THE CENTRAL BANK OF THE BAHAMAS

MINIMUM DISCLOSURE REQUIREMENTS UNDER BASEL II AND III

DISCUSSION PAPER

29th August, 2018

1. Introduction

The Central Bank of The Bahamas ("the Central Bank") has been steadily implementing the Basel II and III frameworks. The Basel II/III regime is based on 3 pillars:

- Pillar 1- Minimum Capital Requirements;
- Pillar 2- Supervisory Review; and
- Pillar 3- Market Discipline.

This paper outlines the Central Bank's proposed approach to Pillar 3 disclosure requirements. Pillar 3 provides market participants with information relating to a bank's regulatory capital and risk exposures. This information increases transparency and promotes comparability between banks.[1] Pillar 3 mandates that banks publicly disclose their risk information to allow market participants to monitor bank capital adequacy, liquidity, and overall performance, and to enable participants to exercise market discipline on bank behavior.

The Central Bank issued Minimum Disclosure Guidelines in December 2016 for all public supervised financial institutions (SFIs) that are subject to Basel II reporting. Due to feedback received from industry, however, the Central Bank withdrew this Guideline in March of 2017 in order to reconsider the intended balance between the costs and benefits of public disclosure.[2]

The Central Bank intends to complete, but more importantly, simplify the Bahamian Basel II and Basel III regulatory framework, consistent with the proportionality principle set out by the Basel Committee.[3] We expect that the policy framework will be completed during 2019, with implementation to follow from 2020.

This discussion paper recommences the consultation on the Central Bank's proposed revisions to its regulatory framework on minimum disclosure. The Central Bank invites comments from stakeholders on the proposals within this paper.

Feedback on this discussion paper is requested by the **31st October, 2018** and should be submitted to the following address:

Policy Unit
Bank Supervision Department
policy@centralbankbahamas.com

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[1] Basel Committee on Banking Supervision paper entitled *Standards Revised Pillar 3 Disclosure Requirements* January 2015 https://www.bis.org/bcbs/publ/d309.pdf

[2] See The Central Bank Notice re: *Guidelines on Minimum Disclosures* dated 31st March, 2017 and 6th November, 2017.

[3] Quarterly Letter for the 4th Quarter, 2017 at http://www.centralbankbahamas.com/download/038109200.pdf

2. Pillar 3: The Basel Committee's Initiative to improve market discipline

Pillar 3 disclosures aim to promote market discipline by providing meaningful financial information to investors and other interested parties on a consistent and comparable basis. There are five guiding principles for achieving transparent, high-quality Pillar 3 risk disclosures:[4]

- ✓ Principle 1: Disclosures should be presented in a form that is understandable to key stakeholders and communicated through an accessible medium.
- ✓ Principle 2: Disclosures should be comprehensive, comprising both qualitative and quantitative information, describing a bank's main activities, risks and any significant changes in its risk exposures.
- ✓ Principle 3: Disclosures should be meaningful to users, thereby highlighting a bank's most significant current and emerging risks and how those risks are managed.
- ✓ Principle 4: Disclosures should be consistent over time to enable key stakeholders to identify trends in a bank's risk profile across all significant aspects of its business.
- ✓ Principle 5: Disclosures should be comparable across banks to enable key stakeholders to perform meaningful comparisons between banks and across jurisdictions.

2.1 Applicability of Pillar 3: Relevant Aspects of the Bahamian banking and capital markets

The Basel Committee's Pillar 3 rules were drafted for large and internationally active banks. Such banks are usually headquartered in countries featuring:

- Deep and liquid equity markets, supported by sophisticated buy-side and sell-side equity analysts;
- Deep and liquid bond markets, supported by debt rating agencies, and sophisticated fixed income analysts; and
- Large, complex, and highly informative annual and interim reports, supported by a great deal of investor information.

None of the above capabilities feature strongly in the Bahamian context. Most home-supervised Bahamian banks are not listed on any stock exchange, and have no debt ratings. Those banks that maintain a stock market listing trade rarely, in an illiquid market. Most host-supervised international banks are part of much larger financial institutions, such that separate disclosure of the Bahamian position is probably unnecessary.

Simply applying the Basel Committee's Pillar 3 disclosure regime in The Bahamas is likely to create material expense for the industry, without creating balancing benefits to the industry's investors, customers, or other stakeholders.

On the other hand, sensible disclosures for Bahamian banks will help support a better-informed market. Accordingly, the Central Bank proposes to create a Pillar 3 disclosure regime that provides substantial financial information to stakeholders, at near-zero cost to Bahamian banks.

