BERMUDA MONETARY AUTHORITY

STATEMENT OF PRINCIPLES

BANKING AND DEPOSIT COMPANIES ACT 1999

DECEMBER 2012

TABLE OF CONTENTS

Introduction

This revised Statement of Principles (the "Principles") replaces the version published in December 2010.

The Principles are made pursuant to section 9 of The Banks and Deposit Companies Act 1999 (the "Act"), which requires the Bermuda Monetary Authority (the "Authority") to publish in such manner as it thinks fit a Statement of Principles in accordance with which it is acting or proposing to act:

i. in interpreting the criteria specified in the Second Schedule and the grounds for revocation specified in section 18;
ii. in exercising its power to grant, revoke or restrict a licence; and
iii. in exercising its power to obtain information and reports and to require production of documents.

These Principles are of general application, and seek to take account of the wide diversity of institutions that may be licensed under the Act and of the prospect of institutional and market changes. Notwithstanding, there may be a need for the Principles to be revised from time to time. If the Authority makes a material change in the Principles, section 9(2) of the Act provides that the change is to be published or a revised version of the Principles issued.

This document is to be read in conjunction with the Authority's *Statement of Principles on the Use of Enforcement Powers* (*October 2012*) ("SPUEP"). The SPUEP, also made pursuant to section 9 of the Act, sets out the principles in accordance with which the Authority acts or proposes to act in exercising its enforcement powers.

PART 1 Explanation for the Statement of Principles

1.1 The Principles are relevant to the Authority's decisions on whether to licence an institution or to revoke or restrict a licence. The Authority's interpretation of the minimum licensing criteria in the Second Schedule and of the grounds for revocation in section 18 of the Act, together with the principles underlying the exercise of its powers, encapsulate the main standards and considerations to which the Authority has regard in conducting its supervision of banks and deposit companies. The functions of deposit-taking supervision include monitoring the ongoing compliance of institutions with these standards and identifying any threats to the interests of depositors and potential depositors. If there are concerns, the Authority considers what steps should be taken to protect depositors and potential depositors. Where appropriate, it seeks remedial action by persuasion and encouragement. However, if the Authority considers that its powers are exercisable and should be exercised in the interests of depositors and potential

depositors, it may impose restrictions on a licence and, ultimately, the revocation of a licence.

1.2 The Principles include references to various policy and guidance papers issued from time to time. Copies of the relevant material are available from the Authority.

1.3 Part 2 of the Principles considers the interpretation of each of the licensing criteria in the Second Schedule of the Act. Part 3 sets out the considerations relevant to the Authority's exercise of its discretion to grant a licence. Part 4 addresses the principles underlying the exercise of the Authority's discretion to revoke or impose restrictions on a licence and to intervene in emergency situations. Part 5 sets out the principles underlying the exercise of the Authority's power to obtain information and reports and to require the production of documents.

1.4 Institutions should be aware that in October 2010, the Authority published a separate Statement of Principles describing how it would use its powers under the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act.

PART 2 Second Schedule: Minimum Licensing Criteria

2.1 Introduction

Before an institution may be granted a licence the Authority has to be satisfied that all the criteria in the Second Schedule to the Act are or are capable of being fulfilled by the applicant. The Authority must also be advised by the Minister that he is satisfied that the granting of a licence would be in accordance with the economic and financial policy of the government. Once licensed, all institutions are subject to the Authority's continuing supervision and regulation. Institutions are required to submit, at intervals determined by the Authority, financial and other information about their business.

While the Act sets out in broad terms the criteria which must be fulfilled by institutions, these criteria are interpreted and applied in the context of the particular circumstances of individual institutions, and developments in banking and finance generally. In addition to reviewing prudential returns and other data received from institutions, the Authority's supervision involves detailed prudential discussions with institutions' senior management on a regular basis. The Authority determines the frequency of those discussions. Meetings may take place either at the Authority's offices or at the institution's own premises. In addition, compliance visits are routinely made to institutions periodically to add to the Authority's understanding of the licensee's management structures, operations, policies and controls and to assist it in satisfying itself that each institution continues to conduct its business prudently and in accordance with all

relevant criteria. Institutions are required to meet the minimum licensing criteria at all times. Where they become aware of breaches or potential breaches, they are expected to alert the Authority forthwith so that any necessary remedial action can quickly be agreed. Similarly, they should alert the Authority to any proposed material change in their business, to enable any implications for fulfillment of the minimum criteria to be assessed.

