THE CENTRAL BANK OF THE BAHAMAS

DOMESTIC SYSTEMICALLY IMPORTANT BANKS

DISCUSSION PAPER

29th August, 2018

1. Introduction

In October 2012, the Basel Committee finalized "*A Framework for dealing with domestic systemically important banks*[1]" outlining a principles-based minimum framework to identify Domestic Systemically Important Banks (D-SIBs) and the higher loss absorbency (HLA) capital requirements for banks that have been identified as D-SIBs.

Under the D-SIB framework, national authorities are to develop a method for assessing the degree to which banks are systemically important in a domestic context[2]. This method should reflect the potential impact of a bank's failure[3]. Appropriate national discretion is allowed to accommodate structural characteristics of the domestic financial system, recognizing that a local authority is best placed to evaluate the impact of failure on its financial system and economy[4].

2. D-SIB Approach

Systemically important banks are those whose failure would have significant negative consequences on their financial system. The Central Bank emphasizes that the designation of a bank as a D-SIB does not make that bank failure-proof. D-SIB designation is intended to ensure that banks perceived to be 'too-big-to-fail' are subject to more intense supervisory oversight and have greater capacity to absorb losses.

The Basel Committee D-SIB framework uses four key indicators of systemic importance: size, interconnectedness, substitutability and complexity[5]. This paper outlines the approach the Central Bank intends to take in implementing a D-SIB framework in The Bahamas.

2.1. The Bahamas Domestic Environment

The Bahamian banking sector is home to financial institutions including commercial banks, international banks, credit unions, and other entities. International banks operating in the sector will not be considered in the analysis, as they are not tied to the domestic economy. International banks make few if any loans and take few if any deposits within the Bahamian economy.

The Central Bank acknowledges that smaller authorized deposit taking institutions such as credit unions are an important part of the Bahamian financial landscape, but has excluded credit unions from the D-SIB analysis due to their size. Credit unions in aggregate, currently comprise approximately 3 per cent of domestic loans and deposits.

Additionally, there are four relatively large SFIs that the Central Bank does not consider D-SIBs. Three of these SFIs are licensed to operate within the domestic economy, but are not active. The fourth is a United States branch that is not required to hold Bahamian capital and therefore is

---

1 A Framework for dealing with domestic systemically important banks (October 2012)
2 The Basel Committee's 12 DSIB Principles; Principle 1.
3 The Basel Committee's 12 DSIB Principles; Principle 2.
4 The Basel Committee's 12 DSIB Principles; Principle 6,7, and 10.
5 The Basel Committee's 12 DSIB Principles; Principle 3 and 5.

exempt from relevant D-SIB regulatory requirements. Finally, the Central Bank does not consider that SFIs wholly or predominantly engaged in trust (as opposed to banking) business can be D-SIBs.

The net effect of the above exclusions is that Bahamian candidate D-SIBs are limited to the domestically licensed commercial banks, providing the bulk of private sector credit, and acting as the main recipient of private sector deposits, in the Bahamian banking industry.

2.2. Identification of D-SIBs in The Bahamas

A summary of Central Bank's assessment framework for identifying D-SIBs is shown in the table below. In creating this framework, the Central Bank has considered international precedents from the IMF, the Australian Prudential Regulation Authority (APRA), and the Canadian Office of the Superintendent of Financial Institutions (OSFI). The Canadian approach is obviously relevant to The Bahamas, and the Australian banking system and its regulation is a close cognate for Canada.

