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UNDERSTANDING MATERIAL CHANGE DISCLOSURES

A Helping Hand For Barbados's Non-Banking Financial Sector

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FEBRUARY 2025

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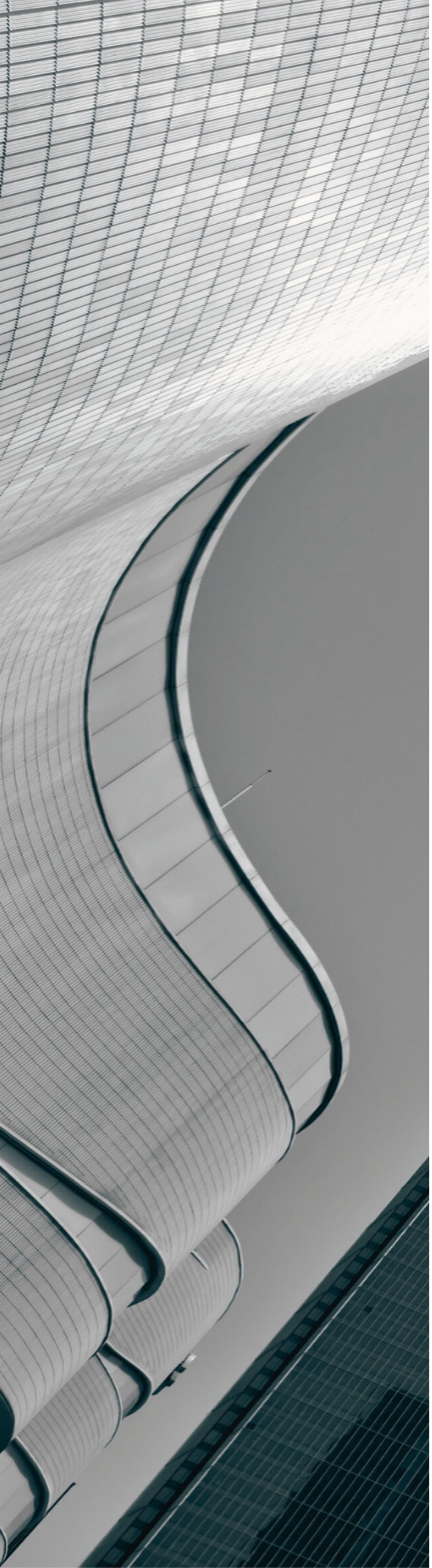
Introduction

The Financial Services Commission (FSC) in November 2024, issued its guideline on Material Change Disclosures (The Guideline). The Guideline establishes clear expectations for timely and accurate reporting to the regulatory body of Barbados' non-banking financial sector. But why are material changes important to our regulatory landscape and will financial institutions easily meet the regulator's expectations?

In this article we examine the importance of material change disclosures, highlight key aspects of the Guideline, opine on the significance question and finally, provide an overview on how companies can effectively ensure compliance with the Guideline's requirements.



Why are disclosures important?

Regulators are of the view that disclosures contribute to fairness and transparency of financial markets. Capital market participants for example are required to publicly disclose:

- Changes to the Board of Directors
- Appointment of senior management
- Investment reporting; and
- Audited financial statements.

These disclosures ensure that current and prospective investors have access to the same information to make informed decisions. In addition to ensuring fairness and transparency, disclosure reporting:

- **Allows regulators to stay abreast** of financial institutions' existing and planned operations.
- **Facilitates adequate planning and preparation** of thematic audits by regulators.
- **Increases financial institutions' oversight and improvement** of their governance framework.
- **Assists financial institutions in understanding** any **regulatory implications** of their business activities; and
- **Assists regulators in their monitoring** of activities that can increase systemic risk.

While the Guideline emphasises material change reporting to the regulator, it must be noted that regulators have powers to enforce public disclosure of any material change if it is in the interest of the public. More importantly failure to comply with material change reporting requirements could lead to revocation of a company's regulatory status.

Highlights of the Material Change Guidelines

The Guideline introduces areas of focus for registered financial institutions relating to:

Required Disclosures

Financial institutions are required to report significant changes in the areas of:

Business operations	Financial soundness	Legal proceedings
Governance	Risk management	Business continuity
Ownership	Business irregularities	Regulatory status

Companies should not limit the reporting of material changes to those outlined under the above in the Guideline but should evaluate whether other categories of changes will have a notable impact to warrant disclosures.

Notification Requirements

Institutions must communicate material changes to the FSC within specified timeframes. These range from prior notification of planned changes to post and immediate notification for event-based changes. Immediacy should be determined based on the acute nature of the change.