This part of the Principles sets out the Authority's interpretation of these criteria.

2.2 Second Schedule Paragraph 1: "Directors etc, to be fit and proper persons"

Directors, controllers and senior executives

2.2.a. This paragraph provides that every person who is or is to be a director, controller or senior executive of an institution is to be a fit and proper person to perform functions in relation to any activity carried on by the institution. With regard to an individual who is, or is to be, a director, controller or senior executive the relevant considerations include whether the person has relevant experience, sufficient skills, knowledge, and soundness of judgment properly to undertake and fulfill their particular duties and responsibilities. The standards required of persons in these respects will vary considerably, depending on the precise position held by the person concerned. Thus, a person could be fit and proper for one position but not be fit and proper for a position involving different responsibilities and duties. The diligence with which the person is fulfilling or is likely to fulfill those duties and responsibilities is also considered, so that the Authority can assess whether the person does or will devote sufficient time and attention to them. In addition, the Authority needs to consider the extent to which conflicts of interest exist or may arise between the institution and a director, controller or senior executive, and be satisfied that any unavoidable conflicts will be appropriately dealt with in directing the institution's affairs. Institutions are expected to notify the Authority immediately if they become aware of material information affecting the fitness of any person subject to vetting by the Authority.

2.2.b. The Authority sees the standards as being particularly high in the case of those persons with main responsibilities for the conduct of an institution's affairs, taking into account the nature and scale of the institution's business.

2.2.c. In assessing whether a person has the relevant competence, soundness of judgment and diligence, the Authority considers whether the person has had experience of similar responsibilities previously, the record in fulfilling them and, where appropriate, whether the person has appropriate qualifications and training. As to soundness of judgment the Authority looks to, inter alia, the degree of balance, rationality and maturity demonstrated in the person's previous conduct and decision-taking.

2.2.d. The probity of the person concerned is very important: it is essential that a person with responsibility for the conduct of a deposit-taking business is of high integrity. In contrast to the fitness elements of this criterion which reflect an individual judgment relating to the particular position that the person holds or is to hold, the judgment of probity reflects much more of a common standard, applicable irrespective of the particular position held.

2.2.e. Specifically, the Authority takes into account the person's reputation and character. It considers, inter alia, whether the person has a criminal record; convictions for fraud or other dishonesty would clearly be particularly relevant. The Authority also gives particular weight to whether the person has contravened any provision of banking, insurance, investment or other legislation designed to protect members of the public against financial loss, due to dishonesty, incompetence or malpractice. In addition, it considers whether the person has been involved in any business practices appearing to the Authority to be deceitful or oppressive or improper or which otherwise reflect discredit on his method of conducting business. In addition to compliance with statutory provisions, the Authority considers a person's record of compliance with various non-statutory codes in so far as they may be relevant to the authorisation criteria and to the interests of depositors and potential depositors.

2.2.f. The Authority also takes into consideration whether the person has been censured or disqualified by professional or regulatory bodies, e.g. the Bermuda Stock Exchange, the Bermuda Bar Association, the Institute of Chartered Accountants of Bermuda, the Association for Investment Management and Research or corresponding bodies in other jurisdictions. Those who have are unlikely to be acceptable.

2.2.g. While any evidence of relevant past misconduct needs to be taken into consideration, the Authority recognises that lapse of time and a person's subsequent conduct are factors which may be relevant in assessing whether the person is now fit and proper for a particular position.

2.2.h. Once an institution is licensed, the Authority has continuing regard to the performance of the person in the exercising of his duties. Imprudence in the conduct of an institution's business, or actions which have threatened (without necessarily having damaged) the interests of depositors or potential depositors will reflect adversely on the competence and soundness of judgment of those responsible. Similarly, failure by an institution to conduct its business with integrity and professional skills will reflect adversely on the probity and/or competence and/or soundness of judgment of those responsible. This applies whether the matters of concern have arisen from the way the persons responsible have acted or from their failure to act in an appropriate manner. The Authority takes a cumulative approach in assessing the significance of such actions or omissions – that is, it may determine that a person does not fulfill the criterion on

the basis of several instances of such conduct which, if taken individually, may not lead to that conclusion.

