Industry Briefing 2018

GOVERNOR'S BALLROOM
BRITISH COLONIAL HILTON HOTEL
TUESDAY 11TH DECEMBER 2018

Meeting Agenda

9:00 a.m. 9:40 a.m.	**Welcome & Opening Remarks** **Strategic Considerations:** **AML & FATF/ Preparing for the next Recession/Cyber Information Security**	**Charles W. Littrell,** **Inspector, Banks & Trust Companies**
9:40 a.m. 10:00 a.m.	**Supervisory Effectiveness Report**	**Ruth Johnson,** **Deputy Manager,** **International Firms Unit** **Anita Bain,** **Chief Examiner** **Examination Unit**
10:00 a.m. to 10:20 a.m.	**AML/CFT Updates – Expectations for 2019**	**Sherrece Saunders,** **Deputy Manager** **Analytics Unit**
10:20 a.m. to 10:40 a.m.	**Policy Initiatives**	**Eva Etienne,** **Deputy Manager** **Policy Unit**
10:40 a.m. to 10:50 a.m.	**Coffee Break**	
10:50 a.m. to 11:10 a.m.	**Sector Profile and FSAP Preparation**	**Karen Rolle** **Deputy Inspector** **Bank Supervision Department**
11:00 a.m. to 12:00 p.m.	**Q & A**	

Welcome
&
Opening Remarks

Presented by Mr. Charles W. Littrell
Inspector
Banks & Trust Companies

Strategic Considerations

Presented by Mr. Charles W. Littrell
Inspector
Banks & Trust Companies

Four Topics

- AML/CFT and FATF
- Preparing for economic adversity
- Summary of supervisory progress
- Information and cyber security

One of these countries doesn't belong here (we hope!)

- BAHAMAS
- BOTSWANA
- ETHIOPIA
- GHANA
- PAKISTAN
- SERBIA
- SRI LANKA
- SYRIA
- TRINIDAD & TOBAGO
- TUNISIA
- YEMEN

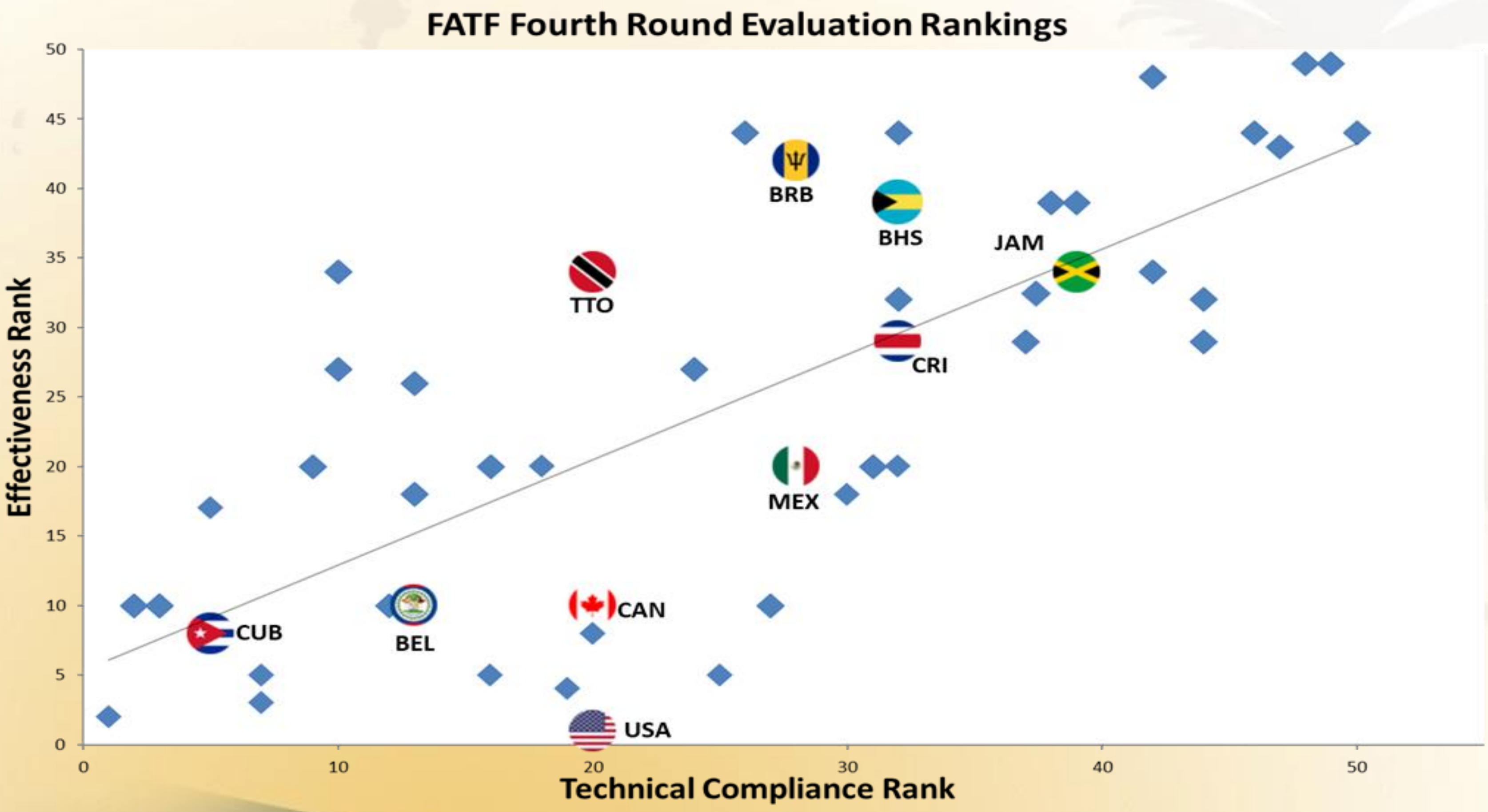
Three important concepts

- We have no choice but to play the FATF's game
- The FATF engagement is mainly public sector
- We must all be good at AML/CFT risk management…and be internationally accepted as good.

How do we improve AML/CFT risk management?