Approvals versus No-objections

Material changes can require either approval pursuant to legislative requirements, or the receipt of a no-objection from the FSC.
It is crucial that Board approved compliance frameworks incorporate policies, procedures and the required controls to ensure satisfaction with these requirements.

Financial institutions should not underestimate the importance of receiving a no-objection correspondence from the regulator. Boards should understand the inherent risk of implementing planned material changes before the receipt of this correspondence such as receiving directives to unwind transactions.

Highlights of the Material Change Guidelines (cont.)

Transparency and Accuracy

Institutions' policies and procedures should contemplate communication to the regulator. Designated compliance officers or individuals responsible for formulating disclosures to the FSC should ensure that communication is complete and accurate.

Key Persons and Parties

Changes involving licensed or registered individuals, senior management, directors, beneficial owners and external parties who perform certain services may be required to be disclosed and where necessary approved. External parties include auditors, actuaries, reinsurers, or trustees.

Common changes include those relating to tenure of employment, fitness and propriety, governance, termination of contracts and reappointments.

Fitness and Propriety

Regulated companies are expected to actively monitor key persons and external parties associated with the company to ensure they remain fit and proper. Any changes which impact the fit and proper status of any of the above-mentioned must be reported immediately to the FSC.

Companies are expected to have Board approved policies and procedures addressing fitness and propriety as part of their compliance framework. Financial institutions should therefore review the draft guidance issued by the FSC and reference global best practices to formulate a framework that mitigates this regulatory risk.

Understanding Significance

The FSC requires significant changes to be reported but has not defined significance.

Given its relative nature, financial institutions should consider their operations, size and risk profile as they evaluate whether changes have the potential to have a notable impact on business operations.

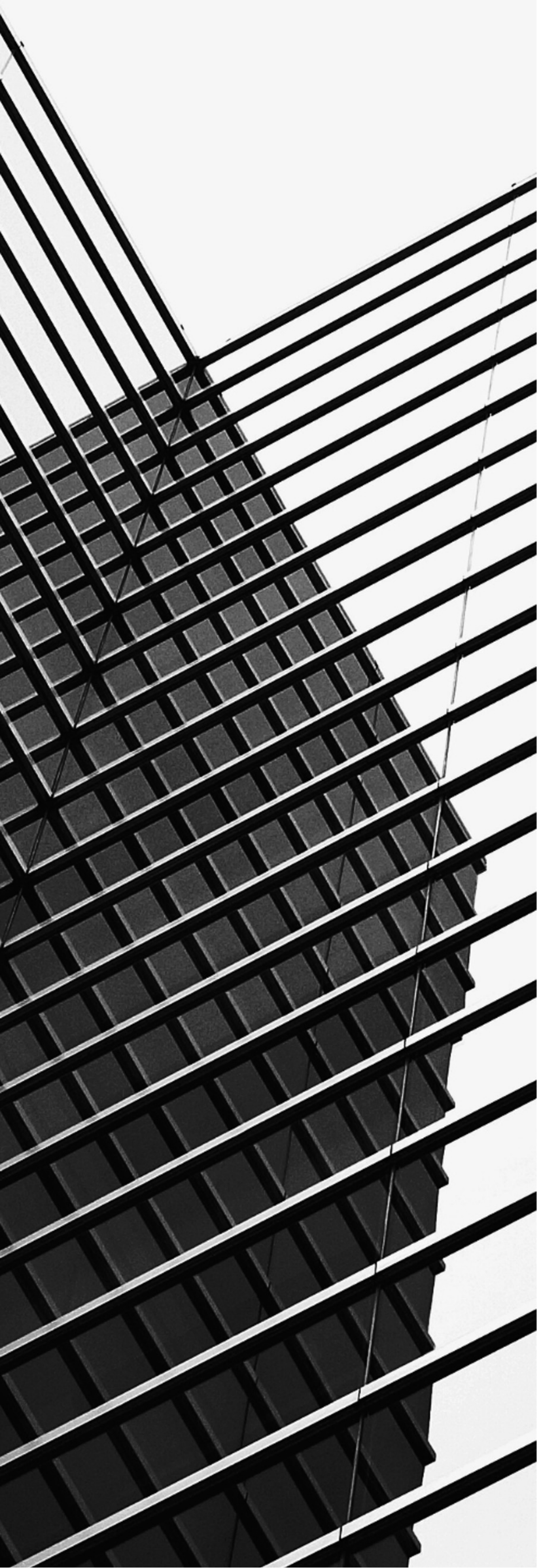
Starting the significance conversation

As companies manage their risks, prudent questions can lead to robust discussion and an evaluation of whether changes are significant.

Some of these questions can be:

- Will our assets be impaired?
- Will this result in a regulatory infraction?
- Are we outside our risk threshold?
- Is this an acceptable risk?