Shareholder controllers

2.2.i. Shareholder controllers may hold a wide variety of positions in relation to an institution, and the application of the fit and proper criterion takes account of this. The key consideration is the likely or actual impact on the interests of depositors and potential depositors of a person holding his particular position as controller. This is viewed in the context of the circumstances of the individual case, and of the particular position held. The general presumption is that the greater the influence on the institution the higher the threshold will be for the controller to fulfill the criterion. Thus, for example, higher standards will generally be required of a shareholder controller owning, say, 40 per cent or more of the shares of an institution compared with a shareholder controller owning 10 per cent.

2.2.j. In considering the application of the criterion to shareholder controllers or persons proposing to become such controllers, the Authority has regard to two main considerations.

2.2.k. First, it considers what influence the person has or is likely to have on the conduct of the affairs of the institution. If the person does, or is likely to, exercise a close control over the business, the Authority would look for evidence that he has the probity and soundness of judgment and relevant knowledge and skills for running an institution. On the other hand, if the shareholder does not, or is not likely to, influence the directors and management of the institution in relation to the detailed conduct of the business, it would not be necessary to require such a level of relevant qualities and experience. The Authority also has regard in this context to whether there could be conflicts of interest arising from the influence of the shareholder on the institution. This could, for example, arise from the closeness of his links with another company.

2.2.l. The second consideration is whether the financial position, reputation or conduct of the shareholder controller or prospective shareholder controller has damaged or is likely to damage the institution through 'contagion' which undermines confidence in that institution. For example, if a holding company, or a major shareholder, were to suffer financial problems it could lead to a run on the institution, difficulties in obtaining deposits and other funds, or difficulties in raising new equity from other shareholders or potential shareholders. Generally, the higher the shareholding, the greater the risk of contagion if the shareholder encounters financial difficulties. The risk of contagion is not, however, confined to financial weakness: publicity about illegal or unethical conduct by a holding company or another member of the group may also damage confidence in the institution. Institutions are expected to notify the Authority immediately in the event that they become aware of material concerns regarding the suitability of a major shareholder.

2.2.m. In the case of a controller who 'directs' or 'instructs' a shareholder controller similar considerations apply to those relevant to assessing the fulfillment of the criterion in relation to shareholder controllers. In other words, the standards that an indirect controller needs to satisfy are likely to be at the minimum the standards also required of the person who is indirectly controlled.

2.2.n. Where a person is a controller by virtue of 'directing' or 'instructing' the board of an institution, the standards required are high. The controller has to have the probity and relevant knowledge, experience, skills and diligence for running an institution. The qualities required are those which are also appropriate for the board of directors of an institution.

2.3 Second Schedule Paragraph 1A: "Corporate governance"

2.3.a This paragraph provides that an institution shall implement corporate governance policies and processes that the Authority considers appropriate given the nature, size, complexity and risk profile of the institution. In assessing whether a deposit-taking institution is implementing appropriate corporate governance policies and processes, the Authority considers the extent to which there is compliance with the Authority's *Corporate Governance Policy (October 2012)***.**

2.3.b. Sub-paragraph 2(a) of the Second Schedule – sometimes known as the 'four eyes' requirement – provides that at least two individuals must effectively direct the business of the institution. The Authority normally expects that the individuals concerned will be either executive directors or persons granted executive powers by, and reporting immediately to, the board.

2.3.c. The Authority requires that at least two independent minds be applied to both the formulation and implementation of the policies of the institution. The Authority does not regard it as sufficient for one of the two persons to make some, albeit significant, decisions relating only to a few aspects of the business – each must play a part in the decision-making process on all significant decisions. They are not expected to duplicate each other's position but both must demonstrate the qualities and application to influence strategy, day-to-day policy and their implementation, and both must actually do so in practice. Where there are more than two individuals directing the business, it is not necessary for all of these individuals to be involved in all decisions relating to the determination of strategy and general direction. But at least two individuals must be involved in all such decisions. Both persons' judgments must be engaged in order that major errors leading to difficulties for the institution are less likely to occur. Similarly, both persons must have sufficient experience and knowledge of the business and the necessary personal qualities to detect and resist any imprudence, dishonesty or other irregularities by the other person. Thus, where a single individual, whether a senior executive, or otherwise, is particularly dominant in an institution this will raise doubts about the fulfillment of the criterion.

2.3.d. Sub-paragraph 2(b) of the Second Schedule provides that the directors include such number of non-executive directors as the Authority considers appropriate. The number will depend on the nature, size, complexity and risk profile of the institution.