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[4] Basel Committee on Banking Supervision paper entitled *Standards Revised Pillar 3 disclosure requirements* January 2015 at https://www.bis.org/bcbs/publ/d309.pdf

2.2 Implementation of Pillar 3 in other countries

Basel requirements are not prescriptive on the medium and location of disclosure, allowing for a level of discretion by regulators worldwide. Regulators in the countries of Australia, Canada and Singapore, for example, require that their institutions produce separate Pillar 3 reports that are publicly available on their websites. However, banks in Canada that are not systemically important are allowed discretion on the location of Pillar 3 disclosures. Deposit-taking institutions in Australia that do not have a website may obtain approval for alternative publication arrangements. In smaller countries, such as Bermuda, banks are required to post their Pillar 3 reports as standalone documents at an easily accessible location on their websites.

3. Proposed Pillar 3 implementation in The Bahamas

3.1 Pillar 3 disclosures posted on the Central Bank's website

The Central Bank proposes to take a different approach from that in its recalled guideline, and from that of other countries, by relieving individual banks from the requirement to publish Pillar 3 data. The Central Bank will instead disclose all the necessary bank data at a dedicated and publicly accessible location on the Central Bank's website.

Posting bank data to the Central Bank's website generates three advantages:

- Because banks will need to provide this data to the Central Bank in any event for supervisory purposes, a central website means that Bahamian Pillar 3 requirements are met at zero additional cost to the banking system;
- Interested stakeholders will be able to extract and compare data for all relevant Bahamian SFIs, without the need to extract this data from roughly 90 individual websites or other sources; and
- Each bank's incentive to produce accurate prudential reporting is increased, as this data will also be in the public domain.

Moreover, posting to the Central Bank's website will be super-equivalent to Basel Standards by optimizing the accessibility, consistency and comparability of banks' financial information, without imposing any additional regulatory burden or costs.

3.2 Disclosures required on the Central Bank's website

The Central Bank proposes that it will provide single-point website disclosure of both quantitative and qualitative data for:

- Domestic banks
- International banks
- Credit Unions

There is an argument, which the Central Bank has considered, that host-supervised international banks should not need to make any disclosures, as their (typically much larger) parents are also making public disclosures. The Central Bank proposes to include host-supervised international banks, in order for stakeholders to capture the full picture of the Bahamian banking industry. As noted later in this discussion paper, however, we are only proposing this approach for the quantitative data, which will already be provided to the Central Bank in any event.

3.3 Quantitative data disclosures

All relevant Bahamian SFIs are required to provide extensive financial information on their capital and liquidity positions to the Central Bank. This quantitative information is essential for the analysis of a bank's regulatory capital and liquidity requirements.

The Central Bank currently collects this data through its online reporting and information management system (ORIMS reporting). The intended Basel III reforms to Bahamian capital and liquidity requirements will necessitate further enhancements to ORIMS.

The Central Bank proposes to disclose all the data reported by each bank (host and home supervised) and credit union on their capital and liquidity positions:

- Risk-based capital;
- The leverage ratio;
- The liquidity coverage ratio (LCR); and
- The net stable funding ratio (NSFR).

Although the Basel III disclosure framework for Pillar 3 focuses upon capital disclosures, the Central Bank intends to include disclosures on liquidity as well. Quantitative disclosures will flow from data the Central Bank will need to collect in any event, as part of its supervision of the new Liquidity Coverage Ratio and Net Stable Funding Requirement arrangements.

Data that identifies individual bank customers, such as large exposures returns, will not be disclosed.

We attach the following pro forma documents to this discussion paper (in the Appendix), to better inform stakeholder feedback:

1) An example of the individual bank capital report; and
2) An example of the individual bank liquidity report.

The reports above are intended to be updated quarterly, and will be available in a time series.

An aggregate bank capital and an aggregate bank liquidity report will be compiled from individual bank reports. The aggregate report will provide a cross-sectional snapshot of individual banks' data at a point in time. Individual bank data will be listed in alphabetical order by peer groups.

3.4 Qualitative disclosures

The Basel Committee's Pillar 3 regime contemplates extensive qualitative disclosures. The Central Bank proposes to address these requirements as follows:

- All domestic banks and credit unions, plus home-supervised international banks, will be required to submit an annual return to the Central Bank with specific qualitative information requirements. These returns will be available on the Central Bank's website;
- Host-supervised international banks will not be required to make qualitative disclosures, as these would typically only repeat what their parents are already disclosing.

If any bank wishes to make additional qualitative or quantitative disclosures via its website or other media, it is free to do so.

We attach a sample of the qualitative disclosure templates in the Appendix. The topic highlighted in the Appendix cover general risk management and information that an individual bank will be expected to disclose in this regard. It should be noted that other qualitative topics such as credit risk management, operational risk management, market risk management and a summary of the Internal Capital Adequacy Assessment Process (ICAAP) will also have to be disclosed, as applicable. This qualitative report will have to be updated annually.

