

9<sup>th</sup> Sept 2009

## BASIL CORE PRINCIPALS NOT MENTIONED IN THE PROMONTORY REPORT

'Dear Sir,

With regard to Matthew Dorman letter in the Guernsey Press dated 6 September 'the evidence of impending failure was there – the GFSC ignored it' I would like to take the opportunity to follow up on a number of issues the letter raised:

The GFSC has previously claimed that the GFSC commissioned report by the Promontory Group absolved it of blame and furthermore the Director General may claim that the report concludes that the GFSC met the requirements of the Basel Core Principles.

These principles consist of 25 bench marks. It would be difficult for Promontory to evaluate all of these as their remit for the report was limited and access to full data was not given. It may be that for the few core principles that Promontory were able to measure the GFSC against that the GFSC did indeed meet the benchmark, however if we look at all 25 of the principles then there are immediate areas where there was an apparent GFSC shortcoming.

These are as follows:

**Principle 11** – *Exposures to related parties: In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.*

- LGDAG contends that in accepting unsubstantiated assurances from the FSA the GFSC permitted LG to enter into contracts with Heritable Bank which it may not have approved if it had undertaken its own, appropriate, due diligence.

**Principle 10** – *Large exposure limits: Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.*

- LGDAG contends that in allowing LG to transfer approximately 35% of its asset value to related companies then further due diligence to ensure the independence of each company should have been undertaken by the GFSC itself.

**Principle 14** – *Liquidity risk: Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.*

- LGDAG identify this as a specific concern of GFSC, however, although Heritable Bank was dependent on Landsbanki Island HF for liquidity it allowed LG to enter into agreements with Heritable.

**Principle 19** – *Supervisory approach: An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness,*

*and the stability of the banking system.*

· LGDAG contends that by accepting assurances from FSA, rather than completing its own evaluation, the GFSC did not consider the global ramifications of the interdependence and relative liquidity of Landsbanki Guernsey and Heritable Bank when examined as part of the 'Landsbanki' corporate structure.

***Principle 24*** – Consolidated supervision: *An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.*

· LGDAG contends that by not assessing the corporate risk using readily available tools, that the GFSC was negligent in considering only a limited portion of the Landsbanki interdependences and as such acted in a manner which ultimately contributed to LG failure and subsequent depositor loss.

**It is time for both the Guernsey Authorities and the GFSC to stop hiding behind secrecy and confidentiality legislation and discuss in a mature manner the events that led up to Landsbanki Failure. The continued intransigence of the GFSC to clarify terms of the new Depositors Compensation Scheme is also worrying and as such the directive should be made clear for current savers.**

**As such LGDAG calls for**

- **The Chief minister to abide by his commitment to review the Landsbanki Guernsey situation if there was indication of regulator negligence;**
- **a full and independent public review of the GFSC and an independent Parliamentary review of the Landsbanki Guernsey failure to commence in the immediate future;**
- **Those responsible in the GFSC for the negligence which led in part to the failure of Landsbanki to explain why their due diligence did not meet an acceptable standard;**
- **That the GFSC and the Board appointed to manage the Depositors Compensation Scheme clarify terms of the directive to remove any doubts and inconsistencies which may lead to existing savers in Guernsey to suffer the same fate as those of Landsbanki Guernsey due to a future bank failure.**

***The simple fact remains:***

***Why, if the GFSC was doing its job correctly did Landsbanki Guernsey fail? If there was no negligence then there would have been no failure.***