (FT) are criminalized largely in line with the international standard and Jersey has implemented the provisions effectively.** The JFCU receives a satisfactory flow of suspicious activity reports and carries out its role of a financial intelligence unit effectively.

38. **The assessment confirms a high level of compliance by Jersey with the FATF Recommendations on preventive measures, with most deficiencies noted being technical in nature.** The application of formal AML/CFT requirements to some categories of Designated Non-Financial Businesses and Professions (DNFBPs) had only recently taken effect at the time of the on-site visit—notably in the case of certain business of accountants and lawyers—and it was, therefore, not feasible to assess the effectiveness of the measures in place. One more material issue relates to the extent and manner of the concessions allowed to financial institutions and certain DNFBPs to rely on intermediaries and introducers to have conducted customer due diligence measures, which the assessment concludes does not comply fully with the international standard; the authorities have indicated that they do not agree with this finding.

39. **Jersey has adopted a risk-based approach to AML/CFT at all levels, in determining the scope of the requirements, in designing implementation measures, and in supervision.** AML/CFT policy is coordinated by an AML/CFT Strategy Group, comprising all relevant authorities, which focuses on identifying and responding to areas of vulnerability.

40. **The Jersey authorities engage actively in international cooperation and are in a position to share information with counterparts, subject to appropriate safeguards.** The legal framework for mutual legal assistance is in place and effective.

III. Stability Issues

A. Vulnerabilities of the Financial System

41. **Overall, banks have a low risk profile, under the crucial provision that the health of their parent banks remains sound.** Banks tend to have a simple balance sheet structure, and their primary role is to collect deposits and provide a stable source of liquidity to the group. Were the health of a group to deteriorate, local banks' large intra-group exposures could destabilize the financial system. The authorities have made an explicit choice to admit only subsidiaries and branches of major banking groups from large jurisdictions. However, the global financial turmoil has shown that even these groups can suffer severe difficulties, and indeed their complexity and size can create little-understood risks and uncertainties. Furthermore, a group that is admitted because of its size and sophistication may change its characteristics. The authorities recognize this vulnerability.

42. **Threats to Jersey's reputation for probity and safety represent another significant potential vulnerability.** As the authorities recognize, a major instance of malfeasance or mis-management, even in one of the smaller institutions such as a CIS or SPV, could provoke a sudden withdrawal of deposits. In such circumstances, banks would generally be able to meet claims by running down deposits with parent banks, but this could threaten the banks' business model and impose a longer-term cost on the island.

43. **Credit risk toward third parties is less important for banks, but should not be ignored since domestic resources are small.**[7] Almost 85 percent of banks' non-interbank loans are to non-residents, and one quarter are mortgage-related, creating marked exposure to a global recession or further fall in housing prices. So far, the local economy has displayed stability, supported by a low level of domestic bank indebtedness by industrial country standards (domestic non-financial bank loans amounted to 95 percent of GVA at end-June 2008) and moderate domestic bank credit growth (13 percent on average for 2004-2007; Table 6).[8]

44. **Other risk factors are less important for systemic soundness.** The insurance and pension sectors are small. Risks in CISs are largely borne by investors who presumably acquired them willingly. There are some risks from mis-selling (though in international business, advice and distribution is mostly handled overseas) and particularly mismanagement—for example, operational risks for fund services providers and other fund managers, which tend to crystallize more often in falling markets when customers also have more cause to make complaints or even to bring legal action. Fund service providers are to an

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[7] Credit to the nonfinancial sector constitutes under a tenth of banks' total assets but amount to six times GVA, over half of which is to households.

[8] Data are not available on nonbank lending and direct borrowing from abroad.

extent protected by capital requirements and professional indemnity insurance. The assets of trust and company service businesses are held off-balance sheet, and losses in this sector would not threaten the financial soundness of the Jersey financial system. It appears that SPVs on Jersey currently pose no direct risk to the financial system as a whole because risks are borne by investors or the sponsoring institutions, which are non-resident. However, if a highly leveraged SPV or fund were to fail, there may be a reputational effect.

Table 6. Jersey: Bank Credit Growth, 2004-08

(GBP millions unless indicated otherwise)

	2004	2005	2006	2007	2008	Average
			(in GBP millions)			
Total Loans	14,946	18,190	20,825	29,557	34,590	…
Real estate	4,945	5,848	6,719	7,952	9,169	…
Property Companies	1,152	1,545	2,012	2,560	2,868	…
House Purchase	3,793	4,303	4,707	5,392	6,301	…
Jersey	3,847	4,498	4,902	5,501	5,904	…
Real estate	2,226	2,559	2,799	2,897	2,975	…
Property Companies	428	616	792	748	782	…
House Purchase	1,798	1,943	2,008	2,149	2,193	…
Non-Jersey	11,099	13,691	15,924	24,056	28,686	…
Real estate	2,718	3,289	3,920	5,055	6,194	…
Property Companies	724	929	1,221	1,813	2,086	…
House Purchase	1,995	2,360	2,699	3,243	4,108	…
			(annual growth in percent)			
Total	...	21.7	14.5	41.9	17.0	23.8
Real estate	...	18.3	14.9	18.3	15.3	16.7
Property Companies	...	34.1	30.3	27.2	12.0	25.9
House Purchase	...	13.5	9.4	14.5	16.9	13.6
Jersey	...	16.9	9.0	12.2	7.3	11.4
Real estate	...	14.9	9.4	3.5	2.7	7.6
Property Companies	...	43.8	28.6	- 5.5	4.5	17.8
House Purchase	...	8.1	3.3	7.0	2.1	5.1
Non-Jersey	...	23.4	16.3	51.1	19.2	27.5
Real estate	...	21.0	19.2	29.0	22.5	22.9
Property Companies	...	28.4	31.4	48.5	15.1	30.8
House Purchase	...	18.3	14.4	20.1	26.7	19.9

Sources: JFSC, and staff estimates.

45. **Were these risks to materialize and result in major losses, there would be an adverse effect on the local economy.** The financial sector is such an important component of the local economy that a downturn would have a major effect on employment and government revenue, with knock-on effects on other sectors. Moreover, a deterioration in the financial health of parent institutions could lead to a domestic credit squeeze, which would hurt the development of the local economy. There may also be feedback via the nonbank lending companies that operate on the island and foreign indebtedness (e.g., UK-based credit card debt) not captured in domestic statistics.

46. **Strains in the financial sector would not in itself produce significant cross-border spillover effects, but Jersey may transmit international shocks.** Any Jersey-specific shock would likely result in the rapid transfer of business to another international center, so the global effect on parent banks could be minimal. However, deposits in one Jersey bank currently fill 10 percent or more of the parent bank's funding gap.[9] Hence, worries about the parent could provoke a withdrawal of deposits from Jersey that would put further pressure on the parent's liquidity position. Furthermore, negative shocks are likely to be correlated: a recession may strain the parent, making it less able to support its subsidiary at the same time as the subsidiary's loan book deteriorates. Jersey may also be involved in the transmission of shocks through highly leveraged specialist investment funds and SPVs.

B. Performance and Stability Indicators

47. **Banks enjoy high asset quality, profitability, and capitalization, but leverage is also high (Table 7).** Asset quality and especially the quality of loans to the local economy has been satisfactory. Risk-weighted CARs are elevated in international comparison, driven largely by banks' low risk-weighted assets, and the tendency to retain profits in a low tax jurisdiction. In contrast, the overall capital to asset ratio is about 2 percent; excluding branches, the ratio is 5.6 percent. Profitability has been comfortable, although this partly reflects transfer pricing arrangements with parent institutions.[10]

48. **The banking sector as a whole exhibits ample liquidity given that claims on groups are mostly short term.** Banks typically match the maturities (and currencies) of their deposits with those of their claims on parents.

49. **The global financial turmoil has had some impact on Jersey's financial institutions.** Most banks have no significant exposure to the most affected asset classes, and the deposit-based nature of much of their funding has ensured stability. While some banks have enjoyed flight-to-quality deposit flows, the system as a whole lost 6 percent of its deposits by value in the year to March 2009 (principally during 2008Q2); certain individual banks suffered quite large deposit outflows. One bank, moreover, suffered significant losses on its investment portfolio. The CIS sector has seen moderate losses and outflows; while currency and other market price movements complicate the interpretation of aggregates, the total NAV of CIS declined by about 11 percent from December 2008 through March 2009, and the number of funds declined by about 2½ percent. Insurance companies are financially strong. Limited data are available on the financial soundness of other nonbank financial institutions (NBFIs) or the nonfinancial sector.

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[9] The funding gap is defined as the amount of group loans not funded through group deposits.

[10] However, when interbank rates sink to very low levels, margins get compressed as the magnitudes of adjustment on the asset and liability sides differ.

Table 7. Jersey: Financial Soundness Indicators for the Banking Sector

(in percent)

	2002	2003	2004	2005	2006	2007	2008
Capital adequacy							
Regulatory capital to risk-weighted assets	16.7	17.4	16.3	16.9	16.1	14.6	13.8
Regulatory Tier I capital to risk-weighted assets	15.3	15.8	14.7	14.2	13.4	12.6	11.2
Capital to assets	4.3	4.2	2.9	2.8	1.8	1.9	2.1
Asset composition							
Sectoral distribution of loans to total loans							
Nonbank financial institutions	0.3	0.4	0.4	0.5	0.4	0.6	0.6
Nonfinancial corporations	0.2	0.3	0.4	0.6	0.6	0.4	0.4
Households	0.6	0.8	1.3	1.1	1.1	0.9	0.9
Nonresidents	98.8	98.5	97.9	97.8	97.3	96.6	96.8
of which : banks	92.9	92.7	91.7	91.2	90.4	87.9	87.3
Other sectors	...	...	...	...	0.6	1.4	1.3
Geographical distribution of loans to total non-bank loans							
Domestic	...	3.0	4.0	4.0	4.0	5.0	8.0
Cross-border	...	97.0	96.0	96.0	96.0	95.0	92.0
of which : UK	...	35.0	20.0	22.0	23.0	17.0	8.0
of which : Other EU	...	8.0	7.0	6.0	7.0	8.0	4.0
of which : Other	...	54.0	70.0	68.0	66.0	71.0	75.0
Asset quality							
Nonperforming loans (NPLs) to total gross loans	0.5	0.5	0.3	0.2	0.2	0.1	0.1
Loan-loss provisions to nonperforming loans	69.5	51.2	68.8	88.5	93.0	82.2	74.5
NPLs net of loan-loss provisions to Tier 1 capital	0.0	6.1	0.0	1.7	0.4	0.1	1.7
FX-denominated loans to total loans	66.3	38.9	34.5	35.4	30.3	39.7	74.0
Large exposures to capital	328.9	518.1	481.3	405.5	314.9	225.7	196.3
Earnings and profitability							
Return on assets	1.0	0.9	0.8	1.0	1.0	1.1	0.3
Return on equity	18.2	16.1	14.8	16.2	17.1	19.7	22.6
Net interest margin 1/	0.6	0.6	0.5	0.5	0.5	0.5	0.9
Gross income as a percentage of average assets	0.9	0.8	0.8	0.8	0.8	0.5	0.4
Net interest income to gross income	67.9	69.2	69.3	67.9	68.6	99.4	113.2
Trading income to gross income	10.6	8.1	8.1	8.5	8.1	-33.2	-42.9
Noninterest expenses to gross income	41.4	42.2	48.2	41.8	43.2	61.1	54.1
Personnel expenses to noninterest expenses	54.6	52.3	49.5	55.6	54.7	57.1	50.1
Liquidity							
Liquid assets to total assets	80.5	79.8	75.4	76.5	76.8	78.3	82.6
Liquid assets to short-term liabilities	95.5	93.3	87.9	90.1	91.4	92.8	97.0
FX-denominated liabilities to total liabilities	72.6	70.2	68.3	69.8	67.0	67.9	66.5
Deposits as a percentage of assets	78.9	77.8	76.7	75.7	68.5	66.8	65.7
Loans as a percentage of deposits	7.7	8.0	9.5	9.9	11.0	13.9	16.5
Sensitivity to market risk							
Off-balance sheet operations to total assets	14.9	14.1	15.3	19.4	19.2	28.5	36.5
of which : interest rate contracts	50.0	52.2	44.7	40.5	38.2	32.5	13.0
of which : FX contracts	20.7	22.4	25.6	27.9	29.7	39.9	37.5
Duration of assets to total assets							
Less than 3 months	83.0	88.8	84.2	85.9	86.4	85.2	83.4
Between 3 months and 1 year	6.5	6.3	6.8	6.7	7.1	5.6	8.4
Between 1 and 5 years	5.1	3.4	5.1	4.3	4.4	6.3	5.5
More than 5 years	5.3	1.5	3.8	3.1	2.0	2.9	2.7
Duration of liabilities to total liabilities							
Less than 3 months	80.6	78.6	77.9	79.2	77.5	77.9	74.8
Between 3 months and 1 year	5.6	4.4	6.6	5.1	9.6	8.7	6.8
Between 1 and 5 years	5.0	4.5	4.7	4.4	4.1	4.7	5.1
More than 5 years	8.8	12.5	10.8	11.3	8.8	8.7	13.3
Net open position in foreign exchange to capital	7.4	6.4	5.2	6.9	7.5	9.2	2.2

Source: Jersey Financial Services Commission.

1/ Net interest income to interest bearing assets.

C. Stress Test Results

50. **Stress tests highlight that, while the close linkages to large parent banks are a source of strength in the case of mild stress, they could create disastrous consequences in the event of extreme stress.** Stress tests were performed to assess the resilience of banks to a variety of shocks. The methodologies and shocks were chosen in consultation between the JFSC and the FSAP team (Appendix III). The most material risk is counterparty risk with the parent (Table 8). A 10 percent loss on claims on parent banks would lead 14 banks to become insolvent. However, concentration risk and spillovers from parent banks are difficult to capture quantitatively. In reality, the banks' sensitivity is more nuanced as the likelihood that a parent bank of a Jersey affiliate fails is small, as reflected in recent events.

51. **Credit risk remains a significant risk factor, although the tests confirmed banks' overall resilience.** For example, based on prudential data, a macroeconomic shock (such as a decline in GDP or higher interest rates) that leads to the default of 10 percent of banks' (nonfinancial) credit outside of Jersey could reduce the system-wide CAR by 340 basis points (bps) to 12 percent. The default of banks' three largest (nonparent) exposures would have an even larger impact, although this test does not capture the ample cash collateral and parental guarantees that cover such exposures.

52. **Stress tests confirmed that the banking system exhibits considerable resilience against a range of large market risk shocks.** This resilience is due largely to banks' small position-taking and various group transfer pricing and other maturity and currency matching arrangements.[11] The largest impact would be a two-notch downgrade on all marketable securities, which would lead to a breach at one bank and lead to a 50 bps reduction of the system-wide CAR.

53. **Banks also exhibit ample liquidity buffers.** A 20 percent daily withdrawal of deposits with maturity up to one month would lead 9 banks (accounting for 6 percent of total assets) to become illiquid after five days, assuming banks have access only to assets with maturity up to one month (excluding liquid marketable instruments) to fund the deposit run (Table 9).

