Central Bank of The Bahamas

QIS Instruction Notes for ERS Reporting Forms

(Quantitative Impact Study – Basel II/III Implementation)

20th March 2015

(Updated December 2015)

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1. Overview

1.1 This Quantitative Impact Study (QIS) seeks to gather data on the impact of the Basel II/III proposals on licensees' capital levels. Continuous dialogue with the Central Bank of The Bahamas ('the Central Bank') is encouraged so that issues may be discussed as they occur and to ensure proposals are interpreted accurately.

1.2 **All QIS worksheets are to be completed on a best efforts basis** and returned to the Central Bank via the Online Reporting and Information Management System (ORIMS) no later than **Thursday, 21st January 2016**. The forms are designed to capture the information needed for analysis.

1.3 A copy of the completed "**General Information Form**" should be signed by two senior officials or authorized alternate(s). The form should be scanned and emailed with the completed ERS submission.

1.4 The instructions and guidance provided for **Sections 3 thru 10** above were taken directly from the Basel II and III frameworks and modified only with regard to the Areas of National Discretion or otherwise not applicable in this jurisdiction. We also encourage licensees to consult the relevant Basel Reports, namely *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework* *and* *Basel III: A global regulatory framework for more resilient banks and banking systems* for additional background information.

1.5 The suite of excel-based templates in the ORIMS Portal to be completed comprise of three (3) new worksheets and three (3) revised worksheets as outlined below:

- Summary Schedule of Total Eligible Capital "CapSum"– ***New***
- Breakdown of Capital Base "CapComp"– ***New***
- Operational Risk "OpRisk"– ***New***
- Credit Risk – On Balance Sheet Items – ***Revised***
- Credit Risk – Off Balance Sheet Items (non-Derivative Instruments) – ***Revised***
- Credit Risk – Off Balance Sheet Items (Derivate Instruments) – ***Revised***

2. General Instructions

2.1 Licensees should enter the data on their exposures as at December 31, 2015. Amounts should be expressed in the thousands **('000s')**.

2.2 Licensees that do not have exact data on all the requested elements may use estimates as long as they are representative of the bank's portfolio and can be justified. Licensees should indicate where estimates are reported as part of the requested information. Estimates should be marked **("est.")**. This notation can be recorded in any text cell adjacent to the amount.

2.3 Where a licensee is unable to calculate or estimate some of the requested data, the cell should be marked as **N/A ("Not Available")**. Where the licensee is unable to comply with any instructions, they must clearly set out these areas in a separate note to the Central Bank.

2.4 Licensees with subsidiaries are asked to calculate their capital requirements on a consolidated basis (i.e. at the local parent and subsidiary level). All operating entities with material exposures should be included. As far as possible, information should be provided for all exposures within given portfolios (e.g. corporate, retail).

3. Summary Schedule of Total Eligible Capital

3.1 The ***Summary Schedule of Total Eligible Capital*** worksheet titled ***"CapSum"*** will be derived based on data collected from the other worksheets of the ERS report. The summary data is presented here for the purposes of presenting the **credit**, **operating** and **market risk** capital charges and the calculation of the total risk weighted asset ratio.

4. Breakdown of Capital Base

4.1 We recommend that licensees be guided by the Consultation Paper issued by the Central Bank (issued December 12, 2014) on the [Definition of Capital] to complete the ***Basel III Capital Composition*** worksheet titled titled ***"CapComp"***.

4.2 Licensees should refer to section 2 of the consultative paper for the interpretation of the terms used in this worksheet. In sum, the overall structure of the capital base calculation is as follows:

	Components of Capital Base	**Ref. in Paper Definition of Capital**
A	Elements of Common Equity Tier 1 (CET1) Capital	2.1
B	Regulatory Adjustments (Deductions from CET1 Capital)	2.3
	CET1 Capital = A - B	
C	Elements of Additional Tier 1 (AT1) Capital	2.4
D	Regulatory Adjustments (Deductions from AT1 Capital)	2.6
	AT1 Capital = C - D	
E	**Total Tier 1 Capital = B + D**	
F	Elements of Tier 2 (T2) Capital	2.7
G	Regulatory Adjustments (Deductions from T2 Capital)	2.9
	Total T2 Capital = F – G	
H	**Total Eligible Capital Base = (Tier 1) + (Tier2)**	

5. Credit Risk – On Balance Sheet Items

5.1 For purposes of this study, capital requirements for credit risk should be calculated with regard to credit/counterparty exposures, including exposures that arise in both the banking and the trading book and taking full account of allowable credit risk mitigation (CRM). The worksheet titled ***"CR – On Balance Sheet"*** should be used to complete this section.

5.2 To assist users in completing this section, a mapping of On-Balance sheet items under the Basel II framework with Form 2 of the ERS, has been provided at Annex B as a general guide.