3.5 Basel Pillar 3 items that will not be disclosed

The Central Bank proposes to relieve banks and credit unions from making any disclosures on:

- Remuneration
- Interest rate risk in the banking book
- Regulatory/Accounting capital reconciliation

The Central Bank does not consider that Bahamian remuneration practices contribute materially to prudential risk in this jurisdiction, so does not collect data on this issue. Similarly, interest rate risk is a very small proportion of total risk, so the costs of compilation and publication exceed any value of making this data public.

The value of a regulatory/accounting capital reconciliation is materially reduced in The Bahamas, due to the Central Bank's proposed approach to capital definition. Under this approach, only common equity, with some (disclosed) regulatory adjustments, will count as capital for prudential purposes.

3.6 Audit status of the disclosures

The quarterly quantitative disclosures on the Central Bank's website will not be required to be audited. Disclosures, however, are expected to be consistent with the disclosures made in the annual audited financial statements. SFIs are required to have adequate controls around their reporting processes including appropriate design, monitoring, and oversight.

As the published material will be sourced from submitted regulatory reports, the existing penalty framework for erroneous regulatory submissions would apply, without any additional reference to public disclosure.

The Central Bank will retain the power to commission a special audit report regarding an SFI's Pillar 3 disclosures, if the Central Bank considers that an SFI is failing to report accurately.

4. Consultation

The Central Bank invites comments from industry stakeholders and the general public on the following questions related to proposals in this paper:-

Q1. What are your views on Bahamian bank Pillar 3 requirements being met through a dedicated section of the Central Bank's website?

Q2. Do you have any views on the mandatory disclosure of capital and liquidity data on the Central Bank's website?

Q3. Is there any additional data on your institution that you would like disclosed on the Central Bank's website?

Q4. Are there any confidentiality concerns regarding the data proposed to be posted on the Central Bank's website?

Q5. Do you have any views on the requirement that domestic banks and credit unions submit specified qualitative information for publication on the Central Bank's website?

Q6. What is the appropriate balance between internal and external audit of each bank's Pillar 3 information flowing to the Central Bank, and how often should these audits be carried out?

Q7. Are there any other comments, suggestions, or concerns that you wish to raise regarding this proposal?

APPENDIX

Quantitative PILLAR 3 TEMPLATES

Capital Report

Common Equity Tier 1 Capital

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Common Equity	xxx
Stock Surplus	xx
Retained Earnings	xx
General or Statutory Reserves as disclosed on the balance sheet	xx
Accumulated Other Comprehensive Income	xx
Less Regulatory Adjustments	xx
Common Equity Tier 1 Capital	xxx

Risk Weighted Assets

Credit Risk Weighted Assets (Credit RWA)

Asset Exposure Balance	Exposure Amount	Risk Weight %	Risk Weight Asset
Exposures to Sovereigns	xx	xx%	xx
Exposures to Non-Central Government Public Sector Entities (PSEs)	xx	xx%	xx
Exposures to Multilateral Development Banks (MDBs)	xx	xx%	xx
Exposures to Banks	xx	xx%	xx
Exposures to Securities Firms	xx	xx%	xx
Exposures to Corporates	xx	xx%	xx
Retail Exposures	xx	xx%	xx
Exposures secured by Residential Real Estate	xx	xx%	xx
Exposures secured by Commercial Real Estate	xx	xx%	xx
Land acquisition, development and construction exposures	xx	xx%	xx
Securitizations	xx	xx%	xx

Cash Items	xx	xx%	xx
Collective Investment Scheme Exposures	xx	xx%	xx
Investments	xx	xx%	xx
Securitizations	xx	xx%	xx
Past Due Exposures	xx	xx%	xx
Other Exposures	xx	xx%	xx
Off-Balance Sheet Items	xx	xx%	xx
Total Credit Risk Weighted Assets			XX

Operational Risk Weighted Assets (Operational RWA)

Gross Income (3 year average)	xx
Business Indicator Coefficient	0.12
Operational Risk Capital Charge	XX
Multiplier	12.5
Total Operational Risk Weighted Assets	XX

Market Risk Weighted Assets (Market RWA)

Market Risk Capital Charge	XX
Multiplier	12.5
Total Market Risk Weighted Assets	XX

Total Risk Weighted Assets (Credit RWA + Operational RWA + Market RWA) **XXX**

Ratios

Capital Adequacy Ratio
(CET1 Capital/[Credit RWA + Operational RWA + Market RWA]) xx%

Leverage
Ratio

CET1 Capital	xxx
Total Assets	xx
Less Items deducted from CET1 Capital	x
Less Specific and general provisions	x
Less All other regulatory adjustments deducted from the calculation of CET1	x
Plus Off Balance Sheet Assets	x
Exposure Measure	xxx
Leverage Ratio (CET1 Capital/Exposure Measure)	xx%