- Compliance vs. risk management approach
- Only the latter is viable
- Do the work: policies, procedures, quality assurance, 3LOD, etc.
- Sell the story internationally

FATF RATINGS MAP



Punishment vs. Prevention

- FATF prefers punishment
- We prefer prevention
- CBOB approach:
  - Avoid small(ish) fines
  - We will deploy large fines
  - Strong response to unsatisfactory firms and people
- “Honest, cooperative, and competent”

Getting ready for a recession

- We don't know when, but it will come
- Clean up your balance sheets
- Be prepared for adversity

Re-engineering the supervision process

- Shorter examination cycles
- Clarity in communicating interventions
- More interventions, less observation

Report of Examination delivery

- Target: 90 per cent delivery within 20 business days
- 2018 result: 100 per cent within 20 business Days
- Prior practice: sometimes several months delay

Directives

DIRECTIVES	Starting Directives	Added Directives	Closed Directives	Ending Directives	Avg. Closing Time
31/12/17 to 31/03/18	26	0	5	21	12.60 months
31/03/18 to 30/09/18	21	0	13	8	28.9 months

Requirements

REQUIREMENTS	Starting Requirements	Added Requirements	Closed Requirements	Ending Requirements	Avg. Closing Time
31/12/17 to 31/03/18	216	44	38	222	15.63 months
31/03/18 to 30/09/18	222	88	116	194	15.2 months

Total Supervisory Interventions

Supervisory Issues (6-month Identification/Clearing)				
	Starting 31/Mar/18	Added	Closed	Ending 30/Sep/18
AML/CFT	114	107	76	145
Directive	2	0	2	0
Requirement	92	74	57	109
Expectation	20	33	17	36
Request	0	0	0	0
Financial/Other	259	71	109	221
Directive	19	0	11	8
Requirement	130	14	59	85
Expectation	108	57	39	126
Request	2	0	0	2
TOTAL	373			366

Approved Persons Timeliness

Applications for Approved Persons							
	31/03/2017	30/06/2017	30/09/2017	31/12/2017	31/03/2018	30/06/2018	30/09/2018
Total No. of Applications	22	9	14	9	25	27	17
Incomplete Packages - Requiring Follow up	55%	56%	64%	33%	72%	44%	29%
Avg. Days from Receipt to Final – if Followed up	85	69	37	31	24	27	27
Avg. Days from Receipt to Final – if Complete	23	19	15	11	8	10	11

Cyber-security and information security

- 2019 development; 2020 move to continuous supervision
- Don’t wait!
  - Resistant to social engineering
  - Patching
  - Licensed software

Summary

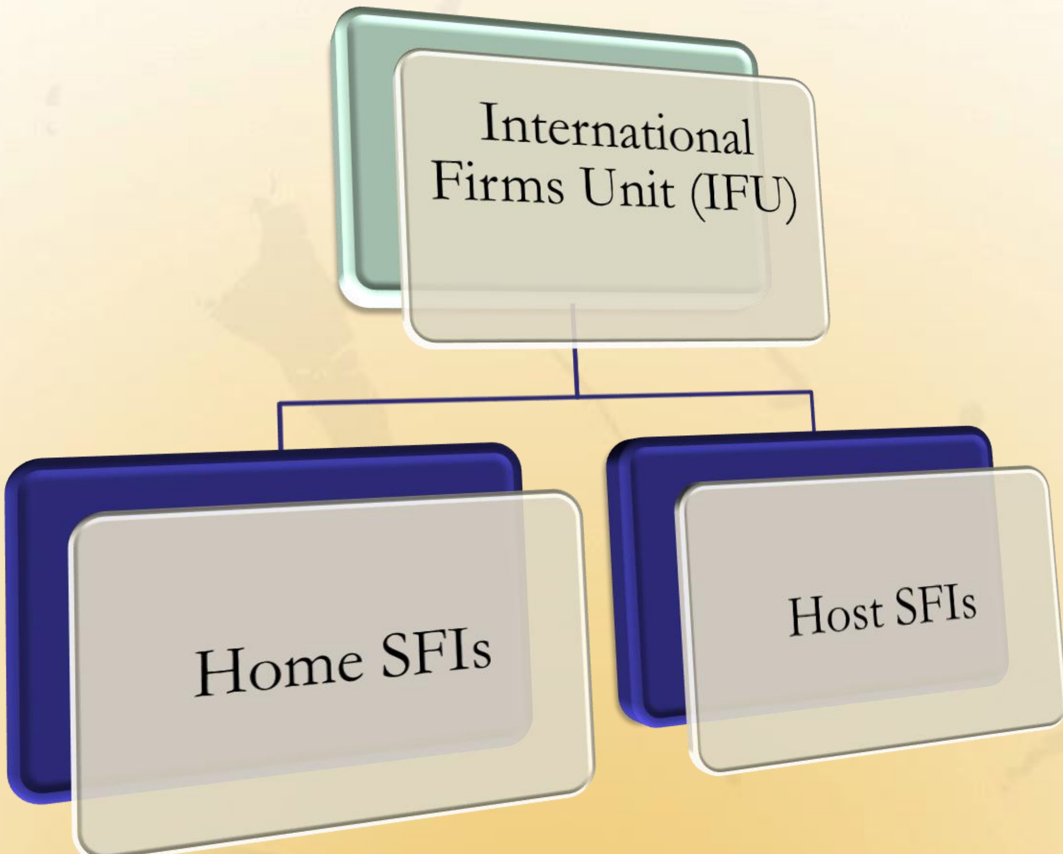
- It was a pretty good year
- In 2019:
  - Extract a better FATF outcome
  - Get ready for economic adversity
  - Continue to improve supervision
  - Tighten up on cyber-security

Supervisory Effectiveness Report

Presented by Mrs. Ruth Johnson & Mrs. Anita Bain

Deputy Manager	Chief Examiner
International Firms Unit	Examination Unit

SUPERVISORY EFFICIENCIES



<u>SUPERVISORYSTRUCTURE</u>

- 2017- 2018 BSD Reorganization *(current & emerging global trends)*
- Grouping of Home & Host SFIs *(surveillance specialization)*
- Change in methodology (Supervisory Efficiency