5.3 Risk weighted assets must be calculated separately for each type or category of exposure highlighted in the worksheet. Exposures are classified according to the nature of the counterparty and should be assigned to the approproate risk weight buckets using the guidance given below.

5.4 Exposures with allowable CRM should be reported in the columns provided. CRM refers to techniques the reporting institution may use to mitigate credit risk and hence reduce the capital requirement of a credit exposure. Where an asset is not covered by any recognised CRM technique, the amounts reported before CRM and after CRM will be the same. Four types of CRM techniques are recognized for this purpose:

- collateral;
- netting;
- guarantees; and
- credit derivatives

Under Basel II framework, there are two methodologies for treatment of collateral[1] in the standardized approach – simple and comprehensive. Under the simple approach a bank may alter the risk weight applied to an exposure according to the collateral held. Also see Section 8. Where collateral is eligible, the collateralised portion of the exposure is assigned the risk weight of the counterparty (generally subject to a risk weight floor of 20%). Licensees should record collateralised exposures before taking account of the collateral held in the pre-CRM columns. In the post-CRM columns, licensees should slot the portion of exposures covered by collateral according to the risk weighting of the collateral. The portion of the exposure that is not collateralised is assigned to the risk weight of the original/underlying counterparty in the post-CRM column.

5.5 Generally, the RWA is a derived field in the form, calculated by multiplying column I *(Total exposures after CRM)* by column J (*Risk Weight)*. The RWA amount for some asset types may consist of several discrete asset exposures, each potentially attracting different risk weights.

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[1]The simple approach is perhaps the most optimum approach. Under the comprehensive approach, licensees will need to calculate their adjusted exposure to the counterparty in order to take account of the effects of that collateral. For further details of the calculation of this approach, licensees should refer to paragraphs 147 to 150 of the Basel Committee Paper titled Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework.

5.6 **Cash Items**

Description of Item	**Guidance**
Notes and coins	Notes and coins are allocated a risk weight of 0%.
Exposures collateralized by cash deposits	Exposures collateralized by cash deposits are allocated a risk weight of 0%.
Gold and precious metals	Gold is allocated a risk weight of 0%. However, the treatment of other precious metals (silver, platinum and palladium) should be discussed with The Central Bank.
Cash items in the course of collection	Cash items in the course of collection refer to the amount of cheques, drafts and other items drawn on other banks that will be paid for the account of the reporting institution immediately upon presentation and that are in the process of collection. Such items are allocated a risk weight of 20%.

5.7 **Claims on Sovereigns and The Central Bank**

Description of Item	**Guidance**
Claims on Sovereigns	Claims on The Bahamas central government and the Central Bank denominated in the national currency and funded in that currency are allocated a risk weight of 0%. Claims on other sovereigns denominated and funded in their local currency may be assigned a preferential risk weight as determined by the supervisory authority of the sovereign, subject to prior written approval of the Central Bank.
Claims on Sovereigns and The Central Bank	Claims on other sovereigns denominated and funded in their local currency, claims on The Bahamas government denominated in currency other than the national currency should be weighted based on ratings assigned by eligible external credit assessment institutions ("ECAI's") outlined below or country risk scores. Refer to **Mapping of ECAI Tables**.

5.8 **Claims on Public Sector Entites (PSEs)**[2]

Description of Item	**Guidance**
Claims on domestic PSEs guaranteed by the Government of The Bahamas	Claims of PSEs which are guaranteed by The Bahamas central government will be assessed an equivalent risk weight of the sovereign and will carry a risk weight of 0%.
Claims on domestic PSEs treated as claims on banks	Claims of PSEs which are not guaranteed by The Bahamas central government and the PSE does not participate in a competitive market will be assessed an equivalent risk weight as a bank and will carry the appropriate risk weight of **Option 1** for banks. See section 5.9 below.
Claims on Domestic PSEs treated as corporates	Claims of PSEs which are not guaranteed by The Bahamas central government and the PSE participates in a competitive market will be assessed an equivalent risk weight as a corporate and will carry a risk weight of 100%.
Claims on Foreign PSEs	Claims on foreign PSEs must be weighted at 100% other than where the Supervisory authority in the jurisdiction concerned permits 'one category less favourable' treatment **and** that supervisory authority applies supervisory arrangements equivalent to those in The Bahamas. An 'equivalent regulator' for the purposes of this document is considered by the Central Bank to regulate banks under a Basel II regime in a manner that is broadly equivalent to the Central Bank's regulatory laws. The Central Bank of The Bahamas has not published a list of regulators that it deems to be equivalent.