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[11] Banks have small net open foreign currency positions, but at times a large fraction of total loans are denominated in foreign currency (Table 7). However, these are almost all loans to parents and reflect short-term liquidity management operations by the parent groups. Hence, associated risks are captured by the exposure to parents.

Table 8. Jersey: Stress Test Results: Market Risk and Credit Risk 1/

Shocks	Bottom-Up							Top-Down						
	CAR 1/	Min.	Max.	No. banks breaching min. CAR	Loss/Gain 1/	Min.	Max.	CAR 1/	Min.	Max.	No. banks breaching min. CAR	Loss/ Gain 1/	Min.	Max.
	In percent				In percent of pre-shock capital			In percent				In percent of pre-shock capital		
Pre-shock capital *(in percent)*	*15.4*	*11.1*	*22.8*	*0*	...	...	...	*15.4*	*11.1*	*22.8*	...	...	...	...
Spot risk 4/														
F1: The pound depreciates by 20 percent against all other currencies.	15.5	11.1	22.8	0	0.5	-0.1	3.7	15.6	11.9	22.8	0	-0.3	-0.4	3.2
F2: The pound appreciates by 20 percent against all other currencies.	15.4	11.1	22.8	0	-0.4	-3.5	0.0	15.5	11.9	22.8	0	0.3	-3.2	0.4
F3: The dollar depreciates by 20 percent against all other currencies	15.4	11.1	22.8	0	-0.3	-2.5	0.1	15.6	12.0	22.8	0	-0.1	-0.4	1.4
F4: The dollar appreciates by 20 percent against all other currencies.	15.1	11.1	22.8	0	0.3	-0.1	2.1	15.6	11.9	22.8	0	0.1	-1.4	0.4
Interest Rate Risk 5/														
Pre-shock capital (in percent)	*15.7*	*11.9*	*22.8*	...	...	...	...	*15.7*	*11.9*	*22.8*	0	...	...	...
I1: Parallel upward shift of the sterling yield curve by 200 basis points.	15.7	11.9	23.3	0	-0.6	-4.5	0.4	15.6	11.7	23.2	0	-4.7	-10.2	2.9
I2: Parallel downward shift of the pound sterling yield curve by 200 basis	15.6	11.8	22.5	0	0.6	-0.4	4.5	15.8	11.8	22.3	0	4.7	-2.9	10.2
I3: Parallel upward shift of the dollar yield curve by 200 basis points.	15.7	11.9	22.8	0	0.0	-1.4	0.5	15.7	11.9	22.8	0	0.0	-0.8	0.0
I4: Parallel downward shift of the dollar yield curve by 200 basis points.	15.6	11.7	22.6	0	0.0	-0.5	1.4	15.7	11.9	22.8	0	0.0	0.0	0.8
I5: Parallel upward shift of the euro yield curve by 200 basis points.	15.7	11.9	22.7	0	0.2	-0.6	2.4	15.7	11.9	22.8	0	0.0	0.0	0.0
I6: Parallel downward shift of the euro yield curve by 200 basis points.	15.7	11.9	22.7	0	-0.2	-2.4	0.6	15.7	11.9	22.8	0	0.0	0.0	0.0
Asset Price Risk														
A1: Prices of all shares listed on foreign stock markets decline by 35 per	15.4	11.1	22.8	0	0.0	0.0	0.0	15.4	11.1	22.8	0	-0.3	0.0	-0.7
A2: Rated securities are downgraded by two categories	14.9	10.4	22.8	0	0.0	0.0	0.0	14.5	8.1	22.8	1	0.0	0.0	0.0
Credit Risk														
C1: Default of the largest three exposures excluding the parent bank	14.6	6.2	22.8	2	-110.0	0.0	-62.6	11.3	-12.2	22.8	4	-28.4	-178.8	0.0
C2: If 10% of domestic nonbank loan fail	15.3	11.1	22.8	0	-19.4	0.0	-9.4	14.9	11.1	22.8	0	-3.8	-14.3	0.0
C3: If 10% of mortgage loans fail	14.9	10.6	20.6	0	-55.7	0.0	-21.5	12.9	2.9	22.7	3	-17.5	-83.6	0.0
C4: If 10% of non-resident non-bank loans fail	14.7	9.2	20.6	1	-83.9	0.0	-33.7	12.0	-1.0	22.7	4	-24.3	-106.5	0.0
C5: If 10% of parent bank fails	-9.5	-33.7	12.0	17	-3,033.0	-5.4	-330.1	-9.5	-33.7	12.0	17	-159.5	-330.0	-5.4

Sources: Jersey Financial Services Commission and staff estimates.

1/ Unweighted average across banks in sample.
2/ Including Citibank, Standard Chartered, HSBC ME, all of which report in USD.
3/ Asset valuation effect.
4/ Instantaneous loss fully absorbed by capital (no impact on risk-weighted assets)
5/ Excludes HSBC Middle East and Standard Chartered.

Table 9. Jersey. Stress Test Results: Liquidity Risk

	Number of illiquid banks			Market share of assets 1/		
	Subsidiaries	Branches	Total	Subsidiaries	Branches	Total
Test L1 2/						
Day 1	0	2	2	0.0	0.7	0.7
Day 2	0	3	3	0.0	2.4	2.4
Day 3	0	4	4	0.0	2.6	2.6
Day 4	3	4	7	1.3	2.6	3.9
Day 5	4	4	8	2.1	2.6	4.7
Test L2 3/						
Day 1	0	2	2	0.0	0.7	0.7
Day 2	0	3	3	0.0	2.4	2.4
Day 3	2	4	6	0.2	2.6	2.9
Day 4	5	4	9	3.0	2.6	5.7
Day 5	5	4	9	3.0	2.6	5.7

Sources: Jersey Financial Services Commission and staff estimates.

1/ Total assets of illiquid banks in percetn of total assets of all banks.

2/ Funding 20 percent of daily run on deposits with maturity up to one month with one-month liquidity.

3/ Same as L1 shock but assuming no access to liquid marketable assets.

D. Safety Nets and Contingency Planning

54. **Even a well-supervised jurisdiction with normally sound banks needs to consider how it would deal with a crisis.** The current global financial turmoil is a reminder of the size, speed, and unpredictability of financial sector shocks.

Safety nets

55. **The authorities are considering the introduction of a bank DCS.** This initiative followed the announcement of broadened deposit insurance, investment business, and bank guarantees by several countries affected by the global turmoil. Currently Jersey has provisions in laws covering the banking, insurance, and CIS sectors for the possibility of ad hoc compensation or a formal scheme, but no formal schemes have been established except for one covering "recognized" CISs (i.e., those eligible to be marketed to retail investors in the UK and certain other countries). Because Jersey is in a monetary union with the UK, there is no central bank to act as a lender of last resort (LOLR).

56. **Jersey should study the benefits and potential costs of a DCS very carefully.** The strongest case can be made for a transparent scheme that concentrates on a limited coverage for Jersey residents. Such a scheme could perhaps be funded largely from a levy on resident deposits. Offering wider coverage may not be credible given the size of the financial sector relative to Jersey's own resources. Experience suggests that a DCS is most valuable when payouts can be made rapidly, which requires schemes to have considerable borrowing capacity and/or be substantially pre-funded. Furthermore, practical aspects of a DCS can be demanding.

57. **In any case, all depositors and other claimants must receive clear information on who is responsible for safeguarding their claims and the DCS coverage, if any.** The JFSC should ensure that banks provide prominent explanations that uninsured deposits are currently the sole liability of the respective institution, and neither Jersey nor a home jurisdiction offers any insurance.

58. **Similar arguments apply to investor or policyholder compensation schemes.** Discretionary or case-by-case schemes, as provided for at present (together with the possibility of ex gratia payments from government) could bias investors' expectations, weaken market discipline, and put government funds at risk. The authorities should review policy on investor and insurance policyholder compensation in the light of the decision on a DCS. There may also be a case for establishing a financial sector ombudsman to deal with consumer protection issues.

Contingency planning

59. **The authorities have rightly recognized the need to plan for contingencies in the financial sector, and preparations have begun.**[12] The starting point for contingency planning should be a clear understanding of priorities among objectives. Objectives may include: (i) safeguarding the savings of Jersey residents; (ii) maintaining the availability of financial services and financing for the local economy; (iii) preserving Jersey's competitiveness as a financial center and in particular its reputation for safety and evenhandedness; and (iv) limiting fiscal and other costs. These objectives go beyond the responsibilities of the JFSC and require close collaboration among the Jersey authorities. Also, certain constraints need to be taken into account, such as:

(i) The large exposure of local institutions to their parent, and their operational dependence for key activities.

(ii) The high probability that, should a parent get into difficulties, it would attempt to extract liquidity and capital from its subsidiaries and branches.

(iii) The absence of a LOLR capacity and relatively small fiscal resources.

(iv) The high probability that, in a crisis, home authorities will look mainly to minimizing the costs to their own tax-payers.

(v) The limited ability of the authorities to track developments in real time, for example, because they cannot monitor the payments system.

Intervention powers and resolution procedures

60. **The JFSC has broadly adequate powers to direct, intervene in, and close a troubled financial institution, but on its own may lack sufficient information to identify incipient problems.** Because the banks are dependent on their parents, the JFSC has to rely on parent supervisors to inform them about rising tensions and possible interventions. The response to tension should include measures to increase local information in real time, for example, requiring frequent (even daily) reporting by affected institutions.[13]

61. **The JFSC must seek to enhance its relationship with relevant home authorities to help ensure that Jersey's interests are given timely consideration in any intervention.** The authorities should review the June 2008 EU MOU on financial crisis management and consider what elements might be introduced into the MOUs with home country authorities.

[12] Attention will focus on banks. Contingency planning for the failure in another sector, perhaps due to operational risk, would also be worthwhile, but the financial effect would typically be much smaller.

[13] The JFSC has intensified monitoring of market developments and bank liquidity during the turmoil.

Jersey might offer in return to participate cooperatively in intervention and resolution procedures, help limit reputational risks, and even engage in equitable burden sharing.

62. **Experience elsewhere suggests that it is useful to have a dedicated bank insolvency regime.** Currently, bank insolvencies would be handled more or less like that of other companies.[14] A bank insolvency regime would recognize the systemic nature of banking, which implies that the stakeholders include not only creditors but also, for example, borrowers and users of transaction services. Provision of, for example, "purchase and assumption" of a set of assets and deposit liabilities can be valuable in reducing disruption to the economy. However, it will be important to maintain compatibility with the UK (and EU) bank insolvency regime.

[14] The JFSC can apply to the courts for a "just and equitable" winding up of a regulated entity, which has proven to be a useful instrument in cases dealing with problem nonbank institutions.

ANNEX—OBSERVANCE OF FINANCIAL SUPERVISION STANDARDS AND CODES—SUMMARY ASSESSMENTS

This Annex contains the summary assessments of standards and codes in the financial sector. The assessment has helped to identify the extent to which the supervisory and regulatory framework is adequate to address the potential risks and vulnerabilities in the financial system.

The following detailed assessments were undertaken:

- Basel Core Principles for Effective Banking Supervision—by Mr. Dreymann (BaFin, banking supervision expert), and Mr. Bell (banking supervision expert).
- The IAIS Insurance Core Principles—by Mr. Tower (MCM)
- The FATF 40+9 Recommendations for AML/CFT—by Mr. Donovan (IMF/LEG); Messrs. Abbott, Fennell, and Sutton and Ms. Dunker (consultants). The assessment was approved by Mr. Sean Hagan.

Jersey's compliance with the international supervisory standards is generally high, and most of the issues raised in the 2003 assessment have been addressed.

A. Basel Core Principles for Effective Banking Supervision

63. **The regulatory system and prudential supervisory practice have been improved, building on the high standard found in the 2003 assessment.** Laws and regulations have been amended to enhance compliance with international standards and keep pace with financial sector developments. The JFSC, which is responsible for financial sector regulation and oversight, has continued to strengthen supervisory practice, for example, by establishing a comprehensive, risk-based system of on-site visits. Cooperation with home supervisors has been enhanced, buttressed by numerous MOUs. The JFSC's operational autonomy has been reinforced. The major supervisory challenge is how to deal with banks' exposures to parent groups.

Introduction

64. **This assessment of implementation of the BCPs was undertaken as part of an IMF FSAP Update for Jersey in 2008, and in particular was prepared during an IMF mission that visited Jersey during November 2008.** This assessment follows-up on an earlier BCP assessment performed in the context of the 2002/2003 IMF OFC assessment of Jersey.

Information and methodology used for assessment

65. **The assessment of compliance with the BCPs was made on the basis of a study of the legal and regulatory framework and detailed discussions with relevant authorities and stakeholders.** The assessment was conducted in accordance with the Basel Committee's revised Core Principles Methodology (October 2006). The assessment team is grateful for the very good cooperation received from the Jersey authorities. This included the comprehensive provision of documentation and extensive supplementary information, and the JFSC's self-assessment of compliance with the BCPs.

Institutional and macroeconomic setting and market structure—overview

66. **Jersey is a British Crown Dependencies.** As such it is not part of the UK and has its own legislature (the States), legal and regulatory system, and tax regime. In December 2005, a system of ministerial government was established.

67. **Jersey's economy has performed satisfactorily over the last decade, but some slowdown is currently expected in the context of the global financial turmoil and the slowing of the British economy.** Annual real GVA growth averaged 3.8 percent over 2003-07.[15] Current strains in global financial markets and especially lower interest rates, combined with slower growth in the UK economy generally, are expected to slow growth in the coming period.

68. **The basis of the economy is the financial sector.** The main activities are banking, fund management, and fiduciary services. The combined financial services sector contributes over half of GVA, and total assets under management are a large multiple of GVA. The island is among the larger OFCs in the banking sector. Branches and subsidiaries from the UK, other EU countries, North America, and some other countries operate on the island. Banks' principal business is the collection of retail deposits from overseas (e.g., from British expatriates or non-domiciled expatriates in the UK), and from corporates and the trusts that are managed on the island. These funds are mainly placed with parent banks. Many banking groups have licenses to perform other financial services, such as fiduciary services, that are ancillary to the wealth management services provided to their clients. Non-interbank lending is mainly to individuals, property companies, and some nonbank financial institutions. Banks have relatively little real estate exposure and most do not operate trading books or independent treasury functions.

69. **Banks enjoy high asset quality, profitability, and capitalization, but leverage is also high.** The banking sector as a whole exhibits ample liquidity given that claims on groups are mostly very short term. Recent global financial turmoil has had some impact on banks.

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[15] GVA in 2007 is estimated at GBP 4.1 billion (GVA equals GDP less net taxes on products).

Preconditions for effective banking supervision

70. **Jersey's macroeconomic performance is generally satisfactory.** Unemployment is low, and the trend growth rate and inflation have been satisfactory.

71. **The legal system, which is broadly based on common law with French and Norman elements, is highly developed.** The courts are well versed in financial matters, and reportedly are able to act quickly if needed. A full range of high-quality accountancy, audit, legal, and ancillary financial services are available on the island.