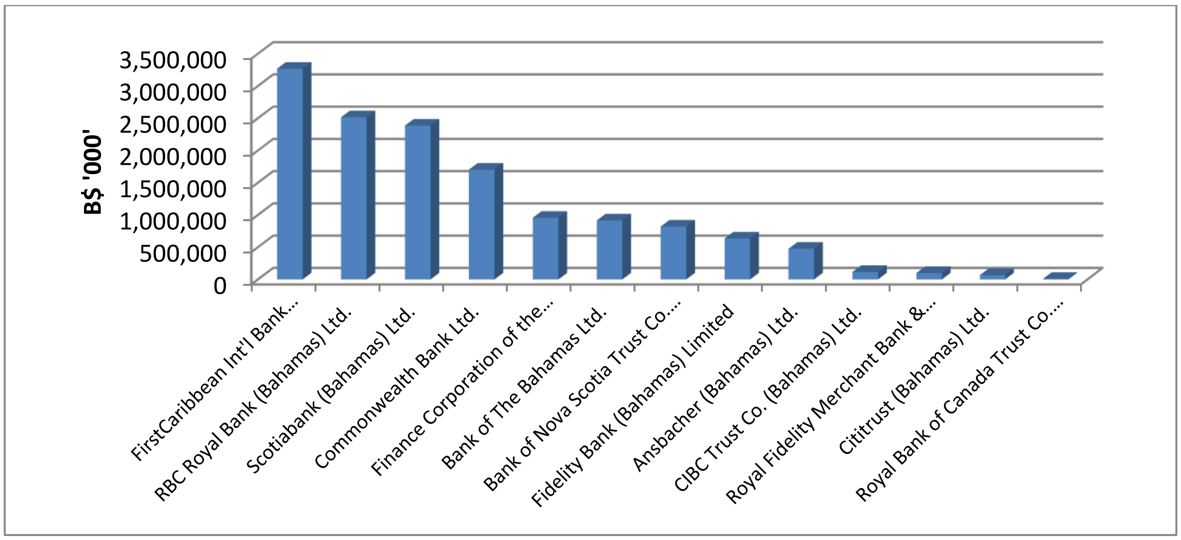
Table 1

Indicator	IMF	APRA	OSFI	CBOB
Size	o Total resident assets	o Total resident assets	o Total Consolidated Assets	o Total Assets o Resident BSD Deposits o Number of Employees
Interconnectedness	o Investment securities o Wholesale funding o Loan/deposit ratio o Intra-group exposures	o Intra-financial system assets o Intra-financial system liabilities o Securities outstanding (Short-term securities, long-term borrowings and CDs) o Large exposures	o Intra-financial assets o Intra-financial liabilities	o Loan/deposit Ratio o Intra-group Exposures (Market Loans)
Substitutability	N/A	o Assets under custody o Payments activity o Underwritten transactions in debt and equity markets o Total gross loans and advances o Total household lending	o Underwritten Transactions in debt and equity markets	o Assets under custody o Total Loans & advances
Complexity	o Trading book o Trading book and qualitative information	o Notional amount of OTC derivatives o Trading and available-for-sale securities o Risk-weighted assets for traded market risk	N/A	N/A

2.2.1 SIZE

A bank's failure is more likely to negatively impact the Bahamian financial system if its activities represent a large share of the domestic banking industry. For the purposes of this exercise the Central Bank used financial data as at 31st March, 2018. Bahamian banks' size was measured using the indicators of Total Assets, Resident BSD Deposits, and total number of employees. The ranking of banks by total assets varies significantly between the Canadian-owned commercial banks and the non-Canadian commercial banks. Trust companies hold few assets on their own balance sheets, which is why the Central Bank considers that they are not D-SIB candidates. The assets of the commercial banks represent 89% of the total assets within the domestic environment[6]. The commercial banks account for almost 100% of the resident BSD deposits. Domestic institutions employ about 58% of the Bahamian banking industry; 88% of these employees work in commercial banking (See Appendix: Selected Statistics).

FIGURE 1: TOTAL ASSETS (B$ 000S)



[6] The domestic environment consists of 17 SFIs; 8 onshore commercial banks, 4 are subsidiaries of Canadian banks, 3 are locally owned and 1 is a branch of a United States based institution (excluded from the analysis). The remaining 9 other local financial institutions include 3 subsidiaries which have been excluded from the analysis.