[2] PSEs are defined as:

- local authority that is able to exercise one or more functions of the central government at the local level with explicit guarantee arrangements;
- an administrative body or non-commercial undertaking responsible to, or owned by, a central government or local authority, which performs regulatory and non-commercial functions;
- public corporations;
- public non-financial institutions and
- public financial institutions.

5.9 Claims on Multilateral Development Banks (MDBs)

Description of Item	Guidance
Claims on MDBs	A risk weight of 0% shall be assigned to claims on highly rated MDBs[3] that fulfill the criteria set out by the Basel Committee on Banking Supervision (BCBS). In the case of other MDBs, risk weights should reflect external credit assessments, as for banks, but with no preferential treatment for short-term claims.
Claims on Sovereigns and The Central Bank	Claims on other sovereigns denominated and funded in their local currency, claims on The Bahamas government denominated in currency other than the national currency should be weighted based on ratings assigned by eligible external credit assessment institutions ("ECAI's") outlined below or country risk scores. Refer to **Mapping of ECAI Tables**.

5.10 Claims on Banks and Securities Firms

<table>
<tr><th>Description of Item</th><th colspan="6">Guidance</th></tr>
<tr><td rowspan="3">Claims on Banks (Option 1)</td><td colspan="6">Claims on banks will be weighted using ratings under Option 1 – as noted below. Under this option, all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of that country.

No claim on unrated corporate may be given a risk weight preferential to that assigned to its sovereign of incorporation.</td></tr>
<tr><td>Credit Assessment of Sovereign</td><td>AAA to AA-</td><td>A+ to A-</td><td>BBB+ to B-</td><td>Below B-</td><td>Unrated</td></tr>
<tr><td>Risk Weight</td><td>20%</td><td>50%</td><td>100%</td><td>150%</td><td>100%</td></tr>
<tr><td>Claims on Securities Firms</td><td colspan="6">Claims on securities firms may be treated as claims on banks provided these firms are subject to supervisory and regulatory arrangements equivalent to those in The Bahamas

Claims on securities firms that do not meet the above criteria shall be treated as claims on corporates.</td></tr>
</table>

[3] MDBs currently eligible for 0% risk weights are: the World Bank Group comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the European Investment Fund (EIF), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB), the Islamic Development Bank (IDB), and the Council of Europe Development Bank (CEDB).

5.11 **Claims on Corporates**

Description of Item	Guidance
Claims on Corporates	Claims on corporates including claims from insurance companies should be subject to a risk weight of 100% without regard to external ratings. No claim on unrated corporate may be given a risk weight preferential to that assigned to its sovereign of incorporation.

5.12 **Investments (Shares and Securities)**

Description of Item	Guidance
Claims on Investments in Equity (inclusive of collective investment scheme (CIS) exposures)	Holdings in shares and securities in public sector bonds will be assigned a risk weight of 20%. All other claims in domestic securities, foreign securities and other investments should be risk weighted at 100%. Investment funds (or CIS) should be included unless they invest in high risk assets, in which case they are categorised as such, or they are fixed income (only debt investments, not equity).

5.13 **Securitizations**

<table>
<tr><th>Description of Item</th><th colspan="7">Guidance</th></tr>
<tr><td rowspan="7">Securitizations</td><td colspan="7">Claims on securitizations should be weighted in accordance with Table 2.
The generic mapping is as follows:</td></tr>
<tr><td>Credit Assessment</td><td>AAA to AA-</td><td>A+ to A</td><td>BBB+ to BBB-</td><td>BB+ to BB-</td><td>B+ and Below</td><td>Unrated</td></tr>
<tr><td>Risk Weight</td><td>20%</td><td>50%</td><td>100%</td><td>350%</td><td>Deduct from capital[4]</td><td>Deduct from capital</td></tr>
<tr><td colspan="7">Where an issue has a specific short term rating, it should be weighted in accordance with Table 3. The generic mapping is as follows:</td></tr>
<tr><td>Credit Assessment</td><td colspan="2">A-1/P-1</td><td colspan="2">A-2/P-2</td><td>A-3/P-3</td><td>Below A-3/P-3</td></tr>
<tr><td>Risk Weight</td><td colspan="2">20%</td><td colspan="2">50%</td><td>100%</td><td>Deduct from capital</td></tr>
</table>

[4] When a bank is required to deduct a securitization exposure from regulatory capital, the deduction must be taken 50% from Tier 1 and 50% from Tier 2 with the exception of 'gain-on-sale' for the purposes of a securitisation transaction. For further details, licensees should refer to paragraphs 560 to 564 of the Basel Committee Paper titled Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework.