Answering the significance question therefore relies on an effective risk management framework with the proper functioning of the Board of Directors, senior management, operational staff and internal audit.



How can financial institutions ensure compliance with the Guideline?

To maintain compliance with legislative requirements, companies must have an effective Board approved corporate governance framework that at minimum addresses the following:

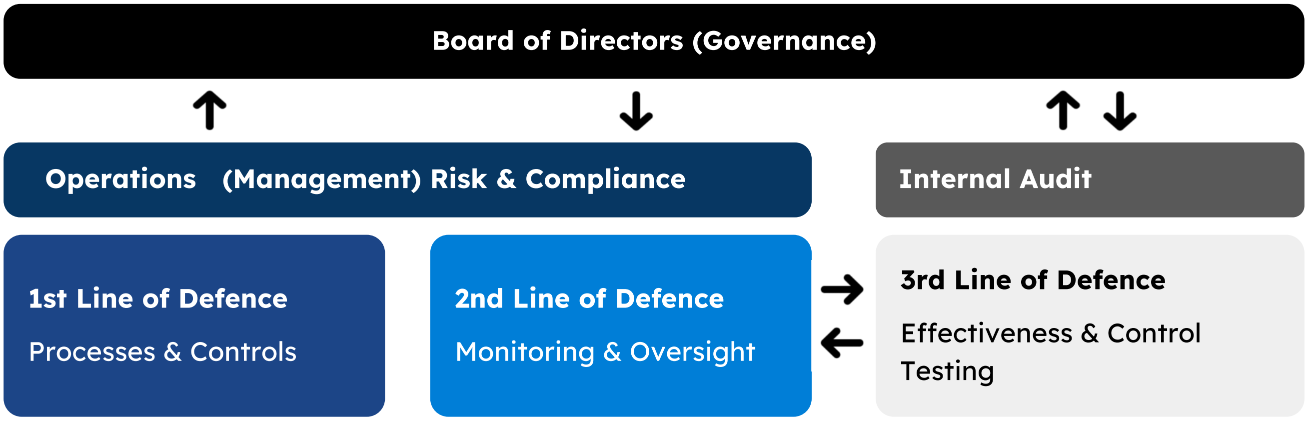
- Governance and Board Oversight
- Regulatory Compliance program
- Risk management framework
- Internal audit and control framework
- Regulatory reporting
- Code of Ethics and Business Conduct

But how does a financial institution determine if their policies and procedures are effective?

The key to effectiveness

Utilizing the three lines of defence model is a trusted approach to ensure effectiveness.

Figure 1: The Three Lines of Defence model



The components of the model are as follows:

Board of Directors	The Board of Directors provides oversight and direction to the financial institution, ensures that all regulatory requirements are met and supervises the compliance, risk and internal audit programs.
First Line Defence	Operational management is trained to understand the financial institution's compliance requirements and inherent risks and consequently design internal controls as the first line of defence.
Second Line Defence	Within the second line, compliance and risk oversight is the focal point. Processes are created to improve the compliance and risk frameworks. They also identify risks within the financial institution's operations and reports on the effectiveness of established internal controls to the Board.
Third Line Defence	The Internal Audit function is the third line of defence and gives the Board of Directors an independent and unbiased view on the effectiveness of Board approved policies, procedures and internal controls.

Where policies, procedures and internal controls are deemed to be ineffective, Internal Audit collaborates with the first and second lines to alleviate all deficiencies before effectiveness confirmation to the Board of Directors.

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[1] Based on a company's size, operations and risk profile there may not be a requirement for a full-time internal auditor. Companies should consider outsourcing the internal function for the purposes of effectiveness testing.

A satisfied Board of Directors!

With policies and procedures being confirmed as effective by Internal Audit, the Board can be satisfied that Management has systems in place to:

- **Determine** significance of changes
- **Evaluate** what is required to be disclosed
- **Assess** whether a material change requires approval or a no-objection
- **Communicate** transparently and accurately to the FSC
- **Monitor** key persons; and
- **Adequately report** on fitness and propriety

The Waterford Wrap Up

To conclude, we have highlighted the importance of material change reporting to the transparency and fairness of financial markets, the role of regulators and financial institutions. Further we see that the answer to the significance question lies in an effective risk management framework.

Examining the three lines of defence model, it is evident that ongoing compliance and the answer to timely and accurate disclosures centers around a robust and effective corporate governance framework with particular focus on compliance, risk management and the internal audit framework.

About
Waterford Capital Inc:

Waterford Capital Inc is engaged in the offering of first-class compliance, regulatory and risk solutions to various sectors that result in sustainability and resiliency. At Waterford Capital we look forward to being your trusted partner as you navigate your regulatory journey.

For more information on Waterford Capital,
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