2.3.e. In assessing the composition of the board of directors of a deposit-taking institution, the Authority considers compliance with Principles 2 and 3 of the Authority's *Corporate Governance Policy (October 2012)*.

2.4 Second Schedule Paragraph 4(1): "Business to be conducted in prudent manner"

2.4.a. Sub-paragraphs 1 and 9 make it clear that there is a general requirement for institutions to conduct their business in a prudent manner. It is the overall responsibility of the board and senior management of an institution to ensure that there is effective control over the entire business and that it is conducted prudently. Board and senior management must understand the underlying risks in the business and be committed to a robust control environment.

2.4.b. Sub-paragraphs 2 to 8 and 10 set out a number of specific requirements with regard to prudence, each of which must be fulfilled before an institution may be regarded as conducting its business in a prudent manner in terms of the paragraph.

2.4.c. However, the Act also makes it clear that the specific requirements outlined in sub-paragraphs 2 to 8 are not exhaustive. Accordingly, the Authority takes into account a range of operational and other risks in assessing whether an institution is prudently run. These include, for example, the institution's general strategy and objectives; planning arrangements; arrangements for the oversight of outsourced functions; policies on accounting, lending and other exposures, and bad debt and tax provisions; policies and practices on the taking and valuation of security, on the monitoring of arrears, on following up debtors in arrears; policies and arrangements for monitoring and controlling risk to earnings and capital adequacy arising from adverse movements in market rates; and recruitment arrangements and training to ensure that the institution has adequate numbers of experienced and skilled staff in order to carry out its various activities in a prudent manner. The Authority would also expect an institution to occupy premises suitable for the purpose of conducting its business.

2.5 Second Schedule Paragraph 4(2) and (3): "Capital adequacy"

2.5.a. The schedule provides that for capital to be sufficient it must be of an amount which is commensurate with the nature and scale of the institution's operations; and of an amount and nature sufficient to safeguard the interests of its depositors and potential depositors, having regard to:

i. the risks inherent in those operations;

ii. the risks inherent in any operations of related entities so far as they are capable of affecting the institution; and
iii. any other factors which appear to the Authority to be relevant.

2.5.b Institutions must maintain procedures for monitoring and reviewing the ongoing adequacy of their capital, having regard both to stipulated regulatory requirements and to senior management's own assessment of their business strategies and outlook.

2.5.c. A key purpose of capital is to provide a stable resource to absorb any losses incurred by an institution, and thus protect the interests of its depositors and potential depositors. Capital must therefore have two main qualities to achieve this purpose – a capacity to absorb losses and permanence. Most types of capital recognised by the Authority can absorb losses while leaving an institution able to continue trading and are, in addition, irredeemable so far as the holder of capital instruments is concerned. As regards permanence, capital will not be of an appropriate nature if there are concerns that it may be paid away to the detriment of depositors' interests. Thus, for example, the Authority will only include distributable reserves in the capital base if the likelihood of their being paid away is remote.

2.5.d. The Authority recognises, however, that certain other types of capital, while not meeting the two criteria mentioned above, can also provide some protection to depositors. Term debt with a minimum maturity of five years is eligible to be included as capital on the terms and within certain limits. An essential feature of such capital is that it must be fully subordinated to the interests of depositors as it thereby provides a measure of protection to such depositors against loss in liquidation. (Certain shorter term subordinated debt may also be included to meet specific requirements arising out of traded market activity.) The Authority would not expect any element of capital regarded as permanent to be repaid at any time other than as part of an agreed capital restructuring, and similarly would not expect subordinated term debt to be repaid before its maturity date (other than in the case of shorter term debt held to meet a trading book requirement). The Authority would normally only give its consent to early repayment of capital where the capital repaid was being replaced by capital of higher quality (for example, replacing term subordinated debt with perpetual debt or equity) or where the institution's need for capital was reduced for the foreseeable future.

2.5.e. In assessing capital adequacy the Authority seeks to take account of all risks of loss to which an institution may be subject. These risks include the risk of counterparty default whether arising from on-balance-sheet or off-balance-sheet business (credit risk); risks arising from open foreign exchange positions (foreign exchange risk); risks arising from open interest rate positions or unhedged investment position (interest rate and position risk); risks arising from negligence or incompetence in the management of either the institution's own assets or exposures or those of third parties; risks arising from subsidiaries, associates and

other connected companies which might expose the institution to direct financial costs or general loss of confidence by association (contagion risk); and risks arising from concentration of business (for example, geographical, sectoral or individual counterparty concentrations). It is necessary therefore to look beyond an institution's lending and investment business to off-balance-sheet activities such as the provision of guarantees and the underwriting of shares, commercial paper or other debenture issues. It is also necessary to take account of group and other connected companies and the risks they may pose to the institution. Moreover, in reviewing and determining the adequacy of capital, the Authority also has regard to potential future developments, including adverse changes in market conditions likely to affect the institution.