5.14 **Regulatory Retail Portfolio**

Description of Item	**Guidance**
Claims in regulatory retail portfolio	Claims on small businesses or individuals that satisfy the criteria as set out below may be considered as retail claims in a retail portfolio and will be risk weighted at 75% (except for past due loans, which need to be reported in item 5.17). A claim should also meet the following conditions in order to qualify as retail: a) Orientation criterion – the exposure is to an individual person or persons or to a small business. b) Product criterion – the exposure can take the form of any of the following: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g. installment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments. c) Granularity criterion – the regulatory retail portfolio should be sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75% risk weight. The maximum aggregate exposure to a single counterparty should not exceed $100,000 of the overall regulatory retail portfolio. d) Low value of individual exposures – the maximum aggregated retail exposure to a single counterparty and its related counterparties should not exceed a threshold of $100,000. Securities such as bonds and equities), whether listed or not, are specifically excluded from this category.
Claims falling outside the regulatory retail portfolio	Claims that do not satisfy the above criteria will be risk weighted at 100%.

5.15 Residential Mortgages

To be included in "Residential Mortgages", claims must meet the following criteria:

- The properties must be either occupied by the borrower or rented to individuals; and
- The loan is not past due for more than 90 days.

Description of Item	**Guidance**
Residential Mortgages: 50%	Claims or lending that is fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented and secured on that property by a first mortgage charge is risk weighted at 50%. A claim or lending is fully secured by residential property if the loan represents 80% or less of the value of the property. First mortgage charge means a first fixed (legal or equitable) charge or a first floating charge. In the case of the latter, reporting institutions must ensure (by, for example, including a negative pledge to this effect in the documentation) that no prior ranking charges can be taken over the assets concerned.
Residential Mortgages: 100%	Residential Mortgages that do not meet any of the above criteria that are past due (non-performing) loans, are to be assigned a risk weight of 100%.

5.16 Commercial Mortgages

Description of Item	**Guidance**
Commercial Mortgages: 100%	Commercial property generally shall be weighted at 100%.

5.17 **Past Due Exposures**

Description of Item	Guidance
Secured	For the purpose of defining the secured portion of the past due loan, eligible collateral and guarantees are treated as for credit risk mitigation purposes. In the case of loans secured by residential property, when such loans past due for more than 90 days they shall be risk weighted at 100%, net of specific provisions. If such loans are past due but specific provisions are no less than 20% of the outstanding amount, the risk weight applicable to the remainder of the loan can be reduced to 50%. Past due loans fully secured by collateral not recognized under CRM framework are to be risk weighted at 150%.
Unsecured and past due 90 days	The unsecured portion of any loan that is past due for more than 90 days, net of specific provisions, including partial write-offs, will be risk- weighted as follows: • 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan; • 100% risk weight when specific provisions are no less than 20% of the outstanding amount of the loan. • 100% risk weight when specific provisions are no less than 50% of the outstanding loan amount.

5.18 **Other Exposures which are not Past Due Exposures**

Description of Item	Guidance
Tangible fixed assets 100%	Premises, plant and equipment, other fixed assets for own use, and other interests in realty and will be risk weighted at 100%. Included are investments in land, premises, plant and equipment and all other fixed assets of the reporting institution which are held for its own use, including any fixed asset held by the institution as lessee under a finance lease. Other interest in land which is not occupied or used in the operation of the reporting institution's business should also be reported here.
High Risk Assets 150%	Investments in venture capital and private equity, including investments in investment funds holding such investments, are weighted at 150%. A venture capital or private equity investment is deemed to be one which, at the time the investment is made, is: a) in a new or developing company or venture; or b) in a management buy-out or buy-in; or c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or d) acquired with a view to, or in order to, facilitate a transaction falling within (a) to (c).
Other Exposures 100%	Exposures to corporates or individuals not elsewhere reported.

6. Off-Balance Sheet Items – (non-derivative instruments)

6.1 Off-balance sheet items under the standardised approach will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs). The credit conversion factor ("CCF") is the percentage value used to convert an off-balance sheet exposure into an on-balance sheet equivalent (i.e. the credit equivalent amount).

6.2 CCFs are generally pre-defined in the worksheet (i.e. 100% of on-balance sheet items) and risk weights (i.e. 0% to 100%) are built into this form. The credit equivalent amount for some off-balance sheet exposure types may consist of several discrete exposures, each potentially attracting different CCFs.

6.3 The reporting institution should categorise off-balance sheet exposures into the following standard items below and determine the appropriate CCF(s) to be applied:

<u>Exposures without CRM</u>

This column is completed for exposures, which do not have any allowable credit risk mitigants. The *Credit Equivalent Exposure* column calculates automatically after inputting the *Principal Amount before CCF*.

<u>Exposures with CRM</u>

This section is completed for exposures which have recognised credit risk mitigants. The *Credit Equivalent Exposure pre-CRM* column calculates automatically after inputting the *Principal Amount before CCF*. However, licensees are required to calculate the *Credit equivalent exposures post-CRM* using the rules outlined in section 8. Off-balance sheet netting is not allowed.