SUPERVISORY EFFICIENCIES

RECENT DEVELOPMENTS

- 2017-2018 Thematic Observations
- Global changes within financial services

Global De-risking
- *Loss of Correspondent Banking Relationships*

CRS
- *Material loss of client base (AuMs)*

AML/CFT
- *Enhanced AML/CFT Supervision*

Mergers & Acquisitions
- *Increases in M&A*
- *Leverage buy-outs: books of business*

SUPERVISORY EFFICIENCIES

SUPERVISORY EFFECTIVENESS: AML/CFT & Fin. Oth

- As at Sept. 30, 2018: **Aggregate Supervisory Issues – 366** (i.e. AML/CFT – 145 & Fin. Oth. - 221)
- **Aggregate Closure** of Requirements & Expectations: **AML/CFT: 20.77% & Fin. Oth: 29.78%**

PRUDENTIAL HIGHLIGHTS: Financial Observatory

- As at Sept. 30th, 2018 International SFIs reported the following average prudential highlights; **liquidity ratio stood at 58.8%, profitability ratio 23.9%, total assets $42.4 billion** (excludes pure trust companies and branches), **total loans to total deposits (coverage ratio) 64x and CET1/RWA 36.9%**.

SERVICE LEVEL AGREEMENTS (SLAs)

- SLAs largely concentrated to Back Office Administration, Wealth Management, Human Resources, Internal Audit, Business Continuity and IT General Maintenance & Support. Analysis also noted that the main service providers for **SLAs are domiciled in The Bahamas (72%), Switzerland (22%) and Cayman (6%).**

SUPERVISORY EFFICIENCIES

INTERNATIONAL SFIs CLIENT CONCENTRATION

- Analysis attributes employing the *country of original domicile and source of wealth* of the *ultimate beneficial owner* of Home SFIs client base, delineates that its client concentration geographically originate from **Europe** *(i.e. Switzerland, United Kingdom, France and Italy)* and **Latin America** *(i.e. Brazil, Panama, Uruguay, Argentina & Ecuador).*
- Statistics also revealed moderate client concentrations from Asia, Cayman, United States and Other Countries.

AML/CFT ASSESSMENT

- Enhanced supervisory focus on **Anti-Money Laundering (AML)/ Combating on Financing of Terrorism (CFT**) risks transitions into our focus on **AML/CFT Half-Yearly Board Communications,** which endeavours to provide formal communique relative to: *(i) identifying the core products and services offered; (ii) understanding the risk arising from the customer base and risk associated with relevant client market concentrations; (iii) assessment of SFI operational vulnerabilities; and (iv) outlining the suite of key inherent risks and mitigating controls at the enterprise-wide level, with specific outcomes.*

2017- 2018 INTERNATIONAL SFIs OFFSITE/PRUDENTIAL HIGHLIGHTS

Onsite Examinations

Presented by Mrs. Anita Bain
Chief Examiner
Examination Unit

Highlights of Re-engineered Examination Process

- **Key features of the re-engineered process include:-**

(a) Risk-based approach

Driven by a risk mitigation plan based on a risk assessment of the SFI's operation performed by the Supervisory Team. However, emerging trends or other external events may also trigger an onsite visit

(b) meetings with external auditors

Prior to the onsite visit to gain insights into their audit approach, key audit areas and concerns they may have with governance, risk management process, financial soundness etc.

(c) Abolition of the Draft Report

written document ("Heads up") with findings are shared with SFI prior to, and discussed during the closing meeting

(d) Redefined Supervisory responses and actions

Consistent taxonomy to describe actions required by SFIs to address deficiencies identified through various supervisory tools i.e. (Directives, Requirements and Expectations)

(e) RoE issued within 20 working days of closing meetings

Supervisory Communication

- **Directive** – to convey a mandatory action, that has legislative backing;
- **Requirement** – to convey a statutorily backed instruction;
- **Expectation** – to convey a preferred action;
- **Request** – to convey a petition (usually for documents and/or information) that has legislative backing

Examinations By Risk Areas – 2018

SFIs	Examinations	AML/CFT	Corporate Governance	Operational Risk (IT/Outs/HR)	Credit	Fiduciary
DSIBs	3	2		2		
MTBs	2	2	2	2		
Int'l Banks	17	17	9	2	1	2

Common Examination Findings

- ML/TF risk assessments not conducted, updated;
- Compromised independence of the CO/MLRO function;
- Passive engagement of independent non-executive directors (INEDs) in the oversight and setting of strategic direction for SFIs; and

Common Examination Findings

- The need to strengthen risk governance frameworks to ensure 3 lines of defense operate across all LOBs (including outsourced functions)
- Gaps in the high level assessment of people risks associated with strategy and succession

AML/CFT Updates Expectations for 2019

Presented by Mrs. Sherrece L. Saunders
Deputy Manager
Analytics Unit

“A Risk-Based Approach”

According to the Financial Action Task Force (“FATF”):

“A Risk-Based Approach to AML/CFT means that countries, competent authorities and financial institutions are expected to identify, assess and understand the ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively”.

AGENDA

1. Supervised Financial Institutions' (SFIs) AML Risk Ratings

2. SFIs' Self Risk Assessments

3. Annual AML Supervisory Cycle 2.0

4. AML Administrative Penalties

5. On-going AML Public Outreach Initiatives

SFIs' Risk Ratings

During 2018, AML/CFT risk assessments were conducted for 75 public bank and/or trust companies and 9 credit unions. Risk assessments of Money Transmission Businesses will be completed during 2019.

Each institution will receive a summary of its assessment over the next months.