2.5.f. The risks outlined above are analysed on the basis of regular standardised returns submitted to the Authority as well as internal management information provided by individual institutions on an ad hoc basis. Some of these risks will be subject to formal measurement systems; others are assessed on a more subjective basis. In certain circumstances, institutions may be permitted to employ internal assessments of risk in the calculation of their regulatory capital, provided appropriate tests are met. The functioning of such internal assessment tools (including models) used to measure components of risk must be subject to periodic independent validation and testing. The Authority's risk analysis is undertaken both on a consolidated basis, in order to capture exposures arising in subsidiaries and other connected companies, and on an unconsolidated basis, in order to assess whether there is an appropriate distribution of capital within a group, having regard to the distribution of capital and risk. In order to enable the Authority to monitor concentration risk there are special reporting arrangements for large exposures. The objective is to assess all the risks to which a particular institution is exposed in the light of its ability to manage those risks. Factors which are taken into account by the Authority in assessing an institution's risk management capabilities include the expertise, experience and track record of its management, its internal control systems and accounting systems, its plans for the future development of the business, its size and position in its chosen markets, as well as exogenous factors such as the future prospects in its areas of business.

2.5.g. The results of this analysis are encapsulated in the form of a minimum capital ratio. This ratio relates an institution's capital base to the measurement framework referred to above. However, in considering the appropriate level of this ratio, the Authority takes into account the various other risks to which the institution is exposed (or to which it may become exposed in the future, as a result of possible adverse changes in market conditions), its capacity to manage those risks, as well as the quality of its capital and assets, and its profitability and general prospects. Individual ratios are set at both solo and consolidated levels for each institution after discussions with its senior management. They take into account the particular characteristics of the individual institution and are normally set within a range established for similar institutions. In no case does the Authority set a minimum capital ratio below the 8% minimum international

standard. In order to lessen the risk of the ratio being breached, the Authority generally expects each institution to conduct its business so as to maintain a buffer of excess capital above the minimum ratio. Where an institution fails to maintain an adequate buffer, it needs to develop plans, either through the raising of fresh capital or a reduction in weighted risk assets, enabling it to re-establish the buffer. In such circumstances, the Authority would generally be willing to take into account, in calculating an institution's regulatory capital, retained earnings not yet audited provided they had been reviewed by the institution's auditors and appropriate evidence provided to the Authority. The Authority maintains the capital ratio under regular review and may from time to time notify an institution of its intention to amend the ratio set previously. When the Authority has concerns about an institution's increasing risk profile or deteriorating control environment, an increase in the stipulated minimum capital ratio is likely.

2.5.f The Authority's detailed policy for the setting and monitoring of requirements for capital adequacy and the effective assessment of risk within institutions is set out in the Authority's paper entitled *Revised Framework for Regulatory Capital Assessment (December 2008).*

2.6 Second Schedule Paragraph 4(4) and (5): "Adequate liquidity"

2.6.a. In assessing whether a deposit-taking institution is carrying on business prudently by maintaining adequate liquidity, the Authority considers the extent to which it complies with the "Principles for sound liquidity risk management and supervision", published in November 2010**.** Adherence to the Principles requires a licensed deposit-taking institution to establish a robust liquidity risk management framework, commensurate with the size, nature of business and complexity of its activities, that ensures it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources.

2.6.b. In addition, the Authority prescribes a minimum quantitative liquidity standard in the form of guidelines that set a limit on the mismatching of assets and liabilities that a licensed deposit-taking institution may incur in various maturity bands. This is further explained in the Authority's paper *The Measurement and Monitoring of Liquidity*, published in amended form in November 2010. Breaches of liquidity guidelines may call into question an institution's compliance with the minimum licensing criteria.