72. **Jersey is not a member state of the EU or the wider European Economic Area.** Consequently, Jersey has not been obliged to implement European directives on the regulation of financial services. Instead, it has voluntarily followed a policy of adopting wider international standards such as those of the Basel Committee. Furthermore, Jersey has introduced a system of information exchange and withholding tax on financial income in accordance with the EU Savings Directive.

73. **The authorities have substantially adequate powers to direct, intervene in, and close a troubled financial institution.** There is no depositor compensation or insurance scheme in place. No bank has failed in recent decades.

Main findings

74. **The BCP assessment confirms the high standard of prudential regulation and supervision described in the 2003 assessment, and found that the issues identified at that time have largely been addressed.** Most importantly, the JFSC now conducts a large program of on-site supervision, supported by off-site analysis. The JFSC follows up on on-site supervision visits with detailed recommendations. In addition, a framework of minimum prudential standards is provided by the Banking Business (Jersey) Law 1991, the Banking Business (General Provisions) (Jersey) Order 2002, and the Codes of Practice for Deposit-taking Business (Banking Codes), which is updated regularly.

75. **The JFSC, as the integrated regulator, has as its main responsibility the supervision and development of financial services provided on the island.** In exercising its functions the JFSC must have regard to reducing the risk to the public of financial loss due to the dishonesty, incompetence or malpractice by or the financial unsoundness of financial institutions; protecting and enhancing the island's reputation and integrity; protecting the best economic interests of Jersey; and countering financial crime.

76. **The JFSC enjoys considerable independence, and is subject to suitable accountability provisions.** A MOU between the JFSC and the responsible minister has clarified that the latter would exercise the statutory power to give the JFSC "direction" only in exceptional circumstances where it is believed that the well-being of the island is at stake,

and with respect to general policy, not individual cases. The minister has never exercised this power.

77. **The JFSC has numerous and effective powers.** The JFSC can request information, issue binding directives, publish warnings and advice, appoint managers or co-signatories, revoke licenses, or even request that a court start bankruptcy or winding-up proceedings. Fines can be imposed mostly for administrative matters, such as late submission of supervisory returns. The JFSC is adequately resourced.

78. **The authorities cooperate with the home supervisors of institutions active on the island.** Numerous MOUs with supervisors abroad have been signed to address both on-going supervision and information exchange. Information is in fact exchanged, and regular visits to and from the home supervisors are undertaken, including for the purpose of on-site supervision.

79. **Three broad areas for further work have been identified:**

(i) The authorities have exempted banks' exposures to their parents from limits on exposures to related parties and large exposures, even though these exposures represent the major risk to the system. It is recommended that the authorities make the exemptions less automatic by requiring that the JFSC, on a regular basis, confirm that the parent company still has the will and capacity to support its subsidiary, and try to ensure that local banks develop more autonomous risk management capacity.

(ii) The authorities rely largely on banks' internal controls to ensure adequate loan classification and provisioning. More attention should be paid to this risk factor, especially in the current environment.

(iii) The JFSC should develop more capacity to assess overall financial sector stability and banks' risk models. At present, attention focuses on individual banks. In this connection, the JFSC should consider publishing more statistics on banks and other financial institutions, such as aggregate balance sheets and the mean and distribution of financial soundness indicators.

Table 10. Summary Compliance with the Basel Core Principles

Core Principle	Comments
1. Objectives, independence, powers, transparency, and cooperation	The JFSC has wide powers and autonomy.
1.1 Responsibilities and objectives	Objectives are clearly stated. The JFSC should have regard to the reduction of risk to the public due to financial unsoundness or mis-management in a financial institution; protection and enhancement of the island's reputation; the best economic interests of Jersey; and the need to counter financial crime.
1.2 Independence, accountability and transparency	Operational independence has been enhanced, and in practice the independence is not under threat. The responsible minister may give "direction" on general policy but not on specific issues. Resources are generally adequate. The JFSC is effectively accountable to government and the public.
1.3 Legal framework	The JFSC is legally authorized to issue codes of practice that set out sound principles for the conduct of deposit-taking business, which include prudential requirements; grant and withdraw bank licenses; and require the provision of information.
1.4 Legal powers	A full range of enforcement powers and sanctions are available. Fines are currently used only for infringement of administrative requirements.
1.5 Legal protection	Legal protection of supervisors is provided.
1.6 Cooperation	Means are available and used for domestic and international cooperation.
2. Permissible activities	Permissible activities are well defined.
3. Licensing criteria	The licensing criteria are full satisfactory. The JFSC's licensing policy requires, *inter alia*, that an applicant bank be a member of "a group of stature" (i.e., one ranked in the top 500 by Tier 1 capital), systemically important in its "home" jurisdiction, and that consolidated supervision of a standard judged to be of international standard by the JFSC is applied to the group by its primary regulator.
4. Transfer of significant ownership	Significant ownership is defined. For Jersey-incorporated subsidiaries, the JFSC has the power to restrict the rights of shares transferred without necessary notification and approval.
5. Major acquisitions	Any "registered person" (such as a bank) must obtain the JFSC's prior consent to undertake any new activity in Jersey with significant effect on its business or profitability. It must also notify the JFSC in writing of any decision to commence a new activity, prior to commencement, which is likely to have a material effect on the business or its profitability.
6. Capital adequacy	Capital adequacy requirements (currently 10 percent) are fully adequate. Basel II has been introduced. The JFSC has, via the Pillar 2 process of Basel II, agreed trigger ratios with all Jersey-incorporated banks which, if breached, would require a bank's immediate notification to the JFSC.
7. Risk management process	The JFSC regulates and effectively supervises risk management processes, internal controls, and corporate governance provisions. However, given the utmost importance the parent company or group and the home jurisdiction might have on the operations of local entities, the JFSC should consider establishing a more formal process to observe developments at parent company or head office level and within the home jurisdiction of the group.
8. Credit risk	The JFSC regulates and effectively supervises credit risk, including

Core Principle	Comments
	with regard to the granting of credits, their on-going monitoring, provisioning, and exposure limits. Management of credit risk is addressed during on-site supervision visits.
9. Problem assets, provisions, and reserves	Banks are required to recognize problem assets, classify them, and make provisions in a timely fashion. However, the JFSC has chosen not to be very prescriptive on provisioning because Jersey banks, all of which are branches or subsidiaries of major international banking groups, are required to adopt established group standards in this respect.
10. Large exposure limits	Large exposures are defined and limited, with the exception of exposures to related parent banks with maturity less than one year.
11. Exposure to related parties	Exposures to related parties are defined and limited, with the exception of exposures to parent banks with maturity less than one year.
12. Country and transfer risks	Country and transfer risks, while limited for most banks, is adequately regulated and supervised.
13. Market risks	Market risk, while limited for most banks, is adequately regulated and supervised.
14. Liquidity risk	Banks are required to formulate and implement a liquidity management policy. Banks have to measure and monitor net funding requirements, perform a regular review of underlying assumptions, and provide for adequate contingency planning to cover possible disruptions. Guidance is provided on liquidity management.
15. Operational risk	Operational risk is addressed. Operational risk is taken into account in banks' capital requirements under Basel II.
16. Interest rate risk in the banking book	Interest rate risk is adequately regulated and supervised. Banks must employ established standards for valuing positions and measuring risk conduct ongoing assessment of the effects of interest rate changes, and perform independent reviews and appropriate stress testing.
17. Internal control and audit	Banks are required to have effective internal controls and audit and, in particular, require defined responsibilities for bank directors and senior managers. An appropriately skilled and independent compliance officer must be appointed.
18. Abuse of financial services	Extensive provisions, supported by supervision, are in place to deter and prevent the abuse of financial services. The Attorney General (AG) has relevant investigatory and prosecution powers. The Jersey Financial Crimes Unit conducts money laundering (ML) and terrorist financing investigations.
19. Supervisory approach	The JFSC employs both on-site and off-site supervision techniques to evaluate banking institutions. The frequency of on-site examinations depends upon the risk profile of the bank concerned. However, regardless of this profile, most registered banks are subject to an on-site inspection at least every three years, with follow up on issues raised as a result. Cross-bank comparisons and system-wide stability analyses should be developed, for example, through more regular stress testing, evaluation of systemic developments, and review of the distribution of financial soundness indicators.
20. Supervisory techniques	The JFSC makes use of an array of supervisory techniques, including sophisticated off- and on-site supervision. The JFSC utilizes on-site inspections to provide verification of corporate governance practices, provide independent assurances that information provided by banks is reliable, obtain information to support the JFSC's view of risks and

Core Principle	Comments
	controls in the bank, and identify issues that require remediation. The JFSC also conducts inspections on a particular subject or risk area across the banking sector.
21. Supervisory reporting	Supervisory reporting is fully satisfactory. The standard quarterly prudential return includes on- and off-balance sheet assets and liabilities; profit and loss; capital adequacy; liquidity; large exposures; asset concentrations; asset quality; loan loss provisioning; interest rate risk; and market risk.
22. Accounting and disclosure	Banks maintain a high level of accounting. In most cases, international accounting standards are followed by registered banks and these utilize generally accepted valuation rules. However, implementation of disclosure standards by banks can be variable. Presentation of aggregate information on Jersey's banking system is limited to schedules of outstanding deposits, categorized by currency and source, and published quarterly.
23. Corrective and remedial powers of supervisors	The authorities enjoy a wide range of corrective and remedial powers, which they have exercised when the occasion has demanded.
24. Consolidated supervision	The JFSC has the necessary powers to conduct consolidated supervision. All activities of banks are considered in advance of, and discussed during, on-site inspections, including investment business, TCB, fund services business, insurance business, and non-regulated activities. Given the structure of the banking system, the JFSC is not responsible for the consolidated supervision of any banking groups. The JFSC actively supervises the overseas activities of banks incorporated on the island, in cooperation with relevant host supervisors.
25. Home-host relationships	The JFSC actively pursues constructive cooperative relationships with home supervisors. The JFSC has in place a significant number of MOUs. The JFSC maintains contact with "home" supervisors (and "host" supervisors where the JFSC acts as a quasi-"home" regulator) to remain current with relevant regulatory and prudential issues. The JFSC formally writes to the home regulator of every Jersey-registered deposit taker on an annual basis, inter alia, in order to: give the home regulator an indication of the JFSC's view of the bank, and invite the home regulator to provide input in respect of the wider group. The JFSC hosts inspections from home supervisors. However, the JFSC cannot guaranty that home supervisors will inform it promptly of emerging strains.

Recommended action plan and authorities' response

Recommended action plan

Table 11. Recommended Action Plan to Improve Compliance with the Basel Core Principles[16]

CP1(1)	The JFSC should publish statistics and a commentary on the performance of the Jersey banking system as a whole. The JFSC should place greater emphasis on registered persons having available for access by the public either summarized or audited financial statements.
CP1(2)	Schedule 1 (Financial Services Commission (Jersey) Law 1998 (JFSC(J)L) should provide an explicit requirement that the reasons for the dismissal from office of a Commissioner be made public.
CP6	With regard to public disclosure, it would be constructive for the JFSC to require any registered person to display prominently in its premises and in applicable promotional documentation a uniform notice informing the reader of the status of their deposits in Jersey-registered banks in so far as any guarantees, compensation or an insurance scheme apply.
CP7	The JFSC should consider establishing a more formal process to observe developments at a parent company or the head office level and within the home jurisdiction of the group. The JFSC should consider inserting a provision into Principle 3 of the Banking Codes under Paragraph 3.1.4.5 according to which any exceptions to established policies, processes and limits should be reported, and should receive the prompt attention of senior management and the board of a bank, where necessary. The JFSC should consider the explicit inclusion of minimum requirements on new product approval processes and procedures in Appendix I of the Banking Codes.
CP9	The JFSC should on a regular basis form its own view with regard to the necessary assessment of the adequacy of a bank's provisioning policies and processes, and should also approach banks, parent institutions and the respective home supervisors in order to confirm so far as possible the adequacy of the provisioning policy.
CP10	The JFSC should consider having only one single definition of the term "exposure" in the large exposure and concentration risk context. The general exemption of inter-bank loans or placements, certificates of deposit or similar instruments issued by a bank with a maturity of one year or less from concentration risk regulation should be reconsidered. The JFSC should decide on a regular basis whether or not an exemption for large exposures granted should be renewed.
CP11	The regulation of exposures entered into in the inter-bank market and, as it is predominantly the case in this jurisdiction, to related parties, should be reconsidered. Also, the JFSC should review these requirements with a view to ensuring that they cover all transactions with related parties, for example, all kinds of investments, placement of deposits, and capitalization. The JFSC should enlarge the scope, and increase the frequency of its regular review of the status and financial condition of parent companies of local subsidiaries, including through an explicit need for the JFSC to consider whether the exemption of group related exposures from the concentration risk requirements applicable could be renewed. In the case of banks that are subsidiaries, the JFSC may wish to consider requiring receipt of a letter of comfort from parent companies more frequently than every five years (perhaps annually).

[16] Note that several recommendations are included under CPs that are assessed as fully compliant.

	The JFSC should consider including in Appendix I, Paragraph 1.5, of the Banking Codes an explicit provision according to which policies and procedures ensure that all material concentrations should be reviewed and reported periodically to the board.
CP12	The JFSC could incorporate explicit questions with regard to transfer and country risk in its "route planners" and introduce it also as a separate topic for the "Annual Review Meeting."
CP13	The JFSC should consider introducing key requirements for the regulation of market risk into Appendix I of the Banking Codes; e.g., requirements related to foreign currency and interest rate risks and the capital charges applied with regard to different risk types.
CP14	The Banking Codes should include appropriate policies and procedures to limit liquidity risk, and foresee the conduct of a regular analysis of funding requirements under alternative scenarios/stress tests. Furthermore, liquidity risk provisions of Appendix I of the Banking Codes should take into account the degree of diversification of funding sources and the necessary review of concentration limits (which were yet to be established at the time of the assessment; see CP 10 and 11). Standardized questions with regard to those topics should also be formulated and integrated into the route planner. The JFSC should also consider incorporating the maximum mismatch limits from the Liquidity Management and Reporting Guidance Notes into Appendix I of the Banking Codes. Given the recent market turmoil, the JFSC should review its liquidity regulations and guidance delivered to banks with a view of taking into account the new paper on liquidity management and supervision published in September 2008 by the Basel Committee.
CP15	The JFSC should consider including the standard definition of operational risk explicitly under Paragraph 4.1 of Appendix I of the Banking Codes.
CP16	The JFSC should introduce into the route planner, a separate section of specific questions dealing with interest rate risk generally and interest rates in the banking book, and should also take into due regard such questions as the price sensitivity of banking book items and their respective volumes.
CP19	The JFSC should devote more effort to assessing risks affecting the financial system as a whole, including through the undertaking of aggregate stress testing and the examination of the distribution of financial soundness indicators.
CP22	The JFSC should publish statistics and a commentary on the performance of the Jersey banking system as a whole. The JFSC should place greater emphasis on registered persons having available for access by the public either summarized or audited financial statements. Bilateral discussions with external auditors should be held more regularly.
CP25	The JFSC should strive to obtain regularly from home supervisors a written statement indicating whether they have any knowledge of any significant problems of which the JFSC should be aware. The JFSC should strive to obtain from home supervisors a commitment to communicate promptly and on their initiative information that is critical to the stability of the Jersey financial system.

