International monetary fund reports on Guernsey

A depositors reaction,

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You wouldn't know it from the upbeat press releases issued by Guernsey Finance and the Policy Council, but the long shadow cast by the fallout from the collapse of a Guernsey-registered, GFSC-regulated bank in 2008 dominates the majority of the reports on Guernsey recently released by the IMF.
The report, entitled Financial Sector Assessment Program Update — Detailed Assessment of Observance of Basel Core Principles, which is worthy of particular note in this connection, states the following:

'**16**,.. An official enquiry has reported to the Guernsey government on the supervision of Landsbanki. Some 1,600 depositors had £120m, on deposit and there was at the time no compensation scheme...'
A copy of this 'official enquiry' was no doubt supplied to the Guernsey government, but the report was commissioned and paid for by the GFSC and conducted under its own terms of reference with no witnesses summoned and only a carefully redacted version released. What depositors have been calling for is a fully independent, Select Committee-type enquiry such as those conducted in the UK, the Isle of Man and even Iceland. Why has the Guernsey government steadfastly refused to do so?
'**17.** The authorities have responded to the crisis events with regulatory change and a new deposit insurance scheme... Depositor compensation, which had long been provided for in law but not implemented, was introduced from November 2008.' A depositor compensation scheme was rushed in after Landsbanki Guernsey Ltd (LGL) collapsed, despite its implementation having been a strong recommendation of the Edwards report 10 years earlier. Curiously, there was no mention of Landsbanki Guernsey Ltd in the Billet d'Etat proposing the scheme, despite the fact that it was precisely the failure of LGL that had triggered the long-awaited commencement of the DCS.
'21. The deposit insurance scheme covers deposits, mainly those from retail depositors, wherever located, up to £50,000 per person... The precise modalities of the funding mechanism remain under discussion.' Let's hope they can complete these discussions and finalise the precise modalities of the funding mechanism before another Guernsey bank goes under.

'22. The GFSC now conducts a program of on-site supervision, supported by off-site analysis.' Now? Does this mean that the GFSC did not conduct any on-site supervision at all at the time of the Landsbanki Guernsey Ltd collapse?
'28. The GFSC cooperates with the home supervisors of institutions active on the island... However, as experience in the recent past has shown, the asymmetry in the relationship between the GFSC and certain "home" regulators severely limits the benefit that the GFSC can draw from cooperation with them.' The GFSC relied on third-party, unsubstantiated assurances from the FSA that Heritable Bank in the UK was ring-fenced from Icelandic risk instead of carrying out its own due diligence, which would have clearly shown that it wasn't. How could Heritable have been ring-fenced from Icelandic risk when it shared the same parent, Landsbanki hf?

'29. Several broad areas for further action have been identified. Primarily, these require primary or secondary legislative changes and the latter's consequent practical application. In these regards: (i) CP 4 "Transfer of significant ownership" requires that the GFSC be given power to review and, if necessary, rescind, transfers of controlling interests in licensed banks. (ii) A similar power for the GFSC is required by CP 5 "Major acquisitions".' A clear reference to Cheshire Guernsey Ltd. Adherence to Core Principle 5 would have prevented the sale of safe Cheshire savings to an Icelandic bank that no Cheshire Guernsey depositor is likely to have heard of at the time and which we now know was doomed at the time of the sale in August 2006.

Detailed assessment of compliance with the Basel Core Principles

'In November 2009, the GFSC published an implementation paper requiring Guernsey incorporated banks to make clear to their depositor clients that "upstreaming" takes place and to advise clients to satisfy themselves of the parent's ability to enable repayment of deposits. The paper's provisions came into force in January 2010.' Oh, I see: it is the depositors' job to 'satisfy themselves of the parent's ability to enable repayment of deposits', not the paid regulator.