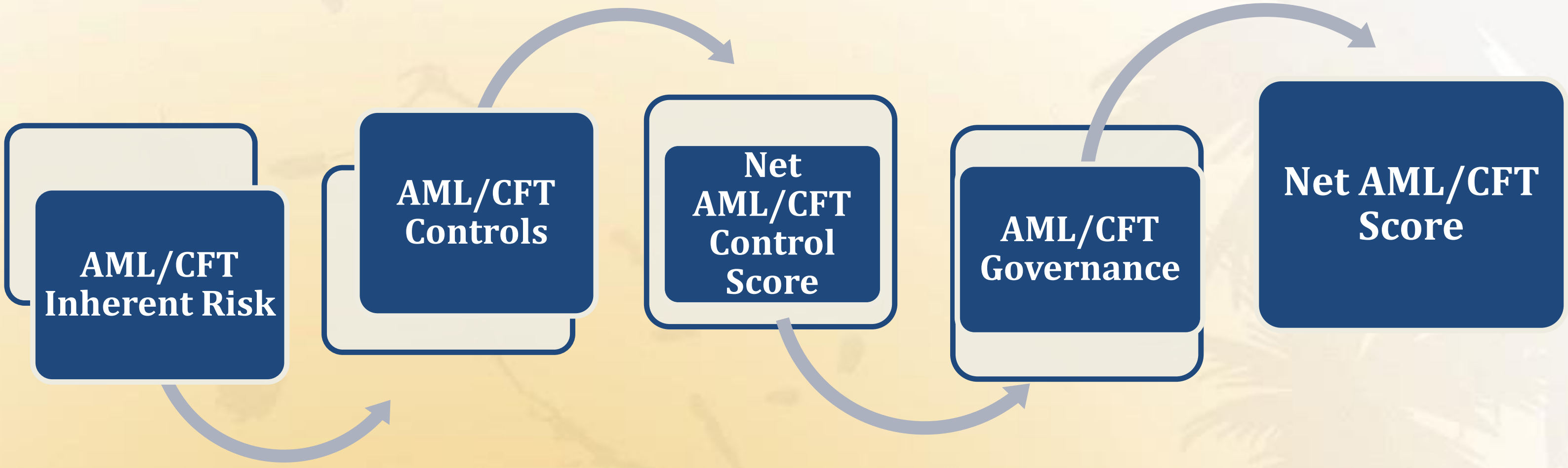
SFIs' Risk Ratings

Methodology

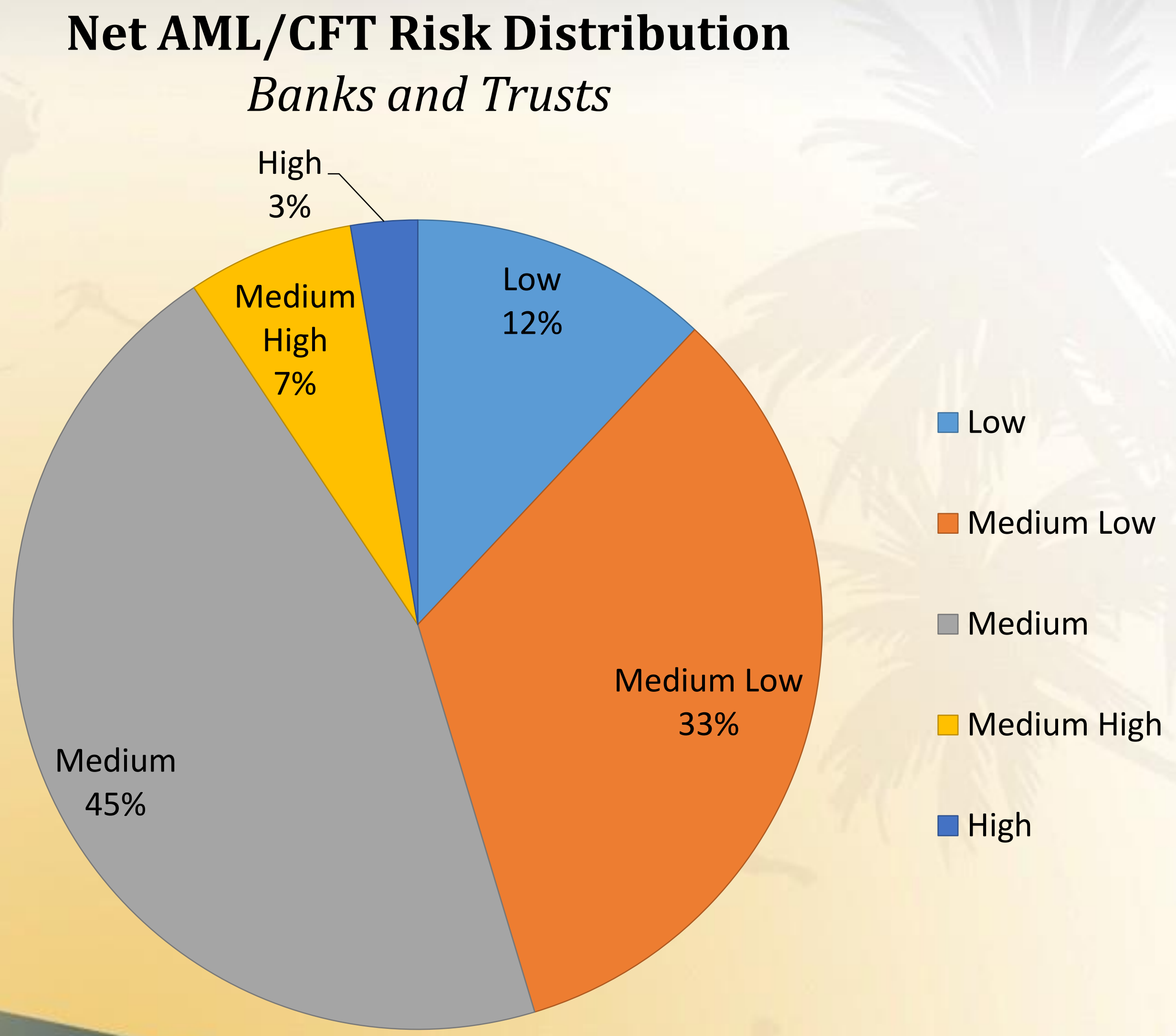
	Risk Score				
	1	2	3	4	5
Inherent Risk	Low	Medium Low	Medium	Medium High	High
Control & Governance	Strong	Satisfactory	Needs Improvement	Deficient	Critically Deficient

AML/CFT Inherent Risks	AML/CFT Controls	AML/CFT Governance
Nature of Business	Client Onboarding	Board Engagement
Products & Services	Ongoing Monitoring	Policies & Procedures
Client Base	Other Related Controls	Adequacy & Independence of Control Functions
Other Related Risks		Outsourcing Arrangements