Authorities' response to the assessment

80. The Commission acknowledges with gratitude all aspects of this assessment and is committed to fully considering the recommendations made.

B. Assessment of Observance of the Insurance Core Principles

81. **Insurance regulation in Jersey broadly meets international standards.** There is only a small number of locally incorporated, mostly specialist insurance companies, but many more companies incorporated abroad are licensed to sell insurance into Jersey on a cross-border basis or through branches. Insurance regulation has been strengthened since the 2003 IMF assessment. The JFSC has expanded its supervisory resources and undertaken on-site visits to most insurers. Extensive codes of practice have been introduced. There are some gaps in the regulatory framework, particularly in relation to controllers of insurers, risk management (especially operational risk), groups (though JFSC has no insurance group responsibilities at present) and disclosure requirements.

Introduction

82. **This assessment of Jersey's compliance with IAIS ICP was carried out as part of the 2008 FSAP Update Mission.** It updates and replaces the assessment conducted in 2002 (published in 2003) in the context of the OFC assessment of the island.

Information and methodology used for the assessment

83. **The assessment was made based on information available in November 2008 at the time of the FSAP Update mission**. The authorities contributed a full self-assessment and further information in response to a pre-mission questionnaire. Full documentation, including all relevant laws and regulations, was supplied. The assessment took account of discussions with the JFSC in the course of the mission as well as meetings with government, insurance companies, managers of insurance companies, local representatives of the accountancy profession, and a representative of a major audit practice. The assessor is grateful for the full cooperation extended by all.

84. **The assessment was based on the 2003 version of the IAIS ICP and Methodology.** It took into account relevant IAIS standards and guidance in addition to the ICPs. The assessment of ICP 28 (AML/CFT) was informed by the parallel assessment of Jersey's compliance with the FATF's AML/CFT recommendations, using the 2004 Methodology (see below for the respective ROSC).

Institutional and market structure—overview

85. **Jersey is one of the three British Crown Dependencies, the others being Guernsey and the IOM.** It is not part of the UK and has its own parliament (the States), legal and regulatory system, and tax regime. However, its economy is highly oriented toward that of the UK and uses the pound Sterling as its currency. Jersey is in a customs union with the EU for trade in goods.

86. **The Jersey economy has performed satisfactorily over the last decade, but some**

slowdown is currently expected in the context of the global financial turmoil and the slowing of the British economy. Annual economic growth averaged 3.8 percent over 2003-07 but has fluctuated considerably over the past decade because of variations in financial institutions' net value added, which depends on global financial market conditions. Current strains in these markets and especially lower interest rates, combined with lower growth in the UK economy generally, is expected to slow growth in the coming year. However, the nonfinancial economy tends to be quite stable. Unemployment is negligible, in part because of immigration restrictions put in place to limit population density.

87. **The basis of the economy is the financial sector.** The main activities are banking, fund management, and fiduciary services. The island is among the larger OFCs in the banking sector. There has been some decline in the number of financial institutions on the island, in large part due to consolidation and shifts in business models, but the volume of assets rose fairly steadily at least through mid-2008.

88. **The insurance sector in Jersey is underdeveloped, in relation to banking and investment businesses on the island and to the insurance sectors in Guernsey and the IOM.** While the authorities have in the past sought to attract international insurance business (for example, captive insurers/managers and international life), other offshore centers developed their insurance sectors earlier and have achieved the critical mass and competitive position that Jersey lacks. A large number of insurers are licensed by the JFSC, but the majority ("Category A firms") undertakes business on a cross-border basis using brokers to access the market and with no physical presence in Jersey. Some of the companies established on the island ("Category B firms") are now closed to new business or in the course of relocation. There is no data for overall market size.

89. **The JFSC is the sole regulator of insurance in Jersey**. It is a statutory body corporate consisting of a chairman and at least six other commissioners appointed by the States on the nomination of the minister for economic development. By convention, members of the States are not appointed commissioners. The composition of the JFSC commissioners has to secure a balance between the interests of providers of financial services, the users of such services, and the interests of the public. The JFSC has 108 staff in total.

90. **Jersey has its own companies legislation, but has no local accounting or actuarial standard setting bodies.** It looks to other jurisdictions, especially the UK, for its framework of accounting, auditing, and actuarial standards. Auditors of Jersey companies must be members of a professional body in the UK or Ireland. Financial statements of insurance companies have to be prepared in accordance with International Financial Reporting Standards (IFRS) or the Generally Accepted Accounting Principles (GAAP) of the UK, the United States (US) or, with the prior approval of the JFSC, "the country or territory in which the beneficial owner of the permit holder resides or is incorporated." Life insurers have to appoint as actuary either a Fellow of the Institute of Actuaries in England and Wales or a

Fellow of the Faculty of Actuaries in Scotland or someone who can satisfy the JFSC that he has “such actuarial qualifications and experience as are appropriate.”

91. **The impact of global credit and liquidity problems on Jersey insurers (Category B) has been limited, reflecting the nature and scale of their activities**. There have been no significant losses. Impacts will be indirect, for example, through reduced interest in the use of Jersey registered insurers by fund managers that wish to establish special purpose vehicles holding investment instruments and which have an insurance element. All Category B firms maintain solvency cover well in excess of their minimum required margins.

Main findings

92. **Insurance regulation has been strengthened since the 2003 assessment.** While the sector (Category B firms) has been contracting in this period, the JFSC has expanded supervisory resources, applied its general risk assessment model, and undertaken on-site visits to all insurers. To maximize resources, some thematic work is outsourced, typically to large international audit firms. General insurance brokers were brought within regulation in 2005. Extensive Codes of Practice for Insurance Business (Insurance Codes) have been introduced, setting requirements for expectations of insurers in areas such as corporate governance and internal controls. One effect has been to align insurance regulation more closely to that of other regulated sectors including banking, although the legislative and regulatory frameworks remain distinct.

93. **There are some gaps in the basic regulatory framework which should be filled as opportunities arise.**

(i) Exemptions to the Insurance Business (Jersey) Law 1996 (IB(J)L) should be narrowed to bring under JFSC regulation one significant domestic insurer currently subject to a separate statute.

(ii) The IB(J)L should be amended to require potential shareholder controllers of insurance companies to seek the JFSC’s consent at the appropriate levels of control.

(iii) The Insurance Codes should be extended to include further provisions on risk management, including operational risk.

(iv) Requirements on insurance companies to disclose appropriate information to stakeholders should be introduced, taking into account the nature and scale of their insurance business.

94. **The JFSC has no specific powers in relation to group supervision.** Although the JFSC has no insurance group responsibilities at present, additional powers to gather information from group companies and a group solvency test could prove valuable in future.

95. **The JFSC would benefit from a review of the Category A regime (companies incorporated abroad).** Most Category A firms originate from the UK and other EU jurisdictions (97 percent) but there are also firms from South Africa and the US. The JFSC's approach, both on licensing and subsequent supervision, relies heavily on the home state regulator. This regime has served Jersey-based insurance consumers well. Furthermore, the JFSC should establish a framework for assessing where home state regulation is equivalent to its own approach and should apply appropriate regulations to the small number of companies operating as branches in Jersey rather than merely offering cross-border services.

Table 12. Summary Compliance with the Insurance Core Principles

Insurance Core Principle	Comments
ICP1 - Conditions for effective insurance supervision	Jersey has well-defined, transparent and effective policy, legal and institutional frameworks for insurance business and access to well-functioning financial markets. The jurisdiction benefits from the availability of professional services locally and through access to the resources of major practices in the UK and elsewhere.
ICP2 - Supervisory objectives	The JFSC has clear and appropriate objectives (expressed as functions and guiding principles) and there is a clear distinction between regulation and promotion of the insurance sector.
ICP3 - Supervisory authority	The JFSC has adequate powers and resources and is operationally independent. The need for government to make regulations and orders covering key aspects of the regulatory requirements could in certain circumstances constrain the JFSC's ability to meet its regulatory objectives and could expose it to political influence. In practice, however, the JFSC enjoys a high degree of operational independence from government. Schedule 1 (Financial Services Commission (Jersey) Law 1998 (FSC(J)L)) should provide an explicit requirements that the reasons for the dismissal from office of any commissioner be made public.
ICP4 - Supervisory process	The JFSC conducts its functions in a transparent and accountable manner. Comprehensive information on its activities is provided to government, the States, and the public through various means. However, more information could be made available specifically on the insurance sector and regulatory activities for insurance
ICP5 – Supervisory cooperation and information sharing	The JFSC is committed to exchanging information with other supervisors, as evidenced by its readiness to become a signatory to the IAIS Multilateral MOU, and is doing so in practice in respect of both insurers and intermediaries. It is rightly focusing on developing its contacts with overseas regulatory agencies with the most importance to its market, particularly the UK.
ICP6 – Licensing	There is a comprehensive framework for the licensing of insurance business as defined by the IB(J)L. However, one general insurance business with significant domestic business is exempted from licensing requirements in Jersey. While in licensing a foreign insurer (a Category A firm), the JFSC must satisfy itself that the regulatory framework in the home state is "adequate", the JFSC has not developed an internal policy for making such an assessment (e.g., is equivalence considered). Category A insurers include a small number of firms with physical presences in Jersey, i.e., branches. The JFSC should review its approach to these firms to implement regulation that reflects their branch status.
ICP7 – Suitability of persons	The JFSC has a comprehensive framework for considering the suitability of key functionaries. The range of functionaries subject to these requirements is limited compared with some jurisdictions, but is adequate to enable the JFSC to properly assess the suitability of those persons with the main influence on compliance. The JFSC could consider whether it would find it useful to have an explicit provision preventing a person holding two positions in a company with potential for conflict of interest. It has adequate powers to identify and address such conflicts where they arise in practice.
ICP8 – Changes in control and portfolio transfers	The IB(J)L provides a framework for the regulation of changes in control and portfolio transfers. However, there is a gap in respect to changes in control—the

Insurance Core Principle	Comments
	IB(J)L does not place obligations directly on controllers to seek approval and shareholder controllers are not required to notify or seek approval for increases above predetermined control levels, even though in practice the requirements on firms to make notifications should enable the JFSC to identify and deal with most changes of control effectively.
ICP9 – Corporate governance	The JFSC has developed a comprehensive set of requirements for corporate governance in its Insurance Codes.
ICP10 – Internal controls	The JFSC has developed a comprehensive set of requirements for internal controls in its Insurance Codes.
ICP11 – Market analysis	The JFSC monitors the activities of licensed firms and wider market developments—taking into account the limited business conducted in Jersey.
ICP12 – Reporting to supervisors and off-site monitoring	The JFSC has a well-developed process for analyzing annual returns and taking follow-up action. The JFSC by choice employs no qualified actuaries and the off-site work therefore relies on the UK Government Actuary's Department (GAD) for the analysis of the most technical issues. This relationship, which has now been in place for a number of years, functions effectively. Supervisory staff take responsibility for the communication and follow-up of issues at all stages of the process.
ICP13 - On-site inspection	The JFSC has greatly increased on-site work in the last 18 months using a well-structured approach to on-site work that links visit frequency and scope to the firm's risk rating and the wider supervisory program. The JFSC should develop the approach to include a thematic visit program—which may be most useful for intermediaries given the diverse nature of the insurance sector. It should also apply the model to branches (i.e., Category A firms with physical presences on the island).
ICP14 - Preventive and corrective measures	The JFSC's approach is informed by its ability to communicate regularly with the small number of authorized insurance companies. This makes it easy to address concerns in the first instance through supervisory dialogue and discussion. However, the JFSC also has powers that it has used in practice to make more formal requirements of firms in the event of actual or expected concerns.
ICP15 - Enforcement or sanctions	The insurance regulatory framework includes extensive formal enforcement powers—many can be exercised directly by the JFSC, others require application to the Royal Court and the imposition of fines requires court proceedings. The JFSC rarely uses its powers in practice—reflecting the limited insurance business on the island and the results it has been able to achieve through preventive and corrective measures before a resort to formal action. The JFSC has taken enforcement action in other sectors under similar powers to those available for insurance business.
ICP16 - Winding-up or exit from the market	The framework clearly provides for appropriate routes for orderly exit and sets out the procedures for dealing with insolvency, including through transfer of policies to another insurer. The insolvency framework has not been tested in practice as no insurer has failed nor has the JFSC ever sought a winding up.
ICP17 - Group-wide supervision	The JFSC currently has no responsibilities as group/home supervisor of any insurance group. Its current framework lacks key elements of the approach it would need were it to acquire such responsibilities, particularly a group solvency test. The JFSC should be able to adopt the necessary requirements and apply them via its directions and conditions powers, were the need to arise.
ICP18 - Risk assessment and management	The JFSC has requirements for risk assessment and risk management in its Insurance Codes. The provisions applying to risk management are relatively limited and could be expanded, for example to set out the need for insurers to have a statement of risk appetite and to be able to assess, monitor and manage operational as well as other risks.
ICP19 - Insurance activity	The JFSC has adequate powers and procedures to require insurance companies to have the tools necessary to price business and manage insurance risks effectively.
ICP20 - Liabilities	The JFSC has no framework of requirements for the establishment of adequate provisions and valuation of amounts recoverable under reinsurance. Instead, it requires firms to use international standards—and normally those of the UK. Given the currently limited range of insurance business in the island—and limited

Insurance Core Principle	Comments
	insurance risks—such an approach is practical and efficient. In addition the JFSC makes use of external actuarial support (GAD) to review the adequacy of individual firms' provisions.
ICP21 - Investments	The JFSC has an adequate framework of requirements on insurers' investments in the IB(J)L, Orders and Insurance Codes. To be fully effective, these requirements need to be enforced by adequate supervision and enforcement—and through periodic exercises such as stress-testing and thematic visit programs. The JFSC should continue to monitor compliance with its requirements in the course of its on-site work in particular.
ICP22 - Derivatives and similar commitments	Given the limited scope of their insurance business, the use of derivatives by insurers in Jersey is low. The JFSC has ensured that the Insurance Codes include the key requirements for derivatives business. In practice, it adopts a tailored approach to the supervision of derivatives risks, allowing firms to use derivatives on a case by case basis. This is appropriate given the nature of the Jersey insurance sector.
ICP23 - Capital adequacy and solvency	The JFSC has an appropriate framework of solvency regulations and processes to monitor solvency levels and to respond to breaches of minimum requirements. However, it should consider whether reliance on the EU Solvency I framework is appropriate. Many other jurisdictions have strengthened their requirements pending developments in international standards.
ICP24 - Intermediaries	The JFSC has a comprehensive framework for the regulation of insurance intermediaries. While the regulation is carried out under different laws and requirements from those applying to insurance companies, the JFSC has equivalent powers, including for enforcement of its requirements.
ICP25 - Consumer protection	The JFSC has a well-developed set of requirements on market conduct, applying to both insurers and intermediaries and, with the exception of Category A firms, assesses the issues in its supervisory work. While Jersey insurers are writing little new business, the JFSC could review its approach to consumer protection issues in firms closed to new business.
ICP26 – Information, disclosure and transparency towards markets	The JFSC has no requirements on disclosure by insurance companies of any of the information specified in this ICP. While for a number of Category B firms, such disclosure would have limited value or would be inappropriate given the nature of the business, one firm has significant numbers of policyholders and some are open to new business.
ICP27 - Fraud	The JFSC has a range of powers to require that insurance companies address fraud risks and it covers the issues in its risk assessment of firms and in its supervisory work. It should consider including in the Insurance Codes some requirements that specifically address the need for insurers to allocate resources and have effective procedures and controls to deter, detect, record, and report fraud.
ICP28 - Anti-money-laundering, combating the financing of terrorism	The JFSC has a well-developed set of requirements and includes AML issues in on-site supervision work. See also the IMF's assessment, carried out in November 2008, of compliance with the FATF AML/CFT standards, using the 2004 Methodology.

