ST. KITTS BRANCH
Financial Services Regulatory Commission

NewsLetter

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The FSRC'S RBS Framework

Introduction

The Financial Services Regulatory Commission (FSRC) is tasked with regulating and supervising the non-bank financial services sector in St. Kitts and Nevis. This includes ensuring that Financial Institutions are compliant with the Laws and Regulations relevant to their sector. The FSRC is also the ultimate regulatory body for Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) in the Federation. To efficiently undertake these responsibilities, the FSRC conducts monthly on-site examinations, as well as, off-site monitoring of each regulated financial institution.

This month's newsletter serves to give an overview of the FSRC's Risk Based Supervision (RBS) Framework which was adopted in 2015 as a guide to assessing the risks posed by each Regulated Entity to the safety and stability of the financial sector. The framework is applied to both off-site and on-site surveillance and analysis. The risk-based approach provides a structured framework for (i) understanding and assessing key risks inherent in an entity's activities, (ii) determining whether its risk management processes (i.e. identification, assessment, measurement, monitoring, controlling, mitigating and reporting of risks) are adequate and (iii) assessing whether its earnings, capital and liquidity are sufficient to enable it to support its risk appetite and withstand unexpected shocks.

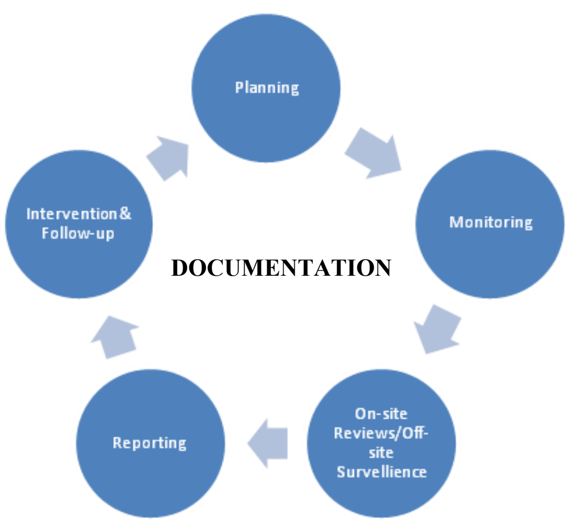
Legislative Authority

The following Laws and Regulations give authority to the FSRC to carry out its supervisory duties through on-site and off-site examinations:

i. Financial Services Regulatory Commission Act, Cap. 21.10;
ii. Anti-Money Laundering Regulations, No. 46 of 2011 (as amended);
iii. Anti-Terrorism (Prevention of Terrorist Financing) Regulations, No. 47 of 2011 (as amended);
iv. Financial Services (Implementation of Industry Standards) Regulations No. 51 of 2011;
v. Proceeds of Crime Act, Cap 4.28 (as amended);

The Supervisory Process

The FSRC assesses the risk of, monitors and regulates the following sectors: Insurance Companies, Development Bank, International Banks, Trust and Corporate Service Providers, Credit Unions and Money Services Businesses. Supervisory departments for each sector have been established. Each department is responsible for the ongoing supervision of the non-bank financial institutions in each sector and for ensuring that supervisory processes are completed effectively and on a timely basis. The main steps of the supervisory process are Planning, Monitoring, On-site Reviews, Off-site Surveillance, Documentation, Reporting, Intervention and Follow-up. These steps are clearly outlined in the RBS Framework.



Topics Discussed:

The Benefit Of Adopting A RBS Approach

The implementation of the supervisory approach allows for a more effective supervision as both macro and micro factors are looked at during assessments. By integrating macro and micro prudential supervision, focus is placed on the early detection of emerging risks and vulnerabilities to facilitate timely interventions.

Macro-prudential risk factors include:

i. the level of economic activity (the Gross Domestic Product [GDP] of the country);

ii. the level of interest rates; and

iii. the stability of the financial market, among other factors.

Industry Risk Factors are also taken into consideration during macro-prudential supervision. These factors take account of experience with products and services offered, nature and extent of competition, trends in growth, profitability, capital levels and liquidity, availability of required skilled resources, and investment trends.

Micro-prudential risk factors focus on the business operations. Supervisors look at the significant activities of the business, its risk management policies and procedures, organizational structure, financial performance/stability and determine whether the business strategies align with its objectives.

Assessing The Risk Profile Of A Regulated Entity

To determine the level of risk an entity poses, the following are assessed:

A. Significant Activities. To identify the activities of an entity, the Supervisors examine the organizational structure, strategic and business plans, capital allocations, and financial statements. Sound judgment is then applied to determine the significance or materiality of the activities. The following are some examples that may be used to determine materiality:

i) assets generated by the activity in relation to total assets;
ii) revenue generated by the activity in relation to total revenue;
iii) return of investments; and
iv) number of clients.