SFIs' Risk Ratings



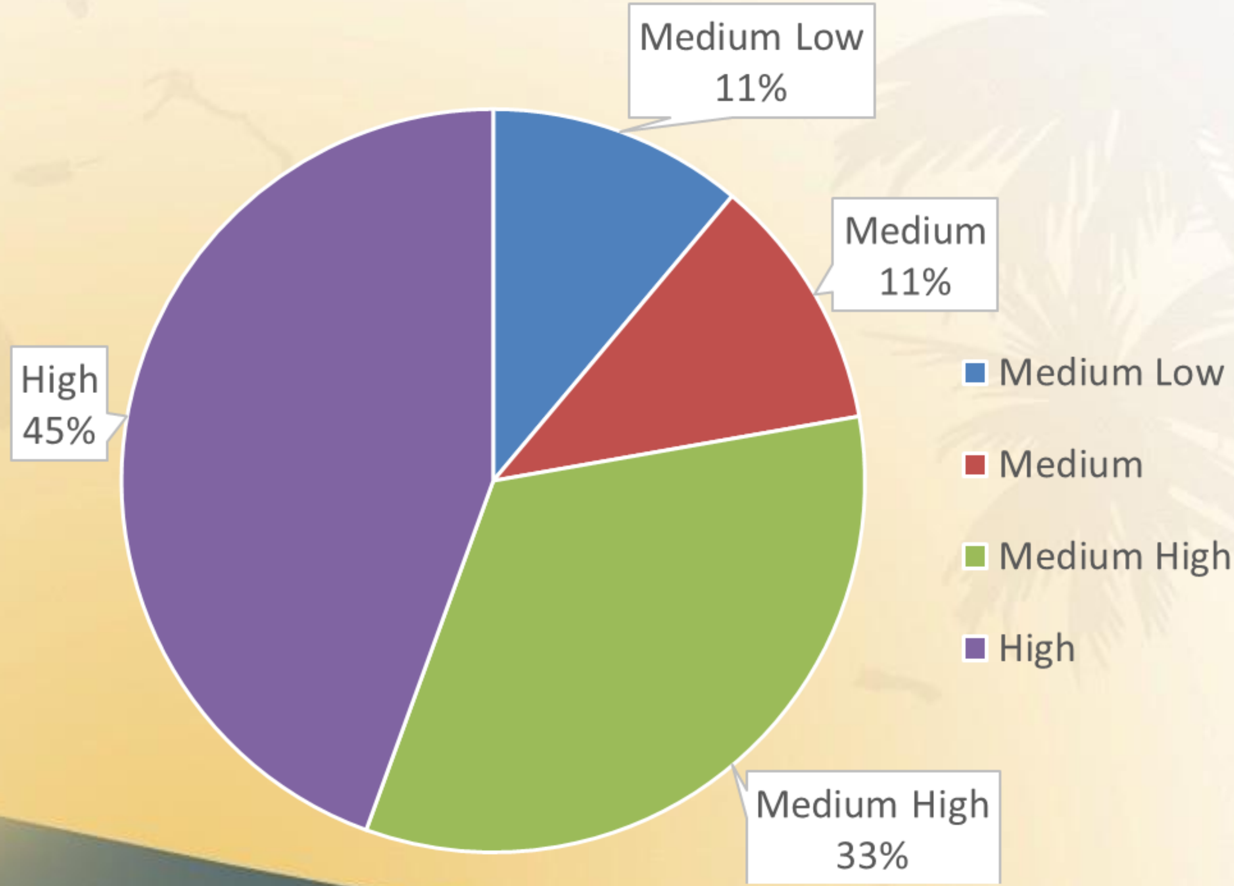
SFIs' Risk Ratings



SFIs' Risk Ratings

Net AML/CFT Risk Distribution

Credit Unions



SFIs' Self Risk Assessments

Guidance for Conducting Risk Assessments

1) Identify and assess inherent risks by adopting a comprehensive risk-based approach.

- Customers, Jurisdictions, Products, Services, etc.

2) Establish risk tolerance levels from an entity specific, sectoral and relationship level perspective.

3) Establish risk mitigation measures by employing proper controls

- Internal Controls/Policies & Procedures (scope of the identification and verification requirements or ongoing monitoring, setting transaction limits)

4) Evaluate residual risks by employing a three lines of defense regime.

5) Monitor and review risks by utilizing a proper governance regime.

SFIs' Self Risk Assessments

MOST IMPORTANTLY when Conducting Risk Assessments

SFIs should take into account **the threats and vulnerabilities that have been identified through any National Risk Assessment**. SFIs should assess how these (and any other aspects of their business) make their business vulnerable to identified risks.

Source: Paragraph 25.3 of AML/CFT/PF Guidelines

SFIs' Self Risk Assessments

- Board Approved Risk Assessments are required to be submitted to the Central Bank within 120 days of the calendar year-end.

- The Corporate Governance Guidelines is being updated to require attestation by the Board to the development and approval of the Risk Assessment.

- Requirement is applicable to all SFIs (Restricted and Public Banks, Trusts, and Banks & Trust Companies; Credit Unions; MTBs).

- Failure to submit will result in an Administrative Penalty.

Annual Supervisory Cycle

- **Annual Supervisory Cycle of AML/CFT**
  - Collection & Analysis of Data
  - Meetings with Money Laundering Reporting Officers (MLROs)
    Beginning 1st Qtr 2019
  - Engagement with Internal and External Auditors
  - Engagement with Board of Directors
    Annual AML/CFT Supervisory Letter to SFIs; meetings per Board Engagement Policy
- **Training**

  Greater emphasis on confirming SFI training – for management and staff that constitute the three lines of defense, as well as the Board of Directors. We will be looking to see if your relevant staff, including client facing personnel, have attained or are attaining the AML/CFT vocational qualifications.