2.7 Second Schedule Paragraph 4(6): "Adequate provision for depreciation or diminution in the value of assets (including provision for bad and doubtful debts)"

2.7.a. An institution must establish appropriate policies and procedures for the early identification of any deterioration in the value of its assets and for the ongoing monitoring of problem assets. Adequate provision must be made for depreciation or diminution in the value of an institution's assets, for liabilities that will or are expected to fall to be discharged and for any losses, which it will or it expects to incur. Thus, provisions need to be made for, inter alia, bad and doubtful debts and expected losses (for example, connected with guarantees or other off-balance-sheet exposures) and tax liabilities. The Authority expects liabilities and losses (including contingent losses) to be recognised in accordance with generally accepted accounting standards.

2.7.b. In assessing the adequacy of an institution's provisions, the Authority has regard to its provisioning policy, including the methods and systems for monitoring the recoverability of loans (for example, the monitoring of the financial health of counterparties, their future prospects, the prospects of the markets and geographical areas in which they operate, arrears patterns and credit scoring techniques), the frequency with which provisions are reviewed, the policy and practices for the taking and valuation of security and the extent to which valuation exceeds the balance-sheet value of the secured loans. In some cases, clear objective indicators will be available to assist in the determination of the appropriate level of provisions; in others, more subjective judgments will need to be made. The adequacy of provisions must be reviewed at frequent intervals. Where the Authority concludes that adequate provisions have not been made, it requires institutions to take immediate action to address the concern.

2.8 Second Schedule Paragraph 4(7) and (8): "Adequate accounting and record-keeping systems"

2.8.a. The Authority does not regard an institution's records and systems as adequate unless they are such as to enable the business of the institution to be prudently managed and the institution to comply with the duties imposed on it by or under the Act. In other words, the records and systems must be such that the institution is able to fulfill the various other elements of the prudent conduct criterion, and to identify threats to the interests of depositors and potential depositors. They should also be sufficient to enable the institution to comply with the notification and reporting requirements under the Act (for example, under sections 37, 38 and 39). Thus delays in providing information, or inaccuracies in the information provided, will call into question the fulfillment of the requirement of sub-paragraphs 4(7) and 4(8).

2.8.b. The nature and scope of the particular records and systems which an institution should maintain should be commensurate with its needs and particular

circumstances, so that its business can be conducted without endangering its depositors and potential depositors. In judging whether an institution's records and systems are adequate, the Authority has regard to its size, to the nature of its business, to the manner in which the business is structured, organised and managed, and to the nature, volume and complexity of its transactions. The requirement applies to all aspects of an institution's business, whether on or off balance sheet, and whether undertaken as a principal or as an agent.

2.9 Second Schedule Paragraph 4(10): "Failure to comply with legislation and sanctions"

2.9.a In assessing whether a deposit-taking institution is carrying on business prudently, the Authority shall take into account not only compliance with the provisions of the Act, but also all other applicable Bermuda law including: provisions of the law pertaining to anti-money laundering and anti-financing of terrorism as provided in the Proceeds of Crime Act 1997, the Anti-Terrorism (Financial and Other Measures) Act 2004, and the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008. In assessing compliance with relevant provisions of the anti-money laundering and anti-financing of terrorism laws and regulations, the Authority will consider whether an institution has followed any relevant guidance issued by the Authority.

2.9.b Failure by the institution to comply with relevant laws in foreign jurisdictions in which the institution or its subsidiaries operate may also affect the Authority's assessment of prudent conduct.

2.9.c An institution's failure to comply with international sanctions in force in Bermuda will also be taken into account in the Authority's assessment of prudent conduct. The Authority will consider compliance with regulations made under the International Sanctions Act 2003, relevant orders made under the Anti-Terrorism (Financial and Other Measures) Act 2004 and any other applicable sanctions in force in Bermuda.

2.10 Second Schedule Paragraph 5 "Consolidated supervision"

This paragraph requires the Authority to be satisfied, in the case of institutions which are members of wider groups or have ownership links with other entities, that the structures and relationships are not such as to obstruct the conduct of effective consolidated supervision. This reflects the fact that the Authority conducts its prudential supervision on both a solo and a consolidated basis in order to ensure that any risks to an institution arising as a result of its membership of a wider group are fully taken into account. The Authority, therefore, undertakes an overall evaluation – both quantitative and qualitative – of the strength of a group to which an institution belongs. The objective, however, is to supervise the institution as part of its group and not to supervise all companies in the group.