B. Key Risks Inherent in each Significant Activity. Once the significant activities have been identified, the risks inherent in those activities are assessed. Inherent risk is intrinsic to an activity and arises from exposure to and uncertainty from potential future events. The inherent risks of each Regulated Entity would be evaluated based on seven unique categories out of the following thirteen depending on the sector it operates in:

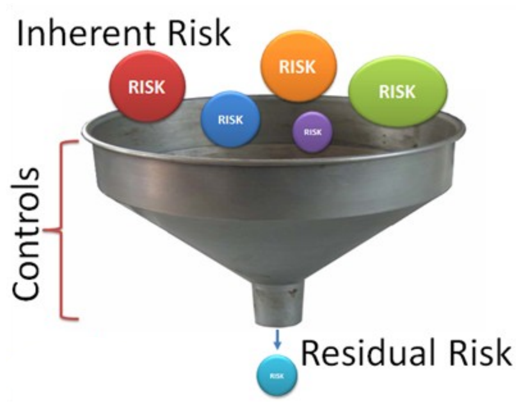
i) Credit;
ii) Market;
iii) Underwriting/Liability;
iv) Operational;
v) Legal/Regulatory;
vi) Strategic;
vii) Reputational;
viii) Concentration;
ix) Geographical;
x) Actuarial;
xi) Money Laundering/Financing of Terrorism;
xii) Product; and
xiii) Counterparty.

The levels of key inherent risks are assessed as **1=Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High (MH) or 5=High (H)**. The higher the level of inherent risks, the more rigorous the day to day management and oversight activities are expected to be.

C. Operational Management, Corporate Oversight and Governance for each Significant Activity. Operational Management is primarily responsible for the day to day oversight of a Significant Activity. This function ensures that policies, processes, control systems, staff levels and experience are sufficient and effective in managing and mitigating the key risks inherent in the Significant Activity. The presence and nature of Corporate Oversight and Governance functions vary based on the size, structure and complexity of a Regulated Entity. Regulated Entities incorporated in the country are required by legislation to have a Board of Directors and Senior Management while those entities incorporated outside the country, are required to have a principal officer generally to carry out the role and responsibilities of Senior Management. Oversight functions should include risk management, internal audit and compliance. Operational Management, Corporate Oversight and Governance functions are assessed as **1=Strong (S),2=Satisfactory (SA),3=Needs Improvement (NI),4=Weak (W) or 5=Critically Deficient (CD).**

D. Residual Risk in each Significant Activity. Residual risk refers to the risk that remains after controls have been put in place. The Supervisors usually consider the extent to which key inherent risks are managed by Management, as well as, independently overseen by an internal/independent audit function. The residual risk is assessed for each Significant Activity. These assessments are multi-dimensional and are based on informed qualitative judgments. Net residual risk for an activity is assessed as **1=Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High (MH) or 5=High (H).**

The residual risk assessments include a determination of the direction of residual risk. Direction is assessed as **Decreasing (D), Stable (S), or Increasing (I)** over an appropriate time horizon for the entity. The direction of residual risk adds a forward looking perspective to the risk-based approach. It looks at the adverse impact that an entity may face due to exposure and uncertainty from potential future events.



E. Overall Residual Risk for all Significant Activities. Overall Residual Risk of all Significant Activities taken together is a weighted aggregate of the residual risk of the individual Significant Activities. The assessment considers the residual risk in each activity and its relative materiality in developing the overall assessment. The overall assessment is a qualitative assessment of the entity's susceptibility to adverse events that might impact its earnings or capital in the foreseeable future. Overall Residual Risk is rated as **1=Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High (MH) or 5=High (H)**.

F. Earnings, Capital and Liquidity. Earnings, Capital and Liquidity are first assessed separately to understand how they individually contribute to the safety and soundness of the Regulated Entity, and then considered together to assess their adequacy in the context of the Overall Residual Risk in the entity's Significant Activities. Earnings, Capital and Liquidity are assessed as **1=Strong (S), 2=Satisfactory (SA), 3=Needs ,Improvement (NI),4=Weak (W) or 5=Critically Deficient (CD).**

G. Risk profile of the entity. The assessment of the risk profile is an overall assessment of the Regulated Entity after considering the adequacy of its capital supported by earnings, and its liquidity in the context of the Overall Residual Risks in its Significant Activities. It is an assessment of the safety and soundness of the entity. The risk profile is assessed as **1=Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High or 5=High (H).**

Interventions

Subsequent to assessing the risk profile of a Regulated Entity, the Supervisors will consider the level of intervention necessary depending on the regulated entity's risk profile and the nature and significance of prudential concerns uncovered. This is to ensure that concerns are addressed on a timely basis. (Appendix G of the RBS Framework outlines the types of actions that supervisors consider).

Regulated Entities are encouraged to review the FSRC's RBS Framework for a clearer understanding of how the risk of each entity is evaluated. **The document can be found on our website.**

Reference:

- The FSRC Risk-based Supervisory Framework, 7 June 2017.

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