Annual Supervisory Cycle

- **On-site Examinations**
  - For all sectors, more targeted and thematic reviews, using a Risk Based Approach for all sectors

- **Industry Briefings**
  - To be held at least annually

- **Inter-agency Coordination & Cooperation**
  - AML/CFT Task Force
  - Group of Financial Services Regulators (GFSR)
  - Coordination with Financial Intelligence Unit

- **Coordination with International Supervisors/Regulators**

AML Administrative Monetary Penalties

<u>Supervisory Intervention/Enforcement</u>

In addition to our Ladder of Supervisory Intervention, Administrative Penalties Regime, and “Fit and Proper” Reviews, the Central Bank along with other supervisory authorities will begin to administer AML Monetary Penalties in accordance with the Financial Transaction Reporting Act, 2018 (see section 57), as applicable.

Breaches will be identified as minor, serious, very serious; and can attract an administrative penalty up to $200,000.

AML Public Outreach Initiatives

- Annual AML Publication – by 2018 year-end
- AML Conferences (National /Regional)
- AML National Website – 2019
- Engagement with Correspondent Bankers

Policy Initiatives

Presented by Ms. Eva Etienne
Deputy Manager
Policy Unit

Policy Initiatives

Basel II & III Discussion Papers

- Industry Comments reviewed
- Table of CBoB’s responses prepared

Next Steps

- Drafting of Regulations: - **Bank and Credit Union Capital Requirement**
    - Simple
    - Low Regulatory Compliance Cost
    - Easy for SFIs to adhere to
    - Easy for Central Bank to implement and supervise

In the Pipeline

- Liquidity Discussion Paper: year-end 2018

Sector Profile
&
FSAP Preparation

Presented by Ms. Karen Rolle
Deputy Inspector
Bank Supervision Department

Financial Sector Assessment Program (FSAP)

- **What is the FSAP?**
  - It is a comprehensive assessment of a country's financial sector; the programme brings together Bank and Fund expertise to help countries reduce the likelihood and severity of financial sector crises.
  - The Bahamas underwent a **FSAP** in 2012 and will undergo another from 8^{th} – 28^{th} January, 2019 during which time the financial services sector will be assessed.

- **Assessment of the Basel Core Principles (BCPs)**
  - The Upcoming FSAP will include an assessment of the 2012 Revised BCPs- which now consist of 29 principles compared with the earlier version of 25
  - The assessment is two tiered that it is the ratings are based on technical compliance and effectiveness .

- **Ratings for the BCPs from the 2012 FSAP**

  - Aggregate: Compliant (C) – 21,
  - Largely compliant (LC) – 9,
  - Materially noncompliant (MNC) – 0,
  - Noncompliant (NC) – #,
  - Not applicable (N/A) – #

- **The Upcoming Mission is not a full scope FSAP**

Scope of the Mission

- **The scope of the mission will include:-**
  - An assessment of the financial services sector mainly focused on the banking sector and credit unions

    (i) vulnerabilities and resilience;

    (ii) quality of the financial stability policy framework;

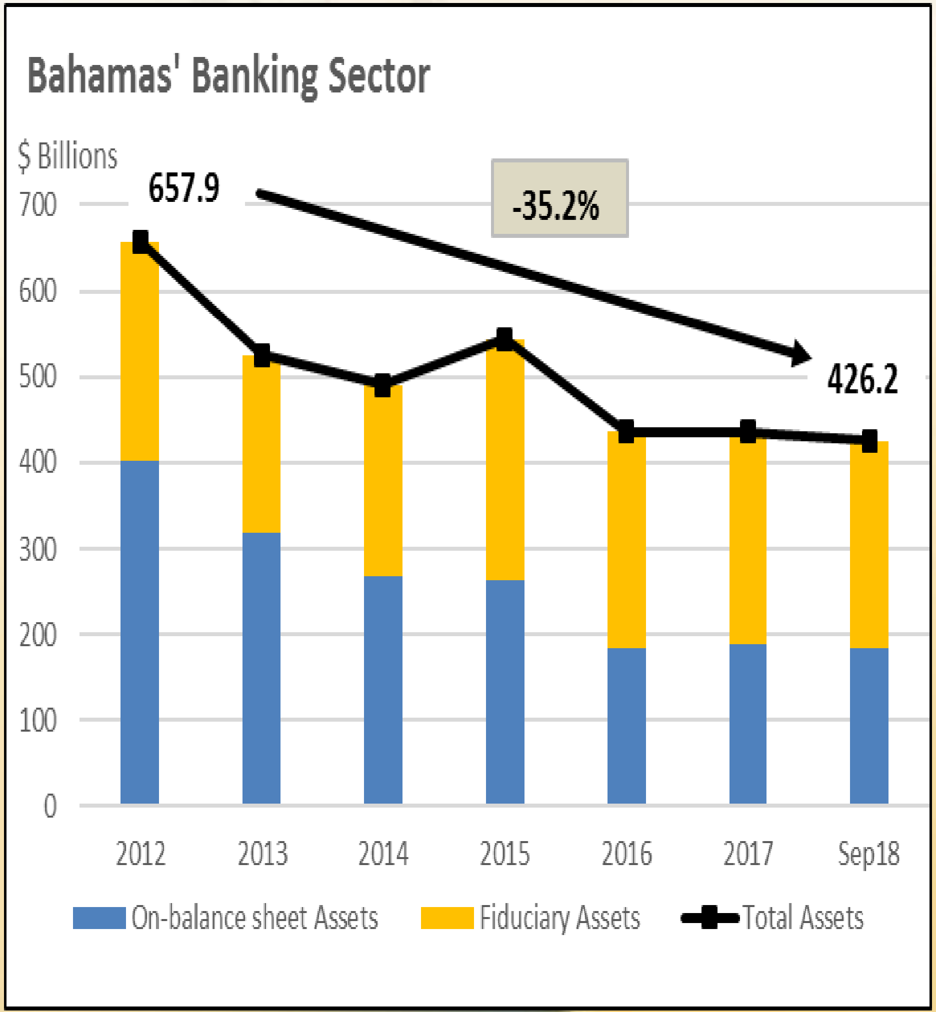
    (iii) assessment of macroprudential risks and policies;

    (iv) analysis of interconnectedness among financial markets and institutions (including nonbanks) and cross-border exposures and spillovers;

    (v) financial safety nets, including the evaluation of crisis preparedness and crisis management frameworks; and,

    (vi) stress testing.
  - Insurance and Securities companies will also be looked at but not in as much detail as the banking sector.