FIGURE 2: RESIDENT B$ DEPOSITS (000S)

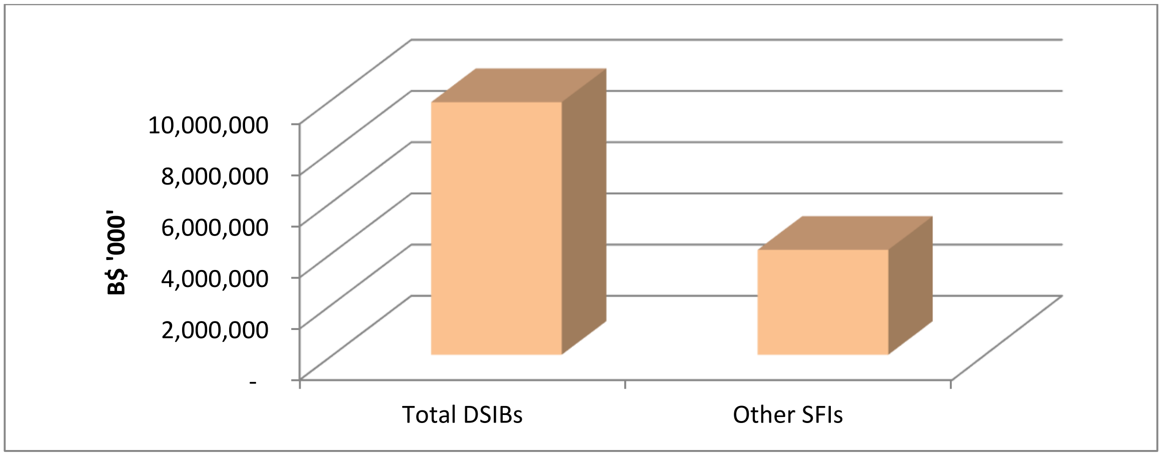
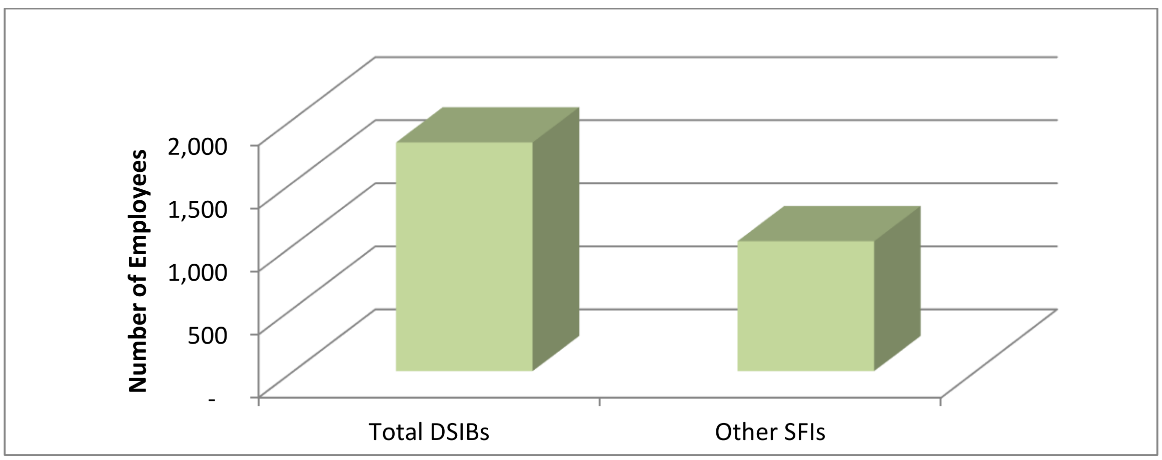


FIGURE 3: TOTAL NUMBER OF EMPLOYEES



2.2.2 INTERCONNECTEDNESS

In general, the more inter-connected a bank is to other financial institutions, the greater the potential that the failure of one bank will generate distress in the financial system and the economy. There is currently no active domestic interbank market among commercial banking institutions. With respect to lending to financial institutions, collectively, commercial banks represent only 1% of the 10 largest market loans (Figure 4) and only 2% of the 20 largest exposures in the Bahamas (See Appendix: Selected Statistics).