6.4 To calculate the credit equivalent amount ("CEA") for the relevant off-balance sheet exposure multiply the principle amount of a particular transaction by the relevant CCF. Exposures allowing for credit risk mitigation must also be reported in the columns provided.

Instruments	**Credit Conversion Factor (%)**
Commitments that are unconditionally cancellable without prior notice	**0%**
Commitments with original maturity of less than one year	**20%**
Short-term self liquidating Trade related contingencies	**20%**
Transaction related contingencies	**50%**
Note Issuance facilities (NIFs) and revolving underwriting facilities (RUFs)	**50%**
Commitments with original maturity of one year and over	**50%**
Direct credit substitutes	**100%**
Sales and repurchase agreements and asset sales with recourse	**100%**
Securities Lending or posting of securities as collateral	**100%**
Forward asset purchases, forward forward deposits and partly paid shares and securities	**100%**
Other Commitments	**100%**

7. Off-Balance Sheet Items – (derivative instruments)

7.1 The treatment of forwards, swaps, purchased options and other similar derivatives needs special attention because institutions are not exposed to credit risk for the full face value of their contracts (notional principal amount), but only to the potential cost of replacing the cash flow (on contracts showing a positive value) if the counterparty defaults. The credit equivalent amount (CEA) of these transactions, whether held in the banking or trading book, must be determined by using the current exposure method. The current exposure method is calculated as outlined in section 7.3

7.2 The credit equivalent for Exposures are classified according to the:

- Type of instrument, Sections A thru E represent the banking book, whereas Section F represents the trading book:

  A – Interest Rate Contracts

  B – Foreign Exchange & Gold Contracts

  C – Equity Contracts

  D – Other Precious Metal Contracts

  E – Other Commodities Contracts

  F – Credit Derivatives: Buyers & Sellers

- Residual maturity (in years); and
- Nature of the counterparty.

Exposures without CRM

These columns are completed for exposures, which do not have any allowable credit risk mitigants. The *Credit Equivalent Exposure* column calculates automatically after inputting the *Replacement Cost of Contracts* and *Principal amounts.*

Exposures with CRM

This section is completed for exposures which have recognised credit risk mitigants. The *Credit Equivalent Exposure pre-CRM* column calculates automatically after inputting the *Replacement Cost of Contracts* and *Principal Amounts*. However, licensees are required to calculate the *Credit equivalent exposures post-CRM* using the simple approach as outlined in section 8. Off-balance sheet netting is not allowed.

7.3 **The current exposure method**

To calculate the credit equivalent amount of derivative instruments, the current exposure method is used, where the licensee would sum:

- The total replacement cost (obtained by "marking to market") of all its contracts with positive value; and

- An amount for potential future credit exposure calculated on the basis of the total principal amount of its book and credit conversion factors segmented by residual maturity as follows:

Residual maturity	Interest rate	Exchange rate and gold	Equity	Precious metals except gold	Other commodities
One year or less	0.0%	1.0%	6.0%	7.0%	10.0%
Over one year to five years	0.5%	5.0%	8.0%	7.0%	12.0%
Over five years	1.5%	7.5%	10.0%	8.0%	15.0%

  - For contracts with multiple exchanges of principal, the factors are to be multiplied by the number of remaining payments in the contract.
  - For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. In the case of interest rate contracts with remaining maturities of more than one year that meet the above criteria, the add-on factor is subject to a floor of 0.5%.
  - Forwards, swaps, purchased options and similar derivative contracts not covered by any of the columns of this matrix are to be treated as "other commodities".
  - No potential future credit exposure would be calculated for single currency floating/floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

8. Credit Risk Mitigation – The Simple Approach

8.1 For collateral to be recognised in the simple approach, the collateral (see eligible types below) must be pledged for at least the life of the exposure and it must be marked to market and revalued with a minimum frequency of six months. Those portions of claims collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion will be subject to a floor of 20% except under the conditions specified below. The remainder of the claim should be assigned to the risk weight appropriate to the counterparty.

8.2 **Exceptions to the Risk Weight Floor**

OTC derivative transactions subject to daily mark-to-market, collateralised by cash and where there is no currency mismatch should receive a 0% risk weight. Such transactions collateralised by sovereign or qualifying for a 0% risk weight in the standardised approach can receive a 10% risk weight.