Recommended action plan and authorities' response

Recommended action plan

Table 13. Recommended Action Plan to Improve Observance of the Insurance Core Principles

Principle	Recommended Action
ICP3 - Supervisory authority	Schedule 1 of the FSC(J)L should be amended to provide an explicit requirement that the reasons for the dismissal from office of any commissioner be made public.
ICP6 - Licensing	The scope of exemptions from the IB(J)L needs to be narrowed so that all insurers are required to be licensed and are subject to JFSC supervision. The JFSC should develop an internal policy on the assessment of whether regulation by the home state regulators of Category A firms is equivalent to that of the JFSC. The JFSC should review its approach to the regulation of Category A firms with a presence in the island—these should be regulated as branches.
ICP8 – Changes in control and portfolio transfers	The IB(J)L should be amended to require potential shareholder controllers of insurance companies to seek the JFSC's consent at the appropriate levels of control.
ICP13 - On-site inspection	The JFSC should apply its risk model to branches, i.e., Category A firms with physical presences on the island—and undertake on-site work as justified by its assessment of the risks. It should introduce a thematic (cross-firm) approach to its supervisory work.
ICP17 - Group-wide supervision	The JFSC should review whether, in the event that it were ever to take on group/home supervisory responsibilities, it would have adequate powers and policies. Opportunities to amend the legislation could be taken, for example to give the JFSC powers to obtain information from unregulated entities within a group.
ICP 18 – Risk assessment and management	The JFSC should develop further requirements on risk management, for example setting out the need for insurers to have a statement of risk appetite and to be able to assess, monitor and manage operational risk.
ICP 23 - Capital adequacy and solvency	The JFSC should continue to monitor the development of international standards for risk based solvency. Pending the introduction of these new standards, the JFSC should review its existing solvency requirements and, where appropriate, introduce revised standards or set individual minimum requirements based on the risk assessment of each firm.
ICP26 - Disclosure and Transparency	The JFSC should work with insurers to develop disclosure requirements, taking into account the nature of insurance business conducted by firms incorporated on the island, and taking a view on which insurers to apply them to, for example, whether they should apply to the small number of Category A insurers with physical presence on the island. The JFSC could also consider publishing all or part of its supervisory returns itself.

Authorities' Response to the Assessment

96. **The JFSC is pleased to note that the IMF assessment of Jersey's compliance with the 28 IAIS Core Principles acknowledges that insurance regulation in Jersey has been strengthened since the 2003 assessment.** That earlier assessment rated Jersey as "observed" or "broadly observed" with respect to the previous 17 IAIS Core Principles. The JFSC also appreciates the open and productive nature of the meetings held during the IMF assessment and of the subsequent dialogue held.

97. **The JFSC has considered the IMF report and the recommendations made, with which it is in broad agreement.** It has prepared an action plan to address each of the recommendations, albeit without losing sight of the very limited nature of the Jersey insurance market. For example, the recommendation (ICP 26) relating to disclosure requirements will be developed in the context of the specialized nature of the local market. In some instances the action plan involves amending legislation to incorporate explicit provisions that reflect the current practices of the JFSC.

98. **The JFSC will continue to consider developments in international standards for insurance regulation and intends to continue with its approach of seeking to incorporate these in its regulatory requirements.**

C. FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

A. Introduction

99. This Report on the Observance of Standards and Codes (ROSC) for the FATF 40 Recommendations for Anti-Money Laundering (AML) and 9 Special Recommendations for Combating the Financing of Terrorism (CFT) was prepared by staff of the IMF. The report provides a summary of the AML/CFT measures in place in Jersey and of the level of compliance with the FATF Recommendations, and contains recommendations on how the system could be strengthened. The assessment was conducted using the 2004 Methodology and is based on the information available at the time it was completed on November 13, 2008, or shortly thereafter. The Detailed Assessment Report on which this ROSC is based has been agreed with the Jersey authorities. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the authorities of Jersey or the Executive Board of the IMF.

B. Key Findings

100. Financial services is a key sector of Jersey's economy accounting for approximately half of the total economic activity and a quarter of the workforce (approximately 13,400 employed). The banking, fund administration, and trust company sectors dominate, supported by extensive legal and accountancy practices. Financial services expertise and international reputation have been significant in attracting business to Jersey, as has the close working relationship with the UK financial system and the availability of favorable tax arrangements in a developed, stable, and well-regulated jurisdiction.

101. A substantial proportion (believed to be around 90 percent in some sectors) of customer relationships is established with nonresidents. Arising from the nature of services provided and the typically nonresident, non-face-to-face nature of much of the client relationships, Jersey's financial sector is inherently exposed to the risk of money laundering, particularly in the layering and integration phases. No particular vulnerability to terrorism financing (FT) was noted.

102. Jersey has put in place a comprehensive and robust AML/CFT legal framework with a high level of compliance with almost all aspects of the FATF Recommendations. The key elements were first introduced in the 1980s and have been kept updated, most substantially in the last two years to reflect the 2003 revision of the FATF Recommendations, in parallel with the implementation by EU member states of the EU Third AML Directive.

103. Both money laundering (ML) and financing of terrorism (FT) are criminalized largely in line with the international standard and Jersey has implemented the provisions effectively. With respect to both offences, however, some technical shortcomings have been identified

that may limit somewhat the scope of criminal confiscation and the effectiveness of procedures for freezing of terrorist assets.

104. The Joint Financial Crime Unit (JFCU) carries out the role of a financial intelligence unit effectively and is benefiting from an increase in its resources. The JFCU receives a satisfactory flow of suspicious activity reports (SARs), mostly from banks and trust businesses (TCBs). Overall, there is scope to improve the timeliness of SAR submission and to increase the range of types of entities submitting SARs. Once the JFCU receives a SAR, it can consent or not to the financial activity that gave rise to the SAR. Nonconsent has the same effect as a freezing order.

105. Jersey has adopted a risk-based approach to AML/CFT at all levels–in determining the scope of AML/CFT requirements, in designing implementation measures, and in supervision. There is a high level of awareness of AML/CFT risks and requirements across the financial sector.

106. Jersey has a high level of compliance with the FATF Recommendations on preventive measures, with most deficiencies noted being technical in nature. CDD requirements for legal entities, trusts, and politically exposed persons (PEPs) largely comply with the international standard. One material issue relates to the extent of the concessions allowed to financial institutions and certain DNFBPs to rely on intermediaries and introducers in conducting CDD. While mostly valid in principle, the concessions do not comply fully with the international standard. The resultant increase in risk is partially mitigated by strong JFSC supervision.

107. AML/CFT requirements for DNFBPs are largely the same as those applied to financial institutions. With the exception of trust company businesses, for which regulatory controls were well established and robust, AML/CFT measures for some DNFBP business were too recent to permit a realistic assessment of the effectiveness of implementation.

108. The JFSC is an effective regulator and supervisor for financial institutions and TCBs in Jersey and its AML/CFT role has been extended to include all other DNFBPs and money service businesses. Arising from its program of on-site inspections, many financial institutions and TCBs were required to implement CDD remedial measures. The range of available sanctions was found to be largely effective, proportionate, and dissuasive, but could be enhanced by providing the JFSC with the power to apply monetary fines.

109. With mandatory registration with the Registrar of Companies, Jersey has measures in place to obtain, maintain, and verify beneficial ownership information for companies, of which more than 34,000 were registered, most being private companies. Trusts have long been established in Jersey but no statistics are maintained on their number. Although trusts are not subject to any registration requirements, acting as a trustee is (with a few exceptions) a regulated activity and is subject to AML/CFT requirements, including to obtain, maintain, and verify beneficial ownership information.

110. Day-to-day cooperation on AML/CFT issues between the domestic authorities is close and effective. The Jersey authorities established in 2007 an AML/CFT Strategy Group to, inter alia, coordinate policy in implementing the FATF Recommendations.

111. At the international level, the legal framework for mutual legal assistance (MLA) and extradition is largely in place and effective. The JFCU is an active member of the Egmont Group and frequently exchanges information with other financial intelligence units. The JFSC is active in international cooperation and in a position to share information subject to appropriate safeguards. There is no statutory banking secrecy provision.

C. Legal Systems and Related Institutional Measures

112. Both ML and FT are criminalized largely in line with the international standard. All relevant offences under the standard are criminalized. However, the offences of acquisition, possession, or use do not extend to self-laundering and the scope of the offences of "concealing or disguising" and "converting or transferring" is not sufficiently wide due to the requirement that these acts are carried out with the purpose of avoiding a prosecution for a predicate offence. For terrorism-related ML, not all elements of the ML provisions of the Palermo and Vienna Conventions are covered. The FT offence does not extend to all offences under the FT Convention. These omissions also impact to some extent on the scope of criminal confiscation. Some further steps are needed to improve the effectiveness of procedures relating to requests for freezing of terrorist assets.

113. Jersey's implementation of UNSCRs 1267 and 1373 is largely sufficient but attention should be given to procedures governing the receipt and assessment of foreign requests and to providing greater clarity regarding coverage of assets that are jointly or indirectly owned or controlled.

114. The JFCU–a joint police/customs unit–carries out the role of a financial intelligence unit effectively. The assessors welcomed the decision of the authorities to provide the JFCU with additional resources to deal with its expanding workload and allow it to provide additional guidance to reporting entities and improve its statistical database. Most of the SARs are received from banks or TCBs. Once the JFCU receives a SAR, it can either consent to the financial activity mentioned in the SAR or not. The effect of a consent may be to provide a defense against a potential charge of money laundering. Conversely, the absence of a consent inhibits the service provider from completing any financial service for the customer for fear of committing a money laundering offense, which has the same effect as a freezing order. Of course, it could also expose the reporting institution to potential litigation from the affected customer.

115. The legal framework for the investigation and prosecution of ML and FT offences operates effectively. The resource constraints affecting the JFCU had impacted on their capacity to conclude investigations and, by extension, on the development of cases for prosecution. It is clear from the statistics, however, that the AG is quite prepared to pursue

ML-related cases and prosecute them in the Jersey Courts. In the period 2005-08, there were 12 relevant prosecutions, of which 10 resulted in a conviction for ML, and a substantial amount of funds was seized and confiscated. Jersey introduced a disclosure system for cross-border currency movements in January 2009 in line with the international standard but, as this occurred post-assessment, it was not possible to assess its effectiveness.

D. Preventive Measures—Financial Institutions

116. The primary legislative foundation for customer due diligence (CDD) and other preventive measures is the Proceeds of Crime (Jersey) Law 1999 (POCL), which defines ML to also include FT offences. The specific requirements are set out in detail in secondary legislation in the Money Laundering (Jersey) Order 2008 (MLO). This is supplemented by a Handbook issued by the JFSC in 2008 which includes further requirements (which qualify as other enforceable means (OEM) for purposes of the assessment), as well as additional guidance. The updating of the requirements in 2008 followed extensive consultations with industry and sought to address the detail of the international standard.

117. Jersey's CDD requirements comply with the FATF Recommendations in most respects and the deficiencies identified during the assessment are largely technical. A more material issue relates to the extent of the concessions allowed to financial institutions and certain DNFBPs to rely on intermediaries and introducers in conducting CDD; while valid in principle, the concessions are an overly-generous interpretation of the international standard and may increase the risk of abuse in some respects. However, the assessors noted that compliance with Jersey's CDD requirements was being tested by the JFSC through on-site inspections and that, in availing of the concessions, at least some reporting institutions applied additional controls in practice.

118. Customers and ultimate beneficial owners are required to be identified in all relevant cases (subject to the concessions mentioned above). Detailed CDD requirements apply to legal entities and trusts and enhanced due diligence is required for higher-risk customers, including PEPs. Records of customer identification and of transactions must be retained for at least five years. All suspicious activity in relation to ML or FT is required to be reported to the JFCU.

119. While the volume of SARs reported to the JFCU appeared satisfactory, there is some scope to improve the timeliness of reporting. Banks and TCBs accounted for the bulk of the reported SARs, although efforts were being made to encourage other reporting entities to increase filing rates. The legal protection for those filing should be limited to those acting in good faith and the tipping-off offence needs to be broadened to comply with the international standard. There was no requirement for financial institutions to have an independent audit function to test for AML/CFT compliance.

120. Implementation of AML/CFT measures by Jersey financial institutions is generally strong. The assessors found a high level of awareness of AML/CFT risks and requirements

during their discussions both with the authorities and the private sector, including banks and other financial institutions, trust company businesses, lawyers, and accountants.

121. The JFSC has demonstrated that it is an effective regulator and supervisor for financial institutions and TCBs in Jersey and, for AML/CFT purposes, its role was extended in 2007 to cover money service business and in 2008 to include the remainder of the DNFBPs–in particular lawyers and accountants. In addition to taking a leading role in consultation and outreach, the JFSC has been delivering an active program of on-site inspections, including for AML/CFT. Many financial institutions and TCBs had been required to implement remedial measures to bring their CDD information, including on beneficial owners, into line with the latest requirements. While implementation in some TCBs was found to be effective, serious deficiencies identified in others have resulted in sanctions, including termination of businesses in Jersey in some cases. The range of available sanctions was found to be largely effective, proportionate, and dissuasive, but could be enhanced by providing the JFSC with the power to apply monetary fines.

E. Preventive Measures— Designated Nonfinancial Businesses and Professions

122. CDD obligations for DNFBPs are largely the same as for financial institutions. Trust company business is defined as a "financial service business" and has been supervised with increasing rigor by the JFSC since it was first brought within its ambit in 2000. As a strong proponent of international regulation of trust businesses, Jersey has been to the fore in seeking to develop international standards in this area and to implement effective measures domestically. As trust and corporate-related business may represent the highest overall reputational risk to Jersey's financial services sector, it is important that the close monitoring is continued.

123. With the extension in the scope of AML/CFT requirements in 2008 to include the remaining DNFBPs, Jersey is well placed to achieve full compliance with the international standard. Lawyers and (to a lesser extent) accountants in Jersey are heavily engaged in providing trust, investment, and wealth-management services, mainly to nonresident clients and have been subject to prudential oversight in respect of these activities for some time. However, as they (in respect of auditing, accounting, and legal services) and other DNFBPs (estate agents, high value dealers) have only recently become subject to AML/CFT oversight in respect of DNFBP activities, the effectiveness of implementation could not be fully tested at the time of the assessment. The JFSC has established an AML unit to address the new areas of responsibility. While it is too soon to fully assess the unit's effectiveness, initial progress appears positive and additional resources might be warranted as the work expands. There are no casinos in Jersey, though, as a result of a recent change in the law, some support services could be based there in future.