FIGURE 4: 10 LARGEST MARKET LOANS ($B 000S)

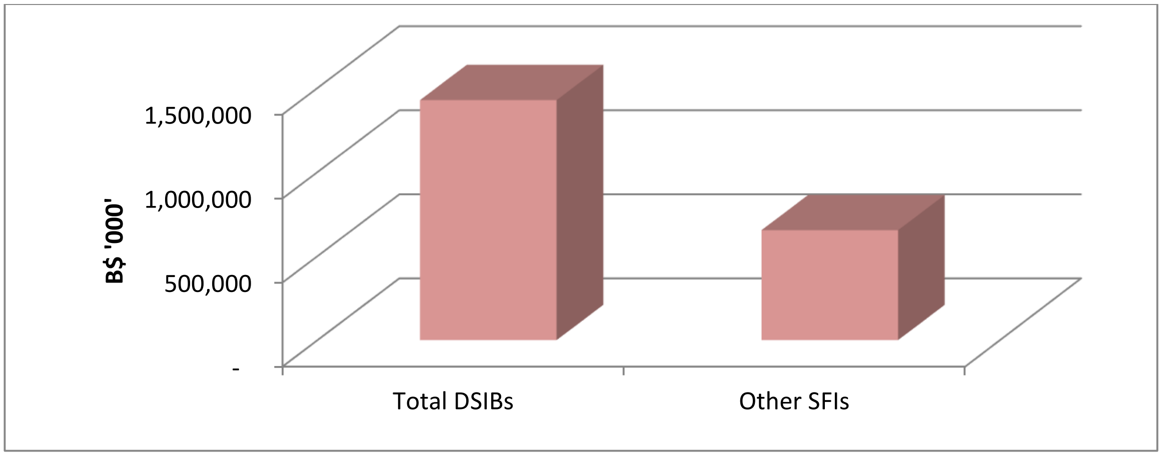
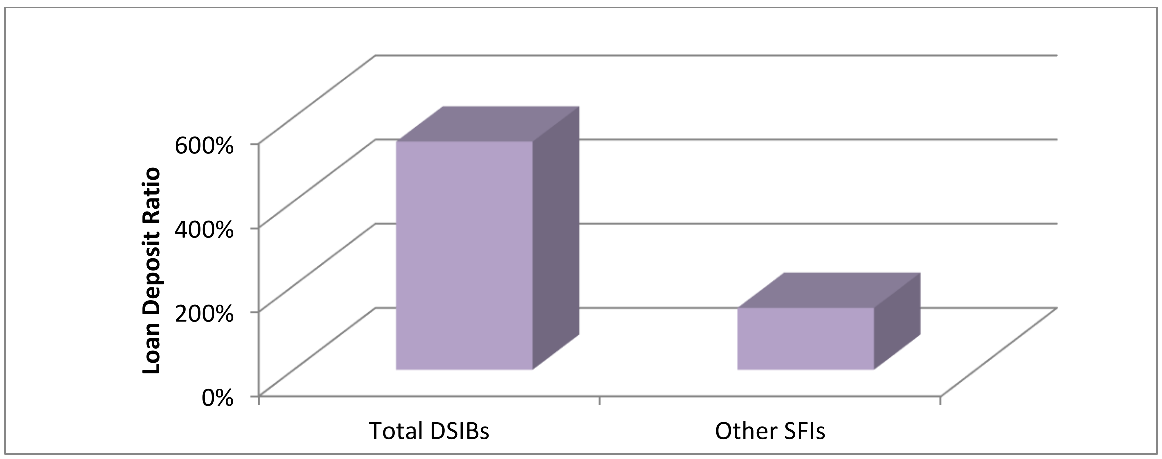


FIGURE 5: LOAN/DEPOSIT RATIO



2.2.3 SUBSTITUTABILITY

Financial institutions whose roles are difficult to replace in domestic financial markets and in the domestic financial infrastructure, are considered systemically important. There is a total of $7.1 billion in domestic loans in the Bahamas. The commercial banking sector is responsible for 99% of domestic loans. Ranking banks by their lending activity demonstrates that there is significant difference between the commercial banks and other domestic institutions (Figure 6). Assets under custody within the domestic environment are insignificant, representing less than 1% of the total assets under custody in the Bahamas. Figure 7 illustrates that within that percentage, one commercial bank has half of assets under custody.