8.3 **Eligible Collateral**

The following collateral instruments are eligible for recognition in the **simple approach:**

a) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank that is incurring the counterparty exposure.[5],[6]
b) Gold.
c) Debt securities rated by a recognised external credit assessment institution where these are either:
   - at least BB- when issued by sovereigns; or
   - at least BBB- when issued by other entities (including banks and securities firms); or
   - at least A-3/P-3 for short-term debt instruments.
d) Debt securities not rated by a recognised external credit assessment institution where these are:
   - issued by a bank; and
   - listed on a recognised exchange; and
   - classified as senior debt; and
   - all rated issues of the same seniority by the issuing bank that are rated at least BBB- or A-3/P-3 by a recognised external credit assessment institution; and
   - the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB- or A-3/P-3 (as applicable).
e) Equities (including convertible bonds) that are included in a main index.

[5] Cash funded credit linked notes issued by the bank against exposures in the banking book which fulfil the criteria for credit derivatives will be treated as cash collateralised transactions.

[6] When cash on deposit, certificates of deposit or comparable instruments issued by the lending bank are held as collateral at a third-party bank in a non-custodial arrangement, if they are openly pledged/assigned to the lending bank and if the pledge/assignment is unconditional and irrevocable, the exposure amount covered by the collateral (after any necessary haircuts for currency risk) will receive the risk weight of the third-party bank.

8.4 **Guarantees (and credit derivatives)**

Only exposures that have been explicitly, irrevocably and unconditionally guaranteed by qualifying central governments and central banks, including international banking agencies and multilateral regional development banks, will qualify for lower risk weights. Such guarantees should be legally enforceable. Where an exposure is partially guaranteed, only that part of the claim which is fully guaranteed will be weighted according to the lower risk weight of the guarantor.

9. Operational Risk – Capital

9.1 There are two methods recognised by The Bahamas for calculating operational risk charges:

- the Basic Indicator Approach ("BIA"); and
- the Standardised Approach ("TSA").

Licensees wishing to use the TSA, are required to obtain the permission of the Central Bank and must satisfy the Central Bank that it meets the qualifying criteria in outlined in Annex C.

A bank should treat any partial year of operation of six months or more as a full year. Any partial year of operation of less than six months should be disregarded. If any partial year is counted as a full year, the gross income of that partial year should be annualised.

9.2 **General layout of form**

The ***Operational Risk*** reporting form titled ***"OpRisk"*** is divided into two sections for reporting, either under the BIA, or TSA. Licensees using any of these approaches should only complete the part of the form that is relevant to the chosen approach. All amounts should be recorded in $000's.

9.3 **Panel A: Reporting Period**

Under the BIA and TSA, a licensee's capital charge for operational risk is calculated using gross income data derived from the last three completed financial years for which audited financial statements have been prepared. The dates should be entered as follows:

Year 1	Date 2 years prior to last year
Year 2	Date 1 year prior to last year
Year 3	Last year

The years will automatically be populated in the appropriate cells under Panels B and C.

9.4 **Panel B: Basic Indicator Approach**

Under the BIA, licensees must hold capital for operational risk equal to 15% of average gross income over the past three years, ignoring those years where income was not positive.

Licensees must input the total gross income for each of the three years. ***Total Gross Income*** is defined as the sum of net interest income and net non-interest income. Net interest income and net non-interest income are defined in the following table:

Item Name	Definition
Net Interest Income	Interest income net of interest expense, gross of any provisions (e.g. for unpaid interest).
Net Non-interest Income	Net non-interest income gross of operating expenses (including fees paid to outsourcing service providers) and should exclude realized profits/losses from the sale of securities in the banking book and extraordinary or irregular items as well as items derived from insurance. Dividend income and other operating income should be included.

Figures for any year in which annual gross income is negative or zero, will be excluded from both the numerator and denominator, when calculating the capital charge.

The worksheet will automatically calculate the capital charge and the Operational Risk Equivalent Assets.

9.5 **Panel C: Standardised Approach**

Under TSA, licensees are required to allocate gross income by eight (8) primary business lines for each of the previous three years. Multiplying these income amounts by the appropriate factor for that business line (the "Beta" factor) gives the capital charge for each of these lines (see table below).

Business Lines	Beta Factors
Corporate Finance (β1)	18%
Trading and Sales (β2)	18%
Retail Banking (β3)	12%
Commercial Banking (β4)	15%
Payment and Settlement (β5)	18%
Agency Services (β6)	15%
Asset Management (β7)	12%
Retail Brokerage (β8)	12%

Note that, in any given year, a negative capital charge (resulting from negative gross income) in a business line will be given a nil capital charge.

The worksheet will automatically calculate the capital charge and the Operational Risk Equivalent Assets.

Licensees must meet the qualifying criteria in **Annex C** in order to use the TSA.