F. Legal Persons and Arrangements & Non-Profit Organizations

124. Company registration and the establishment of trusts are significant activities in Jersey and are subject to strong AML/CFT requirements. Jersey law allows for the incorporation of public and private companies and limited liability partnerships (LLPs), subject to registration with the Registrar of Companies. Close to 34,000 companies were registered at the time of the assessment, a large majority being private companies. All information from the companies' register is publicly available, including online. Pursuant to the Control of Borrowing (Jersey) Order 1958 (COBO), beneficial ownership information must be provided to the JFSC in respect of all registered companies. This information is not publicly available but may be accessed by court order. In addition, Jersey requires its TCBs to obtain, verify, and retain beneficial ownership information on client legal entities and the JFSC monitors compliance with this requirement.

125. Jersey trusts, which are widely used, are legal arrangements governed by the Trusts (Jersey) Law 1984. They are highly flexible and allow for the settlor to maintain, through a range of available mechanisms, significant influence over the trust property. Although there is no requirement for all trusts to be registered or to file information with a central authority, Jersey requires its TCBs to obtain, verify, and retain beneficial ownership information on client legal arrangements and the JFSC monitors compliance with this requirement. The JFSC has a wide range of powers to access any information and documentation held by registered TCBs and may require the production of information, the provision of answers to questions posed, and access to the premises of the supervised person. No statistics are maintained on the number of Jersey trust arrangements or the volume of trust assets administered in Jersey.

126. Non-profit organizations became subject from August 2008 to a requirement under the Non-Profit Organizations (Jersey) Law 2008 to register with the JFSC. Following the closing of the registration period in November 2008, the authorities should proceed to analyze the sector to seek to identify any FT vulnerability.

G. National and International Cooperation

127. The legal framework for mutual legal assistance (MLA) and extradition is largely in place and effective. More than 70 percent of MLA requests received were granted within three months. However, where dual criminality is required, the technical deficiencies in the ML and FT offenses may limit somewhat Jersey's ability to provide MLA, including in extradition cases.

128. The Jersey authorities established in 2007 an AML/CFT Strategy Group to coordinate policy in implementing the FATF Recommendations. Day-to-day cooperation between the domestic authorities is close and effective. Formal gateways are in place to facilitate exchange of information.

129. At the international level, the JFCU is an active member of the Egmont Group and frequently exchanges information with other financial intelligence units. The JFSC is active in international cooperation and shares information subject to appropriate safeguards. There is no statutory banking secrecy provision and information sharing is subject to the common law duty of client confidentiality.

130. While an assessment of taxation matters is not within the scope of this assessment, it is worth noting that Jersey has been among the pioneers of Tax Information Exchange Agreements (TIEAs). Jersey voluntarily applies measures equivalent to the EU Savings Tax Directive offering the option of using the retention tax approach. While tax evasion is not a separate statutory offense under Jersey law, such conduct could be (and has been) prosecuted as "serious fraud" and as such, constitutes a predicate offense for money laundering.

H. Other Issues

131. The level of resources allocated to AML/CFT matters appeared generally adequate, taking into account the decision by the authorities to approve additional resources for the JFCU. The AG and JFSC are in a position to acquire additional legal expertise on contract to handle increases in case-load. The resources of the JFSC may need to be increased somewhat to adequately cover its expanded areas of AML/CFT responsibility, while maintaining the level of AML/CFT supervision of financial institutions and TCBs.

132. Relevant statistics are generally available and well maintained, though the JFCU would need to develop its statistical collection system to demonstrate what action results from submitted SARs, particularly as its workload increases.

Table 14. Compliance Ratings and Recommendations to Improve the AML/CFT System

Compliant (C): the Recommendation is fully observed with respect to all essential criteria.
Largely compliant (LC): there are only minor shortcomings, with a large majority of the essential criteria being fully met.
Partially compliant (PC): the country has taken some substantive action and complies with some of the essential criteria.
Non-compliant (NC): there are major shortcomings, with a large majority of the essential criteria not being met.
Not applicable (NA): a requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country.

FATF 40+9 Recommendations and Ratings	Assessor Recommendations
Legal System & Related Institutional Measures	
Criminalization of Money Laundering **R.1 LC** **R.2 C**	• Amend Articles 34 of the POCL and 30 of the DTOL to: : provide for two alternative purposes for the acts of converting and transferring proceeds, namely to avoid prosecution for the predicate offense or to conceal the illicit origin of the funds, and; : to eliminate the purpose requirement for the acts of converting and transferring proceeds of crime. • The defense (payment of adequate consideration) provided for in Articles 33(2) of the POCL and 38(2) of the DTOL is not provided for in the Vienna and Palermo Conventions and should be eliminated as it may allow money launderers to abuse the provision to avoid criminal liability for the acquisition, possession, or use of criminal proceeds. • Amend Article 18 of the TL to cover all material elements of the money laundering provisions of the Palermo and Vienna Conventions. • Amend the offenses of acquisition, possession, or use of the POCL and DTOL, as well as the money laundering offense contained in the TL 2002 to include criminal proceeds obtained through the commission of a predicate offense by the self-launderer. • The authorities should assess whether the level of proof applied to show that property stems from the commission of a specific predicate offence poses a barrier to obtaining convictions for stand-alone money laundering.
Criminalization of Terrorist Financing **SR.II LC**	• Amend Article 2 of the TL to include a reference to international organizations. • Amend the definition of "terrorism" in Article 2 of the TL to extend to all terrorism offenses as defined in the nine Conventions and Protocols listed in the Annex to the FT Convention.
Confiscation, freezing, seizing of proceeds of crime **R.3 LC**	• Jersey's laws should be amended to address the deficiencies affecting the scope of the ML and FT offenses and thereby also improve the quality of the criminal confiscation regime. • Consideration should be given to providing for restraint of property and or its equivalent or corresponding value from the beginning of an investigation; • In the case of matters arising under the TL, there should be provision for the restraint and confiscation of property of corresponding value. • A more direct legal basis should be provided for the current 'informal freezing' or consent/nonconsent arrangement currently administered

	by the JFCU.
Freezing of funds used for terrorist financing **SR.III LC**	• The authorities should put in place a formal procedure governing the receipt and assessment of requests based on a foreign request to designate/freeze in order to comply with obligations under UNSCR 1373. • The legal framework implementing the UN Resolutions should be amended to expressly extend the definition of 'funds' subject to freezing to cover assets 'jointly' or 'indirectly' owned or controlled by the relevant persons. • The authorities should develop procedures to assess the effectiveness of their program to implement the UNSCRs and keep statistics regarding implementation.
The Financial Intelligence Unit and its functions **R.26 LC**	• The Intelligence Wing of the JFCU should be adequately staffed to perform its functions effectively. • The JFCU should issue periodic reports including statistics, typologies and trends and information on its activities. • The JFCU should maintain comprehensive statistics on the work of the Intelligence Wing on matters relevant to the effectiveness and efficiency of systems for combating ML and FT.
Law enforcement, prosecution and other competent authorities **R.27 LC** **R.28 C**	• The authorities should implement steps to improve effectiveness by seeking to increase investigative resources. • Competent authorities should maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of systems for combating ML and FT.
Cross Border Declaration or disclosure **SR.IX LC**	• Jersey should proceed with its implementation of the newly-established disclosure system to detect the physical cross-border transportation of currency and bearer negotiable instruments that are related to money laundering and terrorist financing.
Preventive Measures: Financial Institutions	
Customer due diligence, including enhanced or reduced measures **R.5 PC** **R.6 LC** **R.7 C** **R.8 LC**	R.5 • The authorities should conduct a risk-based review of the current scope of the concessions allowing reliance on third parties to conduct CDD and limit their availability to be strictly consistent with the FATF Recommendations. • Should the authorities decide to continue allowing source of funds to be used as a principal basis for verification of identity in certain low-risk circumstances, the requirements should be tightened further to eliminate any remaining risk of abuse for ML or FT purposes. • The authorities should review the permitted exemptions from CDD measures in Article 18 of the MLO to ensure that financial institutions must determine that the customer's country of residence is in compliance with and has effectively implemented the FATF standards. • The authorities should amend their requirements to ensure that all concessions from conducting full identification measures are conditioned on the absence of specific higher-risk scenarios. • The authorities should expand the current list of categories of higher-risk customers in the MLO to which enhanced CDD must be applied and consider including, for example, private banking and nonresident customers. • The JFSC should conduct a risk-based review of the use by

	relevant persons of the scope to defer completion of full identification requirements under Article 13(4) of the MLO and issue further guidance as needed to limit the practice. • The authorities should amend the CDD requirements and guidance as necessary to ensure that, in addition to trusts, all other forms of legal arrangement are addressed adequately and consistently. • The authorities should amend their requirements to clarify that, when utilizing the concession permitting an employee of a relevant person to act on behalf of its customer, the relevant person must verify the employee's authority to so act. R.6 • The JFSC should, including through its on-site examination program, continue to seek effective implementation by financial institutions of the latest CDD requirements for PEPs. R.8 • The authorities should issue more detailed guidance on the specific ML and FT risks of new and developing technologies, including for example in relation to e-money and e-commerce.
Third parties and introduced business **R.9 PC**	• The authorities should explicitly require that a relevant person must obtain all necessary CDD information from the intermediary or introducer immediately and should consider requiring relevant persons to perform spot-testing of an intermediary or introducer's performance of CDD obligations. • The authorities should limit the concession allowing financial institutions to rely on intermediaries or introducers to conduct CDD in the following cases: - intermediaries or introducers outside Jersey that could be legally restricted in providing CDD evidence to Jersey institutions; - certain domestic DNFBPs until newly-introduced AML/CFT requirements have been fully implemented. • The authorities should eliminate the concession in the Handbook for Regulated Businesses permitting reliance on an intermediary or introducer that is a group member not itself subject to, nor supervised for compliance with, CDD requirements compliant with Recommendation 5.
Financial institution secrecy or confidentiality **R.4 LC**	• Provide explicitly that financial institutions do not breach their confidentiality duty in exchanging customer information between themselves for AML/CFT purposes.
Record keeping and wire transfer rules **R.10 C** **SR.VII LC**	SR.VII • The authorities should take steps to ensure a stricter approach by Jersey financial institutions when dealing with incoming wire transfers that lack originator information.
Monitoring of transactions and relationships **R.11 C** **R.21 LC**	• The authorities should amend the power to apply countermeasures to remove the limitation tying it to the actions of the FATF.
Suspicious transaction reports and other reporting **R.13 LC** **R.14 PC** **R.19 C**	R.13 / SR.IV • The JFCU and JFSC should consider steps to enhance the timeliness of reporting of suspicious transactions to the JFCU. R.14 • The law should be amended to limit protection for those reporting suspicious transactions to those acting in good faith.

R.25 C **SR.IV LC**	• The tipping-off offense should be broadened by removing the limitation referring to situations that might prejudice an investigation.
Internal controls, compliance, audit and foreign branches **R.15 LC** **R.22 LC**	R.15 • The authorities should introduce a requirement in law, regulation, or other enforceable means that, having regard to the size and nature of the business, financial institutions maintain an adequately resourced and independent audit function to test compliance with AML/CFT procedures. • The authorities should clarify that the current provisions for timely information access for compliance officers must include customer identification data and other CDD information, transaction records, and other relevant information, including where that documentation or information is held by third parties, in or outside Jersey. R.22 • The authorities should introduce a requirement in law, regulation, or other enforceable means for financial institutions to pay particular attention to the requirement to apply AML/CFT measures at least equivalent to those in Jersey in the cases of branches or subsidiaries in countries that do not or insufficiently apply the FATF Recommendations. • The authorities should introduce a requirement that financial institutions must apply consistent AML/CFT requirements at group level to customers doing business with different parts of the group.
Shell banks **R.18 C**	none
The supervisory and oversight system–competent authorities and SROs : Role, functions, duties and powers (including sanctions) **R.17 LC** **R.23 C** **R.25 C** **R.29 C**	R.17 • The authorities should consider expanding the range of sanctioning powers available to the JFSC to include monetary fines.
Money and value transfer services **SR.VI LC**	• The JFSC should sustain its training and onsite supervision to improve compliance for MSBs.
Preventive Measures: Non-Financial Businesses and Professions	
Customer due diligence and record-keeping **R.12 PC**	• The authorities should: -Remove the concession which allows lawyers to apply reduced or simplified CDD measures in cases where funds may only be received and paid to an account in a customer’s name. - Repeal the concession that allows lawyers and accountants to self-certify identification of existing clients. - Sustain close supervision of TCBs to improve compliance with CDD and record keeping requirements. • As lawyers, accountants, real estate agents, and high value dealers, gather experience with the new compliance arrangements, the authorities should continue with its program to evaluate the effectiveness of implementation by these sectors of their CDD

	requirements.
Suspicious transaction reporting **R.16 PC**	• The authorities should continue to conduct on-site monitoring of SAR reporting practices by lawyers, accountants, and estate agents.
Regulation, supervision, monitoring, and sanctions **R.17 LC** **R.24 LC**	• The JFSC should continue with testing implementation of AML/CFT requirements for all DNFBPs not previously subject to its supervision.
Other DNFBPs **R.20 C**	none
Legal Persons and Arrangements & Nonprofit Organizations	
Legal Persons and Arrangements: Access to beneficial ownership and control information **R.33 C** **R.34 LC**	• Even though the vast majority of trust arrangements are covered by the CDD requirements of the MLO**,** the authorities should further seek to put in place measures to ensure that accurate, complete, and current beneficial ownership information is available for legal arrangements administered by any trustees not covered by, or exempted from, the registration requirements under the POCL. • The authorities should put in place measures to ensure that beneficial ownership information is obtained, verified, and maintained for all general partnerships.
Nonprofit organizations **SR.VIII C**	• Based on registration information, the authorities should analyze the FT vulnerability of the NPO sector.
National & International Cooperation	
National Cooperation and Coordination **R.31 C**	none
The Conventions and UN Special Resolutions **R.35 LC** **SR.I LC**	• The authorities should ensure that all provisions of the Palermo and Vienna Conventions are fully implemented. • The authorities should ensure that all provisions of the United Nations International Convention for the Suppression of Financing of Terrorism are implemented. • Jersey should consider requesting extension of the remaining 10 international counter-terrorism related legal instruments.
Mutual Legal Assistance & Extradition **R.36 LC** **R.37 C** **R.38 LC** **R.39 LC** **SR.V LC**	• Amend the law to correct the deficiencies affecting the criminalization of ML and FT offenses, and thus facilitate full compliance with MLA requests related to seizure and confiscation and remove possible obstacles to complying with extradition requests where the dual criminality principle applies.
Other Forms of Cooperation **R.40 C**	none
Other relevant AML/CFT measures or issues	
Resources and Statistics **R.30 LC** **R.32 LC**	• Provide additional resources to the JFCU to deal with increasing workload. • The JFCU should develop its capacity to maintain relevant statistics on all aspects of SAR analysis and external cooperation.