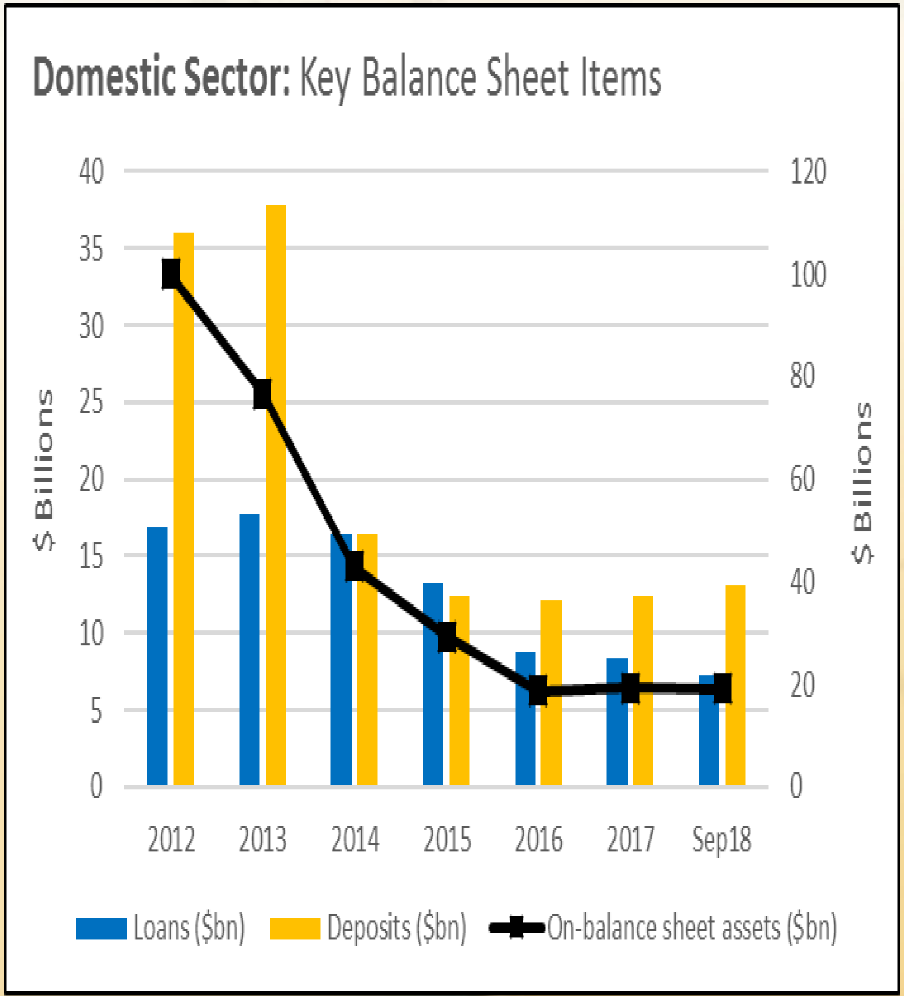
Sector Profile since 2011



Since last FSAP in 2012

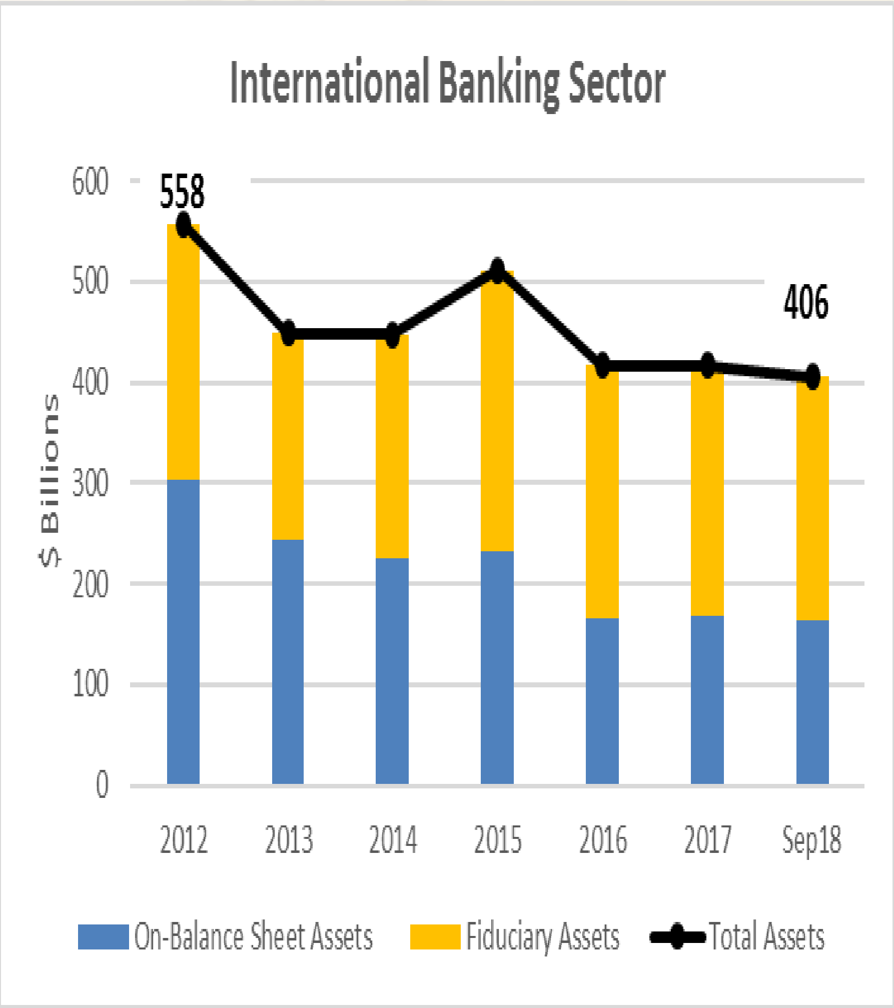
- The Bahamas has experienced a fall-off in the total assets (on- and off-balance sheet) by 35.2%
- The decline owed mainly to a shift in business models by SFIs

Sector Profile (cont'd)