The principles for mapping gross income to the various business lines are outlined in **Annex D.** Additionally, the business lines are defined in further detail in **Annex E.**

Annex A
Mapping of ECAI Tables

Table 1: Mapping of ECAI's credit assessments to risk weightings (Long term mapping)

Standard and Poor's ("S&P") assessments	Fitch's assessments	Moody's assessments	Corporate	Banks and securities firms		Sovereign	PSE (Sovereign rating based)
				Maturity > 3 months	Maturity 3 months or less		
AAA to AA-	AAA to AA-	Aaa to Aa3	20%	20%	20%	0%	20%
A+ to A-	A+ to A-	A1 to A3	50%	50%	20%	20%	50%
BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	100%	50%	20%	50%	100%
BB+ to BB-	BB+ to BB-	Ba1 to Ba3	100%	100%	50%	100%	150%
B+ to B-	B+ to B	B1 to B3	150%	100%	50%	100%	150%
CCC+ and below	CCC+ and below	Caa1 and below	150%	150%	150%	150%	150%

Table 2: Securitisation Mapping of ECAI's credit assessments to risk weightings (Long term mapping)

S&P assessments	Fitch's assessments	Moody's assessments	Risk weight
AAA to AA-	AAA to AA-	Aaa to Aa3	20%
A+ to A-	A+ to A-	A1 to A3	50%
BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	100%
BB+ to BB-	BB+ to BB-	Ba1 to Ba3	350%
B+ and below	B+ and below	B1 and below	Capital deduction

Table 3: Securitisation Mapping of ECAI's credit assessments to risk weightings (Short term mapping)

S&P assessments	Fitch's assessments	Moody's assessments	Risk weight
A-1+, A-1 and A-1-	F1+, F1	P-1	20%
A-2	F2	P-2	50%
A-3	F3	P-3	100%
All short-term ratings below A-3	Below F3	Not prime (NP)	Capital deduction

Table 4: Mapping consensus risk scores from participating ECAs risk weightings

Country Score	Sovereign
0-1	0%
2	20%
3	50%
4-6	100%
7	150%

Annex B

Mapping of On Balance Sheet Items

Basel II/III Standard (New)	ERS – Form 2
• Cash Items	• Notes & Coins (Item 1) • Cheques & Other Instruments in course of collection (Item 9) • Gold and Silver Bullion (Item 11)
• Cash Items – Exposures collateralized by cash deposits	***[NEW]***

• Claims on Sovereigns and The Central Bank	• Balances with the Central Bank (Item 2)
	• Loans and Advances
	    ○ Resident Government
	    ○ Non-Resident Government

• Sovereign Securities	• Government Securities
	    ○ T-Bill
	    ○ Registered Stocks & Other Securities

• Claims on Public Sector Entities (PSEs)	• Loans and Advances
	    ○ Resident – Public Corporation/Public Financial Institutions
	    ○ Non-Resident – Public Corporation/Public Financial Institutions

• Multilateral Development Banks (MDBs)	• Claims on Multilateral Development Banks (MDBs)
• Claims on Banks and Securities Firms	• Balances with Financial Institutions (in Bahamas) • Balance with Financial Institutions (outside Bahamas) • Securities Firms ***[NEW]***
• Claims on Corporates	• Loans and Advances ○ Other

• Investments (Shares and Securities)	• Investment (in Stocks & Shares)
	    ○ Domestic Securities
	    ○ Foreign Securities
	    ○ Other Investments

• Collective Investment Scheme Exposures	***[NEW]***
• Securitizations	***[NEW]*** - Securitization exposures can include, but are not limited to the following: asset-backed securities, mortgage-backed securities, credit enhancements, liquidity facilities, interest rates, currency swaps etc.

Basel II/III Standard (New)	ERS – Form 2
• Regulatory Retail Portfolio	***[NEW]*** - Exposures can take the form of any of the following: revolving credits, lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g. auto loans, educational loans etc.) and small business facilities and commitments. *Partially Included:* • Loans and Advances o Resident – Other – which includes consumer credit (personal loans, inclusive of credit cards), small business loans (Item 7(a)(iv)(a))

• Residential Mortgages	• Loans and Advances
	    o Resident – Mortgages/Residential (Item 7(a)(iv)(a))
	    o Non-Resident – Mortgages/Residential (Item 7(b)(iv))

• Commercial Mortgages	• Loans and Advances
	    o Resident – Mortgages/Commercial (Item 7(a)(iv)(b))
	    o Non-Resident – Mortgages/Commercial (Item 7(b)(iv))

• Past Due Exposures	***[NEW]*** – Non-performing Loans (*this is an "of which" category under Item 7*)
• Other Exposures which are not Past Due Exposures	• Fixed Assets (Item 9) • Other Assets (Item 12)

Annex C
Qualifying Criteria for the Standardised Approach

To qualify for use of the Standardised Approach, a licensee must satisfy the Central Bank that, at a minimum:

- its board of directors and senior management, as appropriate, are actively involved in the oversight of the operational risk management framework;
- it has an operational risk management system that is conceptually sound and is implemented with integrity; and
- it has sufficient resources in the use of the approach in the major business lines, as well as the control and audit areas.