In order to conduct such monitoring and assessment, the Authority clearly needs access to an array of information relating to ownership structures and business activities in other parts of the group and to other connected entities. When there are obstacles to transparency as a result of the particular structure adopted or the location of parts of the group, the Authority needs to satisfy itself that adequate information can be obtained and that the structure and relationships are not such as to cause any other risks to the interests of the institution's depositors and potential depositors.

Supervision of banks engaged in international business is a shared responsibility, and the Authority has regard to the general allocation of responsibilities which has been agreed between home and host authorities under the Basel Principles.

2.11 Second Schedule Paragraph 6 "Integrity and skill"

2.11.a. This paragraph is concerned with the manner in which the business of the institution is carried on and is distinct from the question of whether its senior executives and indirect controllers are fit and proper persons. It covers whether the institution has sufficient personnel with professional skills appropriate to the nature and scale of the activities of the institution concerned and with adequate knowledge, skill and experience necessary for the prudent management and conduct of the business.

2.11.b. The integrity element of the criterion requires the institution to observe high ethical standards in carrying on its business. Criminal offences or other breaches of statute will obviously call into question the fulfillment of this criterion. Particularly relevant are contraventions of any provision made by or under enactments, whether in Bermuda or elsewhere, designed to protect members of the public against financial loss due to dishonesty, incompetence or malpractice. Doubts may also be raised if the institution fails to comply with recognized, ethical standards of conduct such as those embodied in various codes of conduct. The Authority would have regard to the seriousness of the breach of the Code, to whether the breach was deliberate or an unintentional and unusual occurrence, and to its relevance to the fulfillment of the criteria in the Second Schedule and otherwise to the interests of depositors and potential depositors.

2.11.c. Professional skills cover the general skills which the institution should have in conducting its business, for example, in relation to accounting, risk analysis, establishing and operating systems of internal controls, ensuring compliance with legal and supervisory requirements, and in the standard of the various financial services provided to customers. The level of skills required will vary according to the individual case, depending on the nature and scale of the particular institution's activities.

2.11.d. The Authority would expect an institution to have a number of employees sufficient to carry out the range and scale of the business. The Authority, in determining whether a business has sufficient personnel, will take into account human resources that the institution may draw on through other arrangements, e.g. outsourcing, secondments, or other similar arrangements.

2.12 Second Schedule Paragraph 7: "Minimum net assets"

2.12.a. This criterion, which applies purely at the time when the licence is granted, requires institutions to have net assets amounting to not less than $10 million in the case of a bank and $1 million in the case of a deposit company. This is a separate test additional to the ongoing requirement that the institution maintain capital and other financial resources considered appropriate by the Authority.

PART 3 Principles Relating to the Granting of Licences

To grant a licence either as a bank or as a deposit company, the Authority needs to be satisfied that all the minimum licensing criteria in the Second Schedule are met. The Minister must also have advised the Authority that he is satisfied that the grant of the licence would be in accordance with the economic and financial policy of the Government. In addition, the Authority needs to be satisfied as to the ability and willingness of the applicant to provide and maintain the minimum services set out in section 14 of the Act. In order to be so satisfied, the applicant and any other relevant parties must first have provided all the appropriate information requested by the Authority in connection with the application. Even where it is satisfied that the criteria are or can be met, the Authority retains a residual discretion not to grant a licence - notably if it sees reason to doubt that the criteria will be met on a continuing basis or if it considers that for any reason there might be significant threats to the interests of depositors or potential depositors. The Authority also considers in exercising its discretion, whether it is likely that it will receive adequate information from the institution and relevant connected parties in order to enable it to monitor the fulfillment of the criteria and to identify potential threats to its depositors.

PART 4 Principles Relating to Restriction or Revocation of a Licence

4.1 This section is to be read in conjunction with the SPUEP. The SPUEP sets out the interpretation of the various grounds for the revocation of a licence in section 18 of the Act and the principles underlying the exercise of the Authority's discretion to revoke or impose restrictions on a licence and to intervene in emergency situations.

4.2 It is most likely that where the Authority's powers to restrict or revoke a licence are used that this will be in the context of the enforcement process and reference will be to the SPUEP. The possibility remains, however, that these powers may be

used in a supervisory context (e.g. to impose additional reporting requirements or where an institution ceases operations). These powers might also be used in such a manner as to protect the interests of depositors, and potential depositors, in the context of an external threat unconnected with the institution's conduct (e.g. a national catastrophe or force majeure.)