The GFSC has been referring savers that lost money deposited in Cheshire Guernsey, taken over by Landsbanki, to this esoteric paper that they are highly unlikely to have seen and which was first published in the form of a consultation paper on the GFSC website in August 2008. In essence, the GFSC has been telling depositors — after the event — that they should have been aware that parental guarantees were, in fact, not legally binding and therefore not 'guarantees' at all, despite the fact that the regulator had authorised the publication of these 'guarantees' in bank promotional literature and websites and that depositors had not been informed otherwise. In practice, the GFSC has *Periodically* required banks to provide additional information and this can be pertaining to the parent where counterparty risk is significant. For example, during the 2007-9 crisis, several banks were required to report liquidity daily or weekly. In two cases this was made a licence condition.' One of these must have been Landsbanki Guernsey Ltd. That being the case, why didn't the GFSC direct LGL to immediately repatriate the large interbank deposit placed with Heritable in the UK? That action might have saved LGL and in particular, savers' deposits.

'In pursuit of its mandate, the GFSC has unfettered and routine access to all banks' files and carries out file reviews during on- site visits to banks...' Pity they didn't start doing this before Landsbanki Guernsey Ltd failed. '... the GFSC does not have power to object to (and reject) a proposal for acquisition of "significant shareholder" status, but does have power to object to (and reject) a proposal to obtain "shareholder-controller" status.' It was well known and informally confirmed by the GFSC in early 2006 that Cheshire Guernsey Ltd was closing down. Customers were surprised to suddenly discover in August 2006 that it had been acquired by a hitherto largely unknown Icelandic bank. It is now known that Landsbanki hf was doomed at the time of the acquisition.

Why was the sale not blocked by the GFSC, which has vastly superior knowledge, contacts and resources at its disposal than depositors?

In that latter regard, the Banking Supervision (Bailiwick of Guernsey) Law (sec 14(3)) states:

'The Commission may serve notice of objection under this section if it is not satisfied (b) that the interests of depositors and potential depositors of the licensed institution would not in any other manner be threatened by that person becoming a controller of that description.' The Guernsey authorities were no doubt intent on preventing the closure of a Guernsey bank with the contiguous loss of jobs on the island. But were not the interests of depositors and potential depositors threatened by the sale of their safe Cheshire savings to an Icelandic bank that we now know was already doomed? According to section eight of Principle 1/1994/24, 'exposures to companies or person connected with the lending bank... may be justified only when undertaken for the clear commercial advantage of the lending bank, and when they are negotiated and agreed on an arm's length basis.' The large exposure to Heritable was undertaken for the clear commercial advantage of the sister bank and not the lending bank, Landsbanki Guernsey Ltd, and was not negotiated and agreed on an arm's length basis. In addition to the disproportionately big interbank placement, there is also the matter of the large UK loan book, which was inextricably linked in complex contracts with Heritable. 'There is no guidance on the policies and processes to assess, manage and monitor outsourced activities as well as on the content of outsourcing agreements in place... Many of the administered banks do not have any staff in Guernsey at all. In addition, it is to be pointed out that one service provider bank in Guernsey manages eight administered banks. This concept of outsourcing even essential parts of banking business is not compatible with international standards regarding outsourcing.' Customers had no idea that Landsbanki Guernsey Ltd had no staff in Guernsey. Shouldn't they have been informed and might that knowledge not have set alarm bells ringing?

"The Commission is issuing an Outsourcing Guidance... The Outsourcing Guidance will explicitly require banks to consider the effects of and conduct risk assessment before outsourcing" Better late than never, I suppose. "...widely held market concerns over both the Iceland's economy and Icelandic banks - together with events in financial markets - led to the GFSC imposing four conditions on the licence of Landsbanki Guernsey Limited in order to support the bank at a time of stress..." One of the four conditions was the redistribution of assets that had hitherto been mostly upstreamed to Iceland. That much we know. We also now know (thanks to the IMF, above) that several Guernsey banks were required to report liquidity daily or weekly *In* two cases this *was* made a licence condition, so one of them must have been LGL. But what were the other two conditions?

This must be part of the information that the GFSC has declined to release to the Depositors Action Group and, I believe, also to the former administrators, now liquidators. The GFSC must have left it very late, though, because the conditions clearly didn't prevent the bank from failing. Depositors and liquidators alike would be very interested to learn what the other two conditions were, in any event, all will at long last become clear during the inevitable independent inquiry.