The Central Bank will have the right to insist on a period of initial monitoring of a licensee's Standardised Approach, before it is used for regulatory capital purposes.

A licensee must develop specific policies and have documented criteria for mapping gross income for current business lines and activities into the standardised framework. The criteria must be reviewed and adjusted for new or changing business activities, as appropriate.

Licensees using the Standardised Approach must also meet the following additional criteria.

a) The licensee must have an operational risk management system with clear responsibilities assigned to an operational risk management function. The operational risk management function is responsible for developing strategies to identify, assess, monitor and control/mitigate operational risk; for codifying firm-level policies and procedures concerning operational risk management and controls; for the design and implementation of the firm's operational risk assessment methodology; and for the design and implementation of a risk-reporting system for operational risk.

b) As part of the licensee's internal operational risk assessment system, the licensee must systematically track relevant operational risk data, including material losses by business lines. Its operational risk assessment system must be closely integrated into its risk management processes. Its output must be an internal part of the process of monitoring and controlling the licensees operational risk profile. For instance, this information must play a prominent role in risk reporting, management reporting, and risk analysis. The licensee must have techniques for creating incentives to improve the management of operational risk throughout the company.

c) There must be regular reporting of operational risk exposures, including material operational losses, to business unit management, senior management and to the board of directors. The licensee must have procedures for taking appropriate action according to the information within the management reports.

d) The licensee's operational risk management system must be well documented. The licensee must have arrangements in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operational risk management system, which must include policies for the treatment of non-compliance issues.

e) The licensee's operational risk management processes and assessment system must be subject to validation and regular independent review. These reviews must include both the activities of the business units and/or the operational risk management function.

f) The licensee's operational risk assessment system (including the internal validation processes) must be subject to regular review by internal and external auditors and/or the Central Bank.

Annex D
Principles for Business Line Mapping

a) All activities must be mapped into the eight (8) business lines in a mutually exclusive and jointly exhaustive manner.

b) Any activity (banking or non-banking) which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. In the event that more than one business line is supported through the ancillary activity, an objective mapping criteria must be consistently adopted and the reasoning behind adopting that criterion recorded by the Bank.

c) When mapping gross income, if an activity cannot be mapped into a particular business line then the business line yielding the highest capital charge must be used. The same business line equally applies to any associated ancillary activity.

d) Licensees may use internal pricing methods to allocate gross income between business lines, provided that total gross income for the licensee (as would be recorded under the Basic Indicator Approach) still equals the sum of gross income for the eight business lines.

e) The mapping of activities into business lines for operational risk capital purposes must be consistent with the definitions of business lines used for regulatory capital calculations in other risk categories, i.e., credit and market risk. Any deviations from this principle must be clearly explained and documented.

f) The mapping process used must be clearly documented. In particular, written business line definitions must be clear and detailed enough to allow third parties to replicate the business line mapping. Documentation must, among other things, clearly explain any exceptions or overrides and be kept on record.

g) Processes must be in place to define the mapping of any new activities or products.

h) Senior management is responsible for the mapping policy (which is subject to the approval of the board of directors).

i) The mapping process to business lines must be subject to independent review.

Annex E
Mapping of the Business Lines

Business Line	Major Business Segment	Activity Groups
Corporate Finance	Corporate Finance	Mergers and acquisitions, underwriting, privatisations, securitisation, research, debt (government, high yield), equity, syndications, IPO, secondary private placements
	Municipal/Government Finance	
	Merchant Banking	
	Advisory Services	
Trading & Sales	Sales	Fixed income, equity, foreign exchanges, commodities, credit, funding, own position securities, lending and repos, brokerage, debt, prime brokerage
	Market Making	
	Proprietary Positions	
	Treasury	
Retail Banking	Retail Banking	Retail lending and deposits, banking services, trust and estates
	Private Banking	Private lending and deposits, banking services, trust and estates, investment advice
	Card Services	Merchant/commercial/corporate cards, private labels and retail
Commercial Banking	Commercial Banking	Project finance, real estate, export finance, trade finance, factoring, leasing, lending, guarantees, bills of exchange
Payment and Settlement[7]	External Clients	Payments and collections, funds transfer, clearing and settlement
Agency Services	Custody	Escrow, depository receipts, securities lending (customers) corporate actions
	Corporate Agency	Issuer and paying agents
	Corporate Trust	
Asset Management	Discretionary Fund Management	Pooled, segregated, retail, institutional, closed, open, private equity
	Non-Discretionary Fund Management	Pooled, segregated, retail, institutional, closed, open
Retail Brokerage	Retail Brokerage	Execution and full service

[7] Payment and settlement losses related to a bank's own activities would be incorporated in the loss experience of the affected business line.