4.3 Section 20 of the Act provides that where the Authority concludes that its powers are exercisable and should be exercised, it must first issue a Warning Notice. An institution then has a period within which it can make representations, which the Authority needs to consider before either issuing a Decision Notice regarding the action to be taken or, if satisfied by representations received, choosing to take no further action.

4.4 Section 21 of the Act provides for the Authority to impose or vary restrictions with immediate effect (i.e. without serving notice of its intention to act) when it considers it a matter of urgency. This provision may apply in the supervisory application of the powers, such as the aforementioned national catastrophe or force majeure scenarios.

PART 5 Power to Obtain Information and Reports

Prudential supervision involves the receipt and analysis of a wide variety of regular and ad hoc financial and other information from institutions. The Authority's standard reporting arrangements are kept under review, agreed with institutions from time to time and amended in the light of developments. Such reports and information are routinely provided by institutions on an entirely voluntary basis.

Certain matters are, however, the subject of specific statutory reporting requirements – notably, for example, the requirement for institutions to make reports to the Authority under section 38 of the Act in respect of large exposures. The implementation of the statutory large exposures' reporting arrangements is set out in the Authority's paper of May 2007 on the management and control of credit risks and the implementation of the statutory provisions for large exposures.

In addition, section 39 of the Act provides formal powers for the Authority by notice in writing to require from an institution such information as it may reasonably require for the performance of its functions under the Act. The section also provides for the Authority to require an institution to provide it with a report by the institution's auditor or by an accountant or other person with relevant professional skill on, or on any aspect of, any matter about which the Authority has required or could require the institution to provide information under the section.

Formal use of the power requiring an institution to provide the Authority with such information is most infrequent since the Authority is able generally to rely on the willingness of institutions to provide information voluntarily. In particular

circumstances, however, the Authority must consider whether to make use of this power – notably, for example, where it has material concerns about the accuracy or completeness of information provided by an institution.

Use of the formal power to commission reports from an institution's auditor or from another relevant professional is, however, used more routinely to provide the Authority with reassurance about aspects of an institution's internal systems and controls or about the accuracy of its prudential information. Full details of the approach taken by the Authority to the commissioning of such reports are set out in its separate paper on relationships with auditors and reporting accountants. Generally the Authority has agreed that auditors and reporting accountants are not used routinely to report on systems and controls and that, instead, routine compliance visits by Authority staff are used to fulfill the bulk of the on-site regulatory review work which is required. But reports by an institution's auditors are used periodically on a routine basis for the verification of prudential data, in order to provide direct reassurance to the Authority that its prudential analysis is soundly based.

The Authority has also agreed with institutions that routine reports under this section are as a general rule commissioned from each institution's normal auditors, rather than from an independent firm or expert. Exceptionally, however, the Authority may require such reports from an independent firm or expert. The circumstances in which this is appropriate include, for example, where an in-depth review is required which calls for particular technical skills, or where the Authority has had reason to be concerned about the quality of the work performed by an institution's own auditors.

Section 40 of the Act provides statutory powers for the Authority by notice in writing to require an institution to produce relevant documents or information. This power can also be used to obtain relevant documents in the possession of other persons; and also to require information or documents from entities related to an institution. Section 41 of the Act provides the Authority with specific powers to enter the business premises of such persons for the purpose of obtaining relevant information or documents. Use of these powers is exceptional, and generally reflects circumstances in which the Authority has serious concerns about the operations of an institution or of companies with which it is linked.

PART 6 Explanatory Notes

NOTE 1 Section 14(3): "The Minister acting on the advice of the Authority may by order amend the Second Schedule by adding new criteria or by amending or deleting the criteria for the time being specified in the Second Schedule"

The Principles are based on the licensing criteria set out in the Banks and Deposit Companies Act 1999. The Minister of Finance acting on the advice of the Authority may

by order amend the licensing criteria and prescribe additional criteria necessitating changes to the Principles.

NOTE 2 Section 9(2): "If the Authority makes a material change to the principles it shall publish a statement of the change or the revised statement of principles in the same manner as it published the statement under subsection (1)."

PART 7 Conclusion

The Principles set out in this statement are of general application, and take account of the wide diversity of institutions which may be licensed under the Act and of the prospect of institutional and market changes. Nevertheless, there is likely to be a need for them to be revised from time to time. The Authority will publish a statement of any changes to the Principles and will issue revised versions of the Principles when there have been significant developments in its approach.