I. Authorities' Response

133. Jersey was very pleased to welcome the IMF assessment team and to share openly with it what the Island has done since 2003 to protect the jurisdiction from being used for money laundering and the financing of terrorism.

134. It is pleasing to note that the report confirms that Jersey has a "high level of compliance" with almost all aspects of the revised FATF Recommendations and has been assessed as "compliant" or "largely compliant" with 44 of the 49 Recommendations and 15 of the 16 "core" and "key" Recommendations.

135. Like the large majority of FATF member countries, Jersey has been assessed as "partially compliant" with Recommendation 5. The Island has also been assessed as "partially compliant" with Recommendations 9, 12, 14, and 16.

136. Recommendation 5 sets out due diligence measures that are to be applied by financial institutions, and Recommendation 9 provides for reliance to be placed on third parties to carry out elements of those measures. Whilst the report confirms that Jersey has a high level of compliance with the FATF Recommendations on preventative measures, with most deficiencies noted being technical in nature, comment is made that the extent of concessions that permit reliance to be placed on third parties is an "overly-generous" interpretation of the international standard.

137. The insular authorities do not share this view. The Island has implemented FATF Recommendations 5 and 9 in a way that is equivalent to the EU Third AML Directive. In particular, that Directive provides that customer due diligence measures (which include identifying the beneficial owner of a customer) need not be applied in the case of a customer that is a credit or financial institution.

138. Recommendations 12 and 16 extend the application of AML/CFT measures to DNFBPs. In Jersey, such measures have been applied to DNFBPs since February 2008 (though trust and company service providers have been subject to measures for much longer). At the time of the IMF's on-site assessment, the JFSC had only recently started to monitor compliance by lawyers (concerning the provision of legal services), accountants (concerning accounting and audit services) and estate agents with requirements set in the MLO. Since the time of the on-site assessment, the JFSC has visited half of the lawyers, accountants, and estate agents that are now registered with it, and is generally satisfied with the level of compliance that it has seen.

139. Assessments such as those carried out by the IMF take an enormous amount of work and effort, both by the assessment team and authorities of the jurisdiction being assessed. Whilst the assessors and insular authorities have occasionally differed on the conclusions reached, the authorities wish to thank the assessors for their patience and care in conducting their work.

140. The insular authorities will publish an annual report on how they have considered the recommendations and action that they have taken. As a first step, an amendment to the MLO will address some of the technical points that have been raised in the report.

Appendix I. The Economy and Financial System

141. **Annual real GVA growth averaged 3.8 percent over 2003-07.**[17] The trend growth rate has been satisfactory, but real GVA has fluctuated considerably over the past decade because of variations in financial institutions' net value added, which depends on global financial market conditions. Current strains in these markets and especially lower interest rates, combined with lower growth in the UK economy generally, is expected to slow growth in the coming year. However, the nonfinancial economy tends to be quite stable. Unemployment is negligible, in part because of immigration restrictions put in place to limit population density. The government is obliged not to run a budget deficit and has accumulated considerable reserves. Retail price inflation has been broadly in line with that of the UK in recent years. It thus accelerated for much of 2008 (reaching 6.4 percent in the 12 months to September) before falling back sharply in late 2008 and early 2009. House prices were stable for much of the last decade, but rose by over 40 percent between end-2005 and September 2008 before falling 5 percent in the final quarter of 2008.

142. **The main activities in the economy are banking, fund management, and fiduciary services (Table 9).** The combined financial services sector contributes over half of GVA, and total assets under management are a large multiple of GVA. The island is among the larger OFCs in the banking sector. There has been some decline in the number of financial institutions on the island, in large part due to consolidation and shifts in business models, but the volume of assets rose fairly steadily at least through mid-2008.

[17] GVA in 2007 is estimated at GBP 4.1 billion. Gross national income (GNI), which measures income of Jersey residents and companies, is estimated at GBP 3.7 billion. With a population slightly over 90,000, GNI per head is about GBP 41,000 (44 percent more than in the UK).

Table 15. Jersey. Sectoral Composition of GVA
(GBP millions)

	2003	In percent	2007 1/	In percent
Agriculture	48	1.5	53	1.3
Manufacturing	63	2.0	53	1.3
Electricity, gas & water	34	1.1	36	0.9
Construction	160	5.1	212	5.2
Wholesale & retail	210	6.7	259	6.3
Hotels, restaurants, bars	113	3.6	119	2.9
Transport and communication	133	4.2	157	3.8
Financial intermediation	1,584	50.2	2,177	53.2
Other business activities	585	18.6	746	18.2
of which: business activities	232	7.4	297	7.3
of which: rental income	353	11.2	449	11.0
Public administration	223	7.1	276	6.7
Total GVA	3,153	100.0	4,089	100.0

Sources: States of Jersey, States Statistics Unit.
1/ Provisional figures.

143. **Banking is the dominant component of the financial sector (Table 1).** Most major British banks have operations on the island. There are branches and subsidiaries from other European countries, North America, and some other countries.[18] The sector is not concentrated. Banks' principal business is the collection of retail deposits from overseas (e.g., from British expatriates and high net worth non-domiciled UK residents). A growing share of deposits are from corporates and the trusts that are managed on the island. These funds are mainly placed with parent banks, where they earn market-related rates.[19] Many banking groups have licenses to perform other financial services, such as fund management and fiduciary services, that are ancillary to the wealth management services provided to their clients. Non-interbank lending is mainly to persons (on the island and also, for example, non-domiciled UK residents), property companies, and some NBFIs; the total is over 700 percent of GVA.[20] Banks have relatively little real estate exposure and most do not operate trading books or independent treasury functions. One bank that is headquartered on the island (and part of a larger UK group) does not offer services locally but has significant lending operations in the Middle East. Another bank currently books a significant part of group funding—including the issue of medium-term notes—through its Jersey branch.

144. **Fund management and associated services are the other main components of the**

[18] Many of the banks have affiliates in the other Crown Dependencies.

[19] Some banks receive the current market rate available to their respective parents, and others receive Libor plus a fixed mark-up.

[20] There is also retail lending by nonbank companies and direct borrowing from the UK, notably in the form of credit card debt.

financial sector. The numbers of CISs and the value of their assets have been growing strongly in the past decade (Table 16). While mass market retail funds continue to be offered, including a small number eligible for sale in the UK and certain other countries, the sector is increasingly dominated by schemes aimed at institutional and high net worth individuals; retail funds have tended to migrate to larger centers in the EU. There are now 1,452 funds (open and closed—Jersey regulates both types) with total NAV of GBP 239 billion at end-September 2008. Of these, over 1,000 (with NAV of GBP138 billion) are specialist-property, venture capital, hedge/alternative investment, and private equity funds. Fund services, such as management and administration, are offered by 104 groups, many also including banks. In addition to CISs, Jersey-based discretionary asset managers manage a further GBP 17 billion for private and institutional clients.

145. **Numerous trust and company service providers operate on the island.** They manage companies (either registered on Jersey or elsewhere) and trusts, and provide administration and other services to private clients who may, for example, establish a structure for succession planning purposes, which may include an element of tax mitigation planning, or to corporations who may, for example, be looking to establish an employee share option plan. Trust and company services providers are also increasingly diversifying into the arena of fund services business. Jersey hosts a small but diverse group of SPVs and a few SIVs registered as Jersey public companies which are used, for example, for securitization purposes. Because of the credit crisis, new company formations of this sort have largely dried up.

Table 16. Jersey: Securities Sector Indicators 1/

(in GBP millions unless indicated otherwise)

	2003	2004	2005	2006	2007	2008
Collective investment schemes						
Number of funds 1/	552	833	965	1,157	1,311	1,472
Jersey	441	651	743	904	1,011	999
Public (Jersey CIF)	323	447	560	706	817	817
Private (Jersey COBO)	118	204	183	198	194	182
Non-Jersey	111	182	222	253	300	473
Public (Jersey CIF)	83	136	177	207	254	422
Private (Jersey COBO)	28	46	45	46	46	51
Assets under management (GBP millions)	98,525	104,110	137,430	179,111	246,150	241,172
Jersey	42,133	62,116	75,321	96,275	135,693	111,629
Public	33,734	50,465	64,706	84,384	120,542	100,613
Private	8,399	11,651	10,615	11,891	15,151	11,016
Non-Jersey	56,392	41,994	62,109	82,836	110,457	129,543
Public	41,032	35,302	59,983	80,854	108,492	127,664
Private	15,360	6,692	2,126	1,982	1,965	1,879
Fund Services Business						
Number of investment managers	...	...	...	...	...	81
Number of custodians	...	...	...	...	...	28
Intermediaries - investment businesses						
Number of licensed investment businesses	136	124	124	119	113	113
Class A - dealing	76	72	76	73	72	76
Class B - managing	66	64	67	59	56	60
Class C - advising 2/	70	65	69	68	66	75
Class D - advising 3/	38	35	33	33	33	24
Class E - non-exempted functionaries	3	3	3	3	3	3
Assets under management (GBP millions)	18,135	15,885	18,243	18,254	19,297	18,843

Source: Jersey Financial Services Commission, Securities Supervision Division.

1/ A licensed investment business may be registered to undertake more than one class of business.
2/ Able to hold client money.
3/ Unable to hold client money.

146. **The insurance sector is small (Table 17).** There are only 14 firms incorporated on the island (Category B firms), of which 3 are closed to new business and a further 3 have yet to write any business. The remaining firms write mostly specialist business. A further 172 firms incorporated overseas (Category A firms), of which most are based in the UK and other EU jurisdictions, are licensed to write Jersey business. Jersey insurance business derives both from local businesses and individuals seeking cover for their property, motor and household risks, as well as life assurance and pensions, and from trust and company service providers based on the island seeking cover for a range of mostly international risks such as property portfolios. Most cover is obtained from Category A insurers through the many brokers on the island. There are no data for overall market size. Net premium income in 2007 of the

Category B firms was less than GBP 4 million and their total assets are around GBP 800 million. Pension schemes are not regulated (though service providers are, where funds are established as trusts), but they are minor.

Table 17. Jersey: Insurance Sector Indicators

(in GBP millions unless indicated otherwise)

	2002	2003	2004	2005	2006	2007	2008
Life							
Gross premiums	150	1	...	...	...	...	...
Net premiums	72	1	...	...	...	...	...
Total assets	369	347	290	259	219	198	161
Non-Life							
Gross premiums	11	9	8	8	7	7	7
Net premiums	7	3	3	2	1	1	1
Total assets	181	105	40	47	315	481	721
Reinsurance							
Gross premiums	8	8	6	7	6	6	3
Net premiums	7	8	6	6	6	6	2
Total assets	38	36	30	32	31	31	10
Captives							
Gross premiums	23	37	1	1	0	0	…
Net premiums	9	17	1	...	0	0	…
Total assets	44	48	5	5	3	3	5

Sources: Jersey Financial Services Commission, Insurance Division.

147. **A wide range of legal and accountancy services are available on the island, where all four of the major international accountancy firms are represented.** The judicial system is reportedly expert in financial matters, and statutes are supported by extensive case laws.

148. **The island has been able to attract these industries because of certain advantages that it possesses and that have been built upon by active policy (Box 1).** This position is constantly challenged by other international centers, including those in metropolitan locations, but the island has been able to adapt to changing demand and competitive pressures.

Box 1. Comparative Advantages of Jersey as a Financial Center

Jersey enjoys certain structural advantages. It is in the UK time zone and geographically close to London and other European financial centers. The legal system is related to that of the UK. English is predominantly used. The island is secure and politically stable. It uses a major currency for monetary purposes.

Jersey now offers a wide range of relevant services and a highly skilled workforce. In the ancillary sectors such as legal advice, accountancy and trust and company services, a wide choice of providers are available. However, "critical mass" has not been achieved in all areas: international insurance business (typically captives, international life, and reinsurance) has become established in other centers and there is now little prospect of expansion in Jersey.

The authorities have deliberately adopted a strategy of maintaining a high level of financial sector regulation and oversight, and restricting entry, which is reassuring to major financial institutions and customers. A reputation for integrity and effective regulation is essential for retaining stable and high value-added business.

The tax system is designed to deliver "fiscal neutrality" to international customers but this advantage has declined in importance as other centers have adopted similar fiscal regimes. The recent shift to a "zero/ten" system of corporate taxation will bring Jersey more into line with systems seen elsewhere.1/ However, the availability of fiscal neutrality is still essential to the future success of the island's services. Furthermore, the authorities have long cooperated with tax authorities in other countries as part of the island's strategy of maintaining a sound reputation. Early on, Jersey volunteered to offer both the withholding tax and disclosure options under the EU Savings Directive, which so far has reportedly had little effect on deposit business.

Nonetheless, the very success of the island brings with it certain costs. Housing is expensive, and salaries high, in part because of immigration restrictions and the proximity to London. Hence, certain lower value-added services, such as back office functions, have migrated elsewhere. Also, operations with high fixed costs, such as the management of CISs targeted at a mass market, have largely shifted to larger financial centers-in particular, those located within the EU, from where it is easier to distribute products throughout the EU. There is a risk that further regulatory and fiscal changes in major markets will require Jersey to adjust its business model again.

1/ Until the end of 2008, income tax was levied at a marginal rate of 20 percent for households and corporates (although non-resident companies were exempt). From 2009, the corporate tax rate has been reduced to zero for non-financials and 10 percent for financials and utilities. There is no inheritance or capital gains tax. A 3 percent goods and services tax has recently been introduced.