Liquidity Report

Liquidity Ratio	Total Liquid Assets	xx		
	Deposit Liabilities	xx		
	Liquidity Ratio	xx%		
Liquidity Coverage Ratio				
	Stock of High Quality Liquid Assets (HQLA)	xx		
		Amount	%	Product
	Retail Deposits			
	Stable deposits	xx	5%	xx
	Less stable retail deposits	xx	10%	xx
	Term Deposits with > 30 days residual maturity	xx	0%	xx
	Unsecured wholesale funding			
	Less stable deposits	xx	10%	xx
	Operational deposits generated by clearing, custody and cash management activities	xx	25%	xx
	Operational deposits - Portion covered by deposit insurance	xx	5%	xx
	Cooperative banks in an institutional network	xx	25%	xx
	Non-financial corporates, sovereigns, central banks, MDPS and PSEs	xx	40%	xx
	Other legal entity customers	xx	100%	xx
	Secured Funding			
	Secured funding transactions with a central bank counterparty	xx	0%	xx
	Secured funding transactions by non-Level 1 or non-Level 2A assets	xx	25%	xx
	All other secured funding transactions	xx	100%	xx
	Additional Requirements:			
	Currently undrawn committed credit and liquidity facilities provided to:			
	- Retail and small business clients	xx	5%	xx
	- Non-financial corporates, sovereigns, central banks, MDPS and PSEs	xx	10%	xx
	- banks subject to prudential supervision	xx	40%	xx
	- other financial institutions	xx	40%	xx
	- other legal entity customers	xx	100%	xx
	Any additional contractual outflows	xx	100%	xx
	Net derivative cash outflows	xx	100%	xx
	Any other contractual cash outflows	xx	100%	xx
	Total weighted cash outflows			xx
	Total weighted cash inflows	xx		
	Total Net cash outflows			xx

	Liquidity Coverage Ratio (LCR) (Stock of high quality liquid assets/Net cash outflows)	xx%		
Net Stable Funding Ratio (NSFR)	**Available amount of stable funding (ASF)**	Amount	Factor	
	Regulatory Capital and Other Capital Instruments	xx	100%	xx
	Demand and term deposits (stable) with residual maturity of less than 1 year	xx	95%	xx
	Less stable non-maturity deposits and term deposits w/ residual maturity of less than 1 year	xx	90%	xx
	Funding to non-financial corporates, sovereigns, PSEs, MDBs, Operational Deposits	xx	50%	xx
	Other Liabilities and Equity not included in the above categories	xx	0%	xx
	Total ASF			xx
	Required amount of stable funding (RSF)			
	Cash, Central Bank Reserves, Trade date Receivables	xx	0%	xx
	Unencumbered loans to financial institutions with residual maturities of less than six months	xx	10%	xx
	Other unencumbered loans to financial institutions with residual maturities of less than six months not included in the above categories	xx	15%	xx
	Loans to financial institutions and central banks, HQLA encumbered greater than 6 months and less than 1 year, deposits held at other financial institutions for operational purposes, all other assets not included above with residential maturity of less than 1 year	xx	50%	xx
	Unencumbered residential mortgages with a residual maturity of one year or more, other unencumbered loans not included above	xx	65%	xx
	Other unencumbered performing loans with risk weights greater than 35%, unencumbered securities not in default and not qualified as HQLA, physical traded commodities, including gold, all encumbered assets 1 year or more, and all other assets not included above	xx	100%	xx
	Total RSF			xx
	Net Stable Funding Ratio (NSFR) (Available amount of stable funding/Required amount of stable funding)	xx%		

Sample of Qualitative Disclosure templates

	General
	Overview of Risk Management
	Banks are expected to describe their risk management objectives and policies, in particular:
	(a) How the business model determines and interacts with the overall risk profile (e.g. the key risks related to the business model and how each of these risks is reflected and described in the risk disclosures) and how the risk profile of the bank interacts with the risk tolerance approved by the board
	(b) The risk governance structure: responsibilities attributed throughout the bank (e.g. oversight and delegation of authority; breakdown of responsibilities by type of risk, business unit etc.); relationships between the structures involved in risk management processes (e.g. board of directors, executive management, separate risk committee, risk management structure, compliance function, internal audit function).
	(c) Channels to communicate and enforce the risk culture within the bank (e.g. code of conduct; manuals containing operating limits or procedures to treat violations or breaches of risk thresholds; procedures to raise and share risk issues between business lines and risk functions).
	(d) The scope and main features of risk measurement systems.
	(e) Description of the process of risk information reporting provided to the board and senior management, in particular the scope and main content of reporting on risk exposure.
	(f) Qualitative information on stress testing (e.g. portfolios subject to stress testing, scenarios adopted and methodologies used, and use of stress testing in risk management).
	(g) The strategies and processes to manage, hedge and mitigate risks that arise from the bank's business model and the processes for monitoring the continuing effectiveness of hedges and mitigants.

End of Document