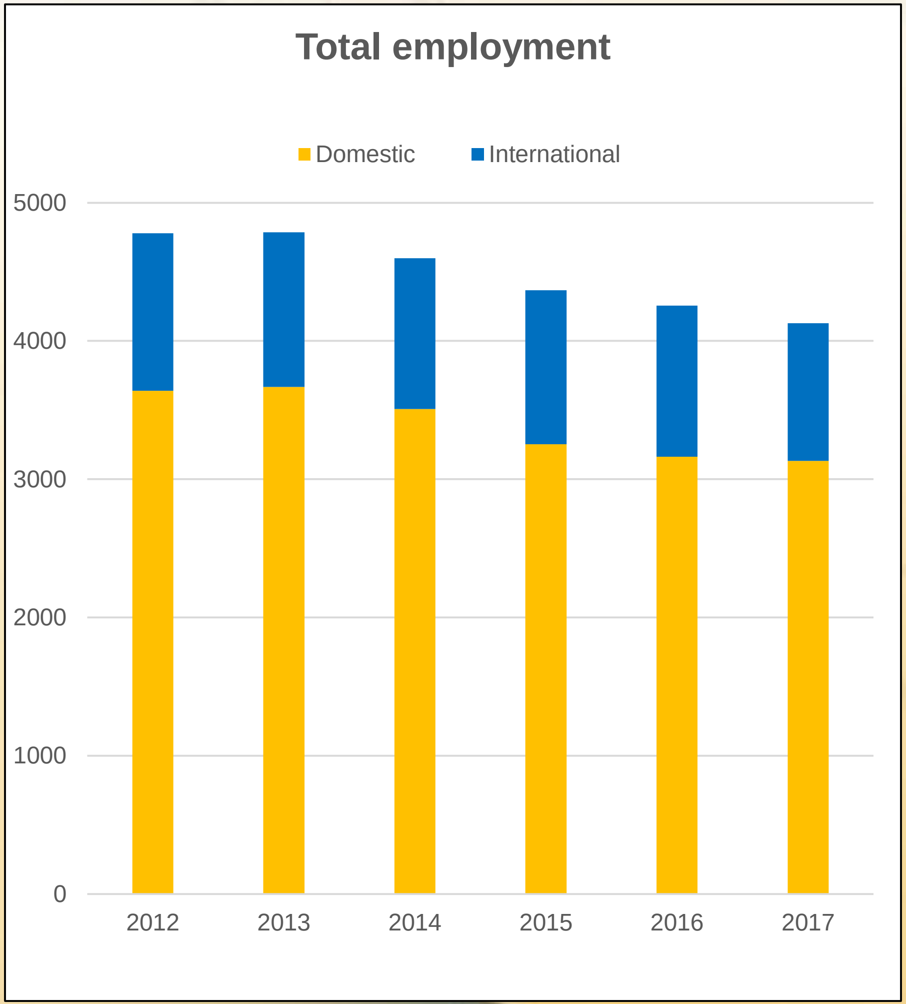
- Significant fall-off in assets over the past 6+ years in total assets from $100.0 billion to just beneath $20.0 billion
- Drop in deposit base is due to shift in business strategy and de-risking

Sector Profile (cont'd)



- Asset base comprises mainly investments and market placements
- Overall decline in total asset base since 2012 however, relatively stable since 2016 to present.

Sector Profile (cont'd)



- Over the past 6 years, total employment in the banking sector showed a decrease of 650 persons (13.6%) from 2012 to 2017, or approximately 113 persons (2.5%) annually, on average.

Crisis Management

- A statutory mandate of the Central Bank (CBOB) is to "ensure the stability of the financial system."
- Since the 2012 FSAP review, The Bahamas has undertaken a number measures aimed at enhancing crisis management preparedness through strengthening legal underpinnings, early intervention and the implementation of a robust resolution regime.
- CBOB has identified The Bahamas' Domestic Systemically Important Banks (D-SIBs) and increased prudential supervisory oversight of this grouping aimed at ensuring that D-SIBs remain sound and resilient to be better able to withstand negative consequences in the face of crises.

Crisis Management Preparedness

Examples of work being conducted with respect to crisis management preparedness include:

Strengthening Early Detection

- Financial stability analysis report is produced annually (since 2013)
- Monitoring of key prudential indicators for capital, liquidity and credit quality
- Peer review and stress testing of banks in offsite monitoring
- Ongoing identification and analysis of vulnerabilities in various sectors of the economy

Strengthening Early Intervention

- Prompt corrective action taken through the Central Bank’s Ladder of Supervisory Intervention
- Robust supervisory framework for banks using a risk-based supervisory approach
- Require D-SIBS to hold substantial capital buffers with high target and trigger ratios
- Implementation of supervisory effectiveness report to assess the effectiveness of CBOB’s supervisory activities

Crisis Management Preparedness (cont'd)

Strengthening Bank Resolution Framework

1. Pending legislative amendments to the Central Bank Act, Banks and Trust Companies Regulation Act and Protection of Depositors Act, will support orderly bank resolution by granting Central Bank full resolution authority powers over all banks and expand resolution tools to address problem banks:
   - utilization of bridge bank, purchase and assumption and asset management company tools
   - appointment of a statutory administrator and liquidator without obtaining a court order

2. Contingency planning and preparedness requirements for preparation of recovery and resolution plans to be used in times of financial distress/failure.

3. Framing of policy infrastructure for CBOB administrative resolution authority

Strengthening Deposit Insurance Framework

- Representation in the national financial crisis management working group (CBOB, DIC, SCB, ICB)
- Advancing work to bring financial credit unions under deposit insurance
- Expansion of public awareness programs on deposit insurance coverage in collaboration with member banks
- Increased number of full-time DIC personnel
- Increased analysis of target funding levels of the deposit insurance fund
- Increased frequency of assessments of eligible deposits held by member banks (insured vs. uninsured deposits)
- Conducting crisis simulation exercises
- Partnering with CGBS in advancing a draft regional financial crisis management plan with respect to cooperation and information sharing
- Partnering with CARICOM in a draft plan on harmonizing deposit insurance through the CARICOM community

Questions
&
Answers