Appendix II. Implementation of the Recommendations of the 2003 Assessment

Table 18. Implementation of the 2003 Recommendations to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action	Action Taken
Each such agency should possess operational independence and adequate resources (CP 1(2))	Conduct a review of the Finance and Economic Committee's power of direction and the JFSC's development function. An in-depth analysis of the resources required to fulfill the supervisory objectives and as a consequence establish a charge	The Financial Services Commission (Jersey) Law 1998 (the Commission Law) (Art. 2(4)) provides that, except as provided therein, the JFSC shall be independent of the Minister for Economic Development (the Minister) (formerly the Finance and Economics Committee) and of the States. Procedures for appointment and terms of appointment and removal of Board members are established. Board members cannot be removed except with good cause and, by convention, a public explanation. The JFSC's independent status, accountability and governance structure is publicly disclosed on its website and in its Annual Report. The Commission Law (Art.12) states that the Minister may, after first consulting with the JFSC and where he/she considers it to be in the public interest to do so, give guidance or give in writing general directions to the JFSC. To date, no guidance or directions have been given to the JFSC. The JFSC has entered into a MOU with the Minister in respect of Art. 12. *Inter alia*, the MOU (Section 4) sets out that: "The (Minister) notes that …(he/she) may only exercise (his/her) power to give to the JFSC guidance or direction where it is in the public interest…(and) confirms that any guidance as well as any direction given …will be general in nature and will not be used so as to influence particular cases, e.g. to require the JFSC to grant (or refuse) a regulatory consent in relation to a particular person." The MOU also removes the JFSC from involvement in the promotion of Jersey's financial services industry. The JFSC is broadly adequately resourced. Art. 15 of the Commission Law has been amended so that the JFSC has the ability to set its own fees following due consultation with and agreement from the industry. Fees are set to cover the costs of regulation plus overheads. From 2009,

Reference Principle	Recommended Action	Action Taken
	plan.	the JFSC no longer pays to government a fixed amount of its revenue from the operation of the Companies Registry. Instead it will collect and remit to government a tax which is to be applied on annual returns that must be made by companies. Staff numbers have grown substantially in the past six years to a about 100.
Credit Policies, Loan evaluation and loan loss provisioning (CP 7and 8)	Develop guidance/guidelines or orders covering generally accepted credit risk policies and procedures	The JFSC requires, through the Banking Codes, standards of corporate governance that ensure that the management of a bank assesses and manages all its principal risks. The codes (most recently revised in July 2008) specifically establish minimum credit risk management controls. In 2004, the JFSC issued industry guidance by way of summarized findings resulting from a themed examination program on credit risk. The JFSC issued Quarterly Reporting and Pillar 2 Guidance in August 2007 under which “Banks must have counterparty credit risk management policies, processes and systems that are conceptually sound and implemented with integrity relative to the sophistication and complexity of a firm’s holdings of exposures that give rise to counterparty credit risk.” The Banking Codes require that a system be in place to classify loans into discrete categories when payments are contractually a minimum number of days in arrears, and that there be “appropriate provisioning policies.” The JFSC has chosen not to be more specific than this because Jersey banks generally are required to adopt established group standards in this respect, and credit other than to parent institutions is not a major business line of most banks. Hence, specific policies on loan classification and provisioning are largely left to the discretion of bank management. However, when the JFSC does conduct credit risk assessment inspections, its applicable “route planner” (see below) addresses problem loan classification and provisioning policy.
Market Risks (CP 12)	Impose market risk capital requirements.	Appendix I to the Banking Codes requires minimum control requirements relating to market risk, including appropriate limits for all significant risks

Reference Principle	Recommended Action	Action Taken
		incurred and regular reviews of these; controls to ensure that all transactions are captured on a timely basis and that the bank's positions are re-valued on an appropriately regular basis; policies and processes to consider valuation adjustments for positions that cannot be otherwise prudently valued; and performance of scenario analysis, stress testing and contingency planning. In 2005, the JFSC issued industry guidance by way of summarized findings resulting from a themed examination program on treasury operations. Basel II requirements introduced in 2008 include new reporting requirements for market risk, including interest rate risk in the banking book. The JFSC has published guidance on additional policies that are required for trading books.
Other Risks (CP 13)	Develop guidance and "best practice" documents.	Appendix I of the Banking Codes specifically establishes minimum operational risk management controls, and also cross-refers to the relevant Basel guidance. In October 2008 the JFSC released an updated Policy Statement and Guidance Notes on Outsourcing.
Internal Control and Audit (CP 14)	Systematic confirmation by senior management and Board regarding their fiduciary responsibilities. Introduce a "best practice" paper on internal controls and internal audit.	Under the Banking Codes, a bank must provide an annual declaration to the Commission, signed by the directors, acknowledging that the directors accept and understand their responsibility for compliance with relevant regulatory and anti-ML, guidance notes, other regulation and guidelines, and the Banking Codes, and that such legislation and all the aforementioned have been complied with, or if not, in what respect. The declaration is to be presented on annual renewal of registration. The Banking Codes (Principle 3) contains, inter alia, minimum requirements for corporate governance and internal controls and, in particular, requires defined responsibilities for bank directors and senior managers (Paragraph 3.1). Paragraph 3.2 requires that the registered person must ensure that the business is planned and conducted properly and adequately and in an orderly manner, and that a registered bank has an appropriate internal audit function that, inter alia, has appropriate independence and reports directly to the board of directors or a group audit committee. Paragraph 3.4 requires that an appropriately skilled compliance officer is appointed.
On-Site and Off-site Supervision (CP16)	Establishment of a full scope on-site examination program supplemented by formalized	The JFSC currently carries out about 25 on-site bank inspections annually, and has annual review meetings with bank management. In addition, the JFSC has assessed banks' ICAAPs. Furthermore, the JFSC

Reference Principle	Recommended Action	Action Taken
	quality control procedures.	conducts on- and off-site inspections of banks' nonbank affiliates. The JFSC has developed a model to assess the probability of certain risks occurring at each bank, and the impact if any of these risks should crystallize. The model and other formalized techniques are used for analysis and supervisory resourcing. On-site supervision is guided by "route planners" defining priorities and procedures, and results in post-assessment recommendations, which are effectively followed up. On-site inspection results and off-site findings are reviewed and approved by the Banking Director/Deputy Director to ensure consistency, quality and appropriateness. The inspection process is supported by documented procedures and checklists to ensure a consistent methodology is applied.

Table 19. Implementation of 2003 Recommendations to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action	Action Taken
(ICP 1) Organization of an insurance supervisor	Increase number of staff of the Insurance Division. Avoid impairment of the independence of the supervisor.	Staff numbers have been significantly increased by recruitment since mid-2007—also to reflect widening responsibilities (regulation of general insurance intermediaries). Staffing is now in line with what is required to regulate the sector effectively. An MOU between the JFSC and the Minister for Economic Development clarifies and limits the ability of government to give guidance or direction to the JFSC (Table 3 above).
ICP 4) Corporate Governance	The JFSC should complete its initiative to incorporate corporate governance requirements into Codes of Practice.	Corporate governance requirements have been incorporated into the Codes of Practices for Insurance Business.

Reference Principle	Recommended Action	Action Taken
(ICP 5) Internal controls	Systematic confirmation by senior management and Board regarding their responsibility for internal controls. Introduce quickly Codes of Practice containing the requirements for the existence of adequate risk management systems.	Firms are now required to make an annual declaration to the JFSC, signed by directors, acknowledging that they accept and understand their responsibilities for compliance with relevant regulations (including internal controls). The Codes of Practices for Insurance Business refer to the need for adequate risk management systems.
(ICP 8) Capital adequacy and solvency	The JFSC should continue to review the minimum capital standards, in light of recent European developments, to ensure that the legal minimum remains appropriate and in line with international standards.	The JFSC has been monitoring EU (and wider international) developments on solvency regulation. Its solvency standards are in line with current EU legal minimum requirements, although they do not reflect latest standards and thinking on the development of risk-based requirements.
(ICP 9) Derivatives	It is recommended that the present practices of the JFSC in relation to derivatives be incorporated in the Codes of Practice.	The Codes of Practices for Insurance Business incorporate provisions on derivatives.
(ICP 13) On-site inspection	Intensify on-site inspections (increasing the number of staff, see above).	Onsite work has been undertaken for all Category B insurance companies and many intermediaries within the framework of the JFSC risk model for assessing firms. In the future, onsite work will be a major part of the JFSC's insurance regulation, with the frequency of visits determined by the risk assessment of each firm.
(ICP 14) Sanctions	Complete the range of sanctions by the power of the supervisor to impose monetary penalties (administrative fines).	Article 15(6) of the Commission Law provides the JFSC with power to impose an administrative fee where a document is to be filed with or delivered to the JFSC or the Registrar by virtue of an enactment and the documentation is filed or delivered late. There are no immediate plans to introduce civil money penalties - though this will be kept under review.

Table 20. Implementation of 2003 Recommendations to Improve Observance of IOSCO Principles

Reference Principle	Recommended Action	Action Taken
(CP 1–5) Principles Relating to the Regulator	Principle 1: The JFSC may wish to consider, in any review of its statement of responsibilities, whether its commitment to the IOSCO Objectives should be recognized more explicitly.	After review, it is considered that IOSCO's first and third objectives (protection of investors and reduction of systemic risk) are adequately addressed by the JFSC's guiding principles. It is considered that the second objective (ensuring that markets are fair, efficient and transparent) is not relevant to a jurisdiction that has no secondary market.
	The JFSC should consider whether to recognize the statutory accountability of the Registrar of Companies in its annual report or otherwise.	The JFSC's responsibility to appoint a person to act as the Registrar of Companies is highlighted in each annual report.
	JFSC should review the authority under the Control of Borrowing (Jersey) Law 1947 by which it regulates the offer of interest in SPVs and certain other investment activity.	The JFSC regulates and supervises all institutions involved in offers of interest in SPVs and other investment activity. SPVs are registered public companies and thus subject to certain requirements. Powers under the Control of Borrowing (Jersey) Law 1947 are viewed as adequate, although the need for some streamlining and modernization is recognized.
	Principle 2: The JFSC and government should review the authority under which the F&E Committee is empowered to give guidance and directions to the JFSC.	An MOU between the JFSC and the Minister for Economic Development clarifies and limits the ability of government to give guidance or direction to the JFSC (Table 3 above).
	The JFSC and the government should complete the review of the procedure under which the JFSC is required to raise money in excess of its operating needs by the use of its fee powers, for transfer to the government.	Art. 15 of the commission Law has been amended so that the JFSC has the ability to set its own fees following due consultation with and agreement from the industry. Fees are set to cover the costs of regulation plus overheads. From 2009, the JFSC will no longer pay to government a fixed amount of its revenue from the operation of the Companies Registry. Instead, it will collect and remit to government a tax which is to be applied on annual returns that must be made by companies
	The mission recommends that the JFSC complete its work to provide Codes of Practice for CIF functionaries.	In November 2007, the regulation of fund functionaries (except for functionaries of Recognized Funds) was transferred from the Collective Investment Funds (Jersey) Law 1988 to the Financial Services (Jersey) Law 1998. Subsequently, Codes of Practice for fund services business have been published. Codes for certified funds product are currently being prepared and it is anticipated that they will be issued for consultation early in 2009.

(CP 8–10) Principles for the Enforcement of Securities Regulation	Principle 9: The JFSC and government should review the respective roles of the JFSC, government and the Court in the enforcement of the law to ensure optimum outcomes having regard to the need to ensure that the process is principled, practical and effective.	Enforcement has been shown to work well in practice. Regular meetings are held between officers of the Law Officers' Department, the JFSC and the Joint Financial Crimes Unit in relation to particular cases. The JFSC has published a policy on referrals to the AG of breaches of AML/CFT legislation. The JFSC's Enforcement division has reviewed its policies and internal procedures. Internal procedures are now made available electronically to all JFSC staff.
	Principle 10: The JFSC should consider whether to place greater emphasis in the supervision process on ensuring that timely, balanced, clear and accurate information is communicated to investors and prospective investors.	The Codes of Practice for Investment Business companies include elements on ensuring that timely, balanced, clear and accurate information is communicated to investors and prospective investors. Filing deadlines for funds vary between four and ten months and may be set either by funds documentation or by certificate condition. The Codes for Certified Funds currently being prepared for consultation will set a maximum filing deadline of seven months.
	The time frames for communicating information should be tightened up. The extent of the responsibility of the investment adviser in respect of promotional literature should be expressly recognized in the Code of Practice.	The Financial Services (Advertising) (Jersey) Order 2008 came into effect in June 2008 and covers financial services advertisements that are made in written or broadcast form.
	The JFSC regularly and routinely conducts on-site inspections of registered persons and others. It relies for this purpose on its statutory authority to obtain all the information which it reasonably requires to perform its functions under the regulatory laws**.** It does not rely on its formal power of entry. The mission believes that the ability to undertake on-site inspections without resort to the formal power of entry should be clearly and unambiguously stated in the Law.	The Regulatory Laws provide the JFSC with the power to acquire information or documents from any person who appears to be in possession of relevant information or documents. Article 8 of the Commission Law also provides the JFSC with a statutory power to conduct oversight.
	The JFSC and the government should complete their work on possible proposals to empower the JFSC to levy administrative fines and the circumstances in which this may be appropriate.	Article 15(6) of the Commission Law provides the JFSC with the power to impose an administrative fee where a document is to be filed with or delivered to the JFSC or the Registrar by virtue of an enactment and the documentation is filed or delivered late. There are no immediate plans to introduce civil money penalties - though this will be kept under review.

(CP 14–16) Principles for Issuers	Principle 14: see recommendation under Principle 10 above. Principle 16: The JFSC should continue to monitor international developments on the authority for financial reporting and audit standards applying to issuers of securities and investment products, whether companies, trusts, partnerships or other vehicles.	The JFSC has agreed with UK bodies (and other Crown Dependencies) a model for auditor oversight. To this end, legislation to amend the Companies Law is being drafted that, in respect of companies that have securities that are admitted to trade on regulated EU markets, will (i) result in one or more professional accountancy bodies monitoring the quality of audit work; and (ii) enable action to be taken against auditors that breach rules designed to ensure high quality audits are carried out in connection with such companies.
(CP 21–24) Principles for Market Intermediaries	Principle 24: The JFSC should finalize and disseminate a contingency plan for dealing with the failure of a market intermediary.	The JFSC has prepared a contingency plan for dealing with the failure of a market intermediary.

Appendix III. Stress Testing Methodology and Shocks

149. **The tests included bottom-up analyses performed by Jersey banks using their in-house risk management systems, as well as top-down analyses performed by the JFSC in collaboration with the mission.** Since many banks have limited independent treasury management functions, the tests were often performed by or in close collaboration with the parent bank. The exercise used end-June 2008 data and focused on 18 of the 20 local subsidiaries of foreign parents, except in the case of liquidity tests, which included an additional 20 foreign branches.

150. **The stress tests assessed the sensitivity of banks to single factor shocks to credit quality, interest rates, exchange rates, asset prices, and liquidity.** The single factor tests were calibrated in line with those used in recent FSAP Updates for EU and other mature market countries, particularly the UK, and accounted for larger shocks experienced during recent global financial turmoil. The interest rate shocks included 200 basis point parallel upward and downward shifts of the sterling, dollar and euro yield curve. The exchange rate shock focused on the impact of a 20 percent depreciation of the dollar and the pound sterling. The credit risk tests analyzed banks' resilience to the default of their three largest exposures (net of claims to parent banks) and various other components of their credit portfolio. Liquidity tests were performed to assess the resilience of the banking system to a daily withdrawal of liabilities without access to external funding, including from parent banks. Given the nature of banks' business and the limited domestic macroeconomic impact on the financial sector, more elaborate scenario tests or more extreme single factor tests are not worthwhile.

151. **The results (Table 8), are expressed in terms of three measures:** (a) the average post-shock CAR (the starting point is shown in the first row of each shock), with the minimum and maximum percentage change across banks (Columns 1-3); (b) the number of banks breaching the minimum regulatory capital of 10 percent (Column 4); and (c) the average income loss/gain in percent of pre-shock capital, with the minimum and maximum percent change across banks (Columns 5-7). The first seven columns refer to the bottom-up approach, whereas the remaining seven columns refer to the top-down approach. Overall, both approaches produce broadly similar results, although the top-down results tend to be more volatile, due to supervisors less detailed knowledge of the banks' collateral and guarantees and hedging strategies, some of which are managed at group-level.