FIGURE 6: TOTAL LOANS AND ADVANCES (B$ 000S)

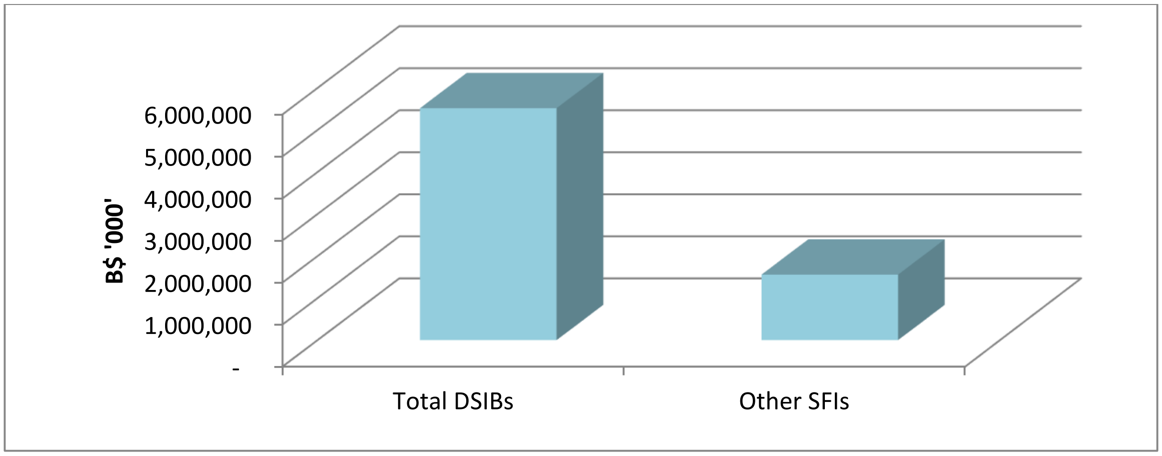
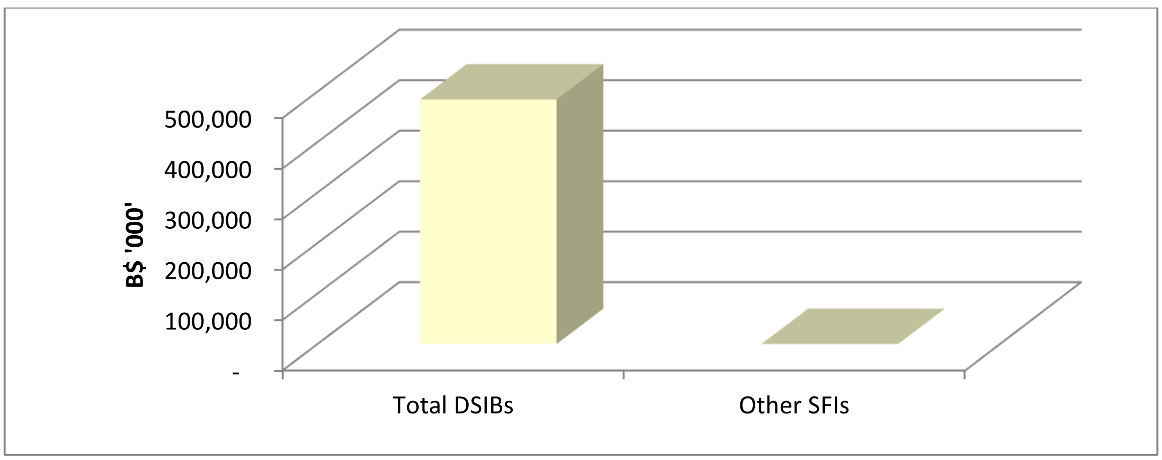


FIGURE 7: ASSETS UNDER CUSTODY (B$ 000S)



2.2.4 COMPLEXITY

The business, structural and operational complexity of a financial institution is expected to significantly contribute to the impact of failure. Increased complexity also increases the costs associated with resolution. Among the four categories assessed, complexity is not considered to be directly relevant to Bahamian D-SIBs. The business of most banks operating in the domestic market can be regarded as simple, with derivative activity (if any) confined to hedging positions.

3. Proposed D-SIB approach in The Bahamas

3.1 D-SIB Determination

Based on our analysis of the indicators noted above, the Central Bank has determined that the following institutions are D-SIBs, (in alphabetical order):

1. Bank of The Bahamas Ltd.
2. Commonwealth Bank Limited
3. Fidelity Bank (Bahamas) Limited
4. Finance Corporation of The Bahamas
5. FirstCaribbean Int'l Bank (Bahamas) Ltd.
6. RBC Royal Bank (Bahamas) Ltd.
7. Scotiabank (Bahamas) Ltd.

Put simply:

- All the domestic retail banks are D-SIBs; and
- No other SFIs are Bahamian D-SIBs.

3.2 D-SIB capital regime

The seven nominated D-SIBs already hold substantial capital buffers, with CET1 capital ratios ranging from 18.8% to 53.2%.

The Central Bank has in a separate paper[7] proposed a single capital buffer regime, in which the domestic banks would be subject to a materially higher capital buffer than other SFIs. This is the proposed de facto arrangement for a Bahamian D-SIB capital buffer.

3.3 Higher loss absorbency (HLA) considerations

The Basel framework contemplates an HLA regime for D-SIBs, to reduce the probability of failure compared to non-systemic institutions. Given our D-SIBs already hold sufficient levels of CET1 Capital to meet the statutory capital buffers, the Central Bank considers the HLA requirement to be included in the proposed 8% Additional CET1 Capital buffer framework, outlined in our Basel III Discussion Paper on Capital Requirements.

[7] Central Bank Discussion Paper: Implementing Basel III Capital Requirements

3.4 CONSULTATION

The Central Bank invites comments and/or questions from industry stakeholders and the general public on these proposals. Feedback on this Discussion paper is requested by **31st October, 2018** and should be submitted to the following address:

Policy Unit
Bank Supervision Department
policy@centralbankbahamas.com

Appendix: Selected Statistics

	# of SFIs	Total Assets	Total Risk-Weighted Assets	CET 1	Total Regulatory Capital	Total Loans and Advances (in $'000s)
Total DSIBS	7	12,373,480	6,968,297	2,072,331	2,278,862	6,985,245
Total Domestic	13	13,963,583	7,653,320	2,339,477	2,546,513	7,076,559
Total Financial Institutions	86	193,666,760	50,568,092	21,939,311	22,204,956	27,926,197
DSIBs/ Domestic Environment	54%	89%	91%	89%	89%	99%
DSIBs/ Bahamas	8%	6%	14%	9%	10%	25%
	Total Resident B$ Deposits (in $'000s)	20 Largest Exposures (in $'000s)	10 Largest Market Loans (in $'000s)	Total Deposits (in $'000s)	Assets Under Custody (in $'000s)	No. Employees
Total DSIBS	6,868,641	1,491,067	869,468	8,099,843	234,180	2,492
Total Domestic	6,870,293	1,866,234	2,081,447	9,023,612	484,239	2,843
Total Financial Institutions	6,886,703	87,596,441	103,590,389	70,479,548	48,670,476	4,295
DSIBs/ Domestic Environment	100%	80%	42%	90%	48%	88%
DSIBs/ Bahamas	100%	2%	1%	11%	0%	58%

End of Document