THE BASEL BULLETIN

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Basel II/III: Ready For Launch!

Over the past year, the Central Bank ("the Bank") has worked diligently to ensure that the necessary preparations for the implementation of the Basel II and III frameworks have been made. Since the previous bulletin was released in April of 2014, there has been substantial progress in terms of policy proposals and consultation to ready the jurisdiction for Basel implementation. We acknowledge that the industry has played a critical role in this process, helping to ensure that the framework and the implementation approach are appropriate for The Bahamas, while meeting international standards.

Following a consultative period earlier this year, the Bank received valuable feedback from licensees with regard to the Areas of National Discretion, the Calculation of the Capital Charge for Operational Risk, the Definition of Capital, and the Minimum Disclosure Requirements under Pillar 3. The feedback provided by licensees proved useful and focused primarily on national discretion areas, operational risk capital charge and the definition of capital. The Bank has since formally responded to licensees addressing their respective concerns. Two additional consultative documents were released during the 3rd quarter relating to; *The Calculation for the Capital Charge for Credit Risk: Standardized Approach* and *Guidance on the Internal Capital Adequacy Assessment Process (ICAAP).* Comments received on these proposals are currently under review.

In addition, there has been several training sessions focused on the Internal Capital Adequacy Assessment Process (ICAAP) which forms part of the Supervisory Review Process (i.e. Pillar II of the Basel II capital framework). Through a partnership with CARTAC, the bank successfully held an Industry Session on the ICAAP, with the intention of sensitizing licensees on key components of the ICAAP, the roles and responsibilities of senior management and the board, in addition to supervisory expectations regarding submission of the ICAAP. The Basel Project Team also held meetings with selected licensees to assist the Bank with the development of its ICAAP guidance. The meetings were very productive and evidenced the range of ICAAP models currently in place, from the very basic to the very sophisticated.

Regarding monitoring work, again, the Bank wishes to thank those licensees who participated in the Quantitative Impact Study (QIS) earlier this year. We look forward to broader participation across the banking sector as we continue our parallel run exercise. The QIS is designed for the purpose of gathering data to assist the Bank in assessing the impact of the new Basel II/III requirements on the quality of, and level of capital post implementation. We are pleased to report that the results of the QIS have been finalized and available for viewing. Generally, the findings suggest that licensees' capital levels will remain robust under the Basel II/III framework. *(See QIS summary below)*

Inside This Issue

From the Desk of The Inspector

As a leading international financial centre, implementation of the international regulatory standards as embedded in the Basel Accord has been a key component of our bank supervisory programme and initiatives.

Broadly, international regulatory initiatives and supervisory reforms aimed at securing financial stability and enhancing standards in the areas of regulation, transparency and international cooperation have continued through 2015. The general consensus is that the regulatory and policy measures to address the aftermath of the global financial crisis are now substantively complete in the G20 jurisdictions and are being rolled out internationally through regional representative groups of the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS) or directly by national bank regulators – The Central Bank of The Bahamas included.

The BCBS has indicated that the focus is now less on new rule making and more on the implementation of the capital accord and underlying qualitative components to ensure simplicity, comparability and effectiveness of supervision. We in The Bahamas will continue to be significantly impacted by these global supervisory outcomes on capital adequacy, liquidity, crisis preparedness and resolution, among others.

The Central Bank's supervision mandate is closely aligned with the BCBS' supervisory thrust. My Bank Supervision Department (BSD) continues to focus on the key objectives of maintaining an effective monitoring and supervisory regime commensurate with the industry risks as well as remaining aligned with industry best practices, international standards and regulatory reforms. The Bank Supervision Department and specifically the Basel Project Team have worked diligently over the past few years towards full implementation of the Basel regime effective January 2016. This bulletin will cover all of the major accomplishments to-date; and note the major milestones on the road ahead.

Sincerely,

Abhilash D. Bhachech

Inspector of Banks & Trust Companies

Basel Readiness Survey

In an effort to assess the readiness of licensees for the implementation of Basel II and III approaches, as well as to assist with the development of the overall Basel framework for The Bahamas, the Basel Implementation Project Team launched a survey in April of 2014 .

The survey was sent to approximately 87 public banks, and bank and trust companies. Responses were received from 67 licensees, representing an overall response rate of approximately 84%. All survey results were collected in May of 2014, and collated the following month.

The major takeaways from the survey include the following:

- 66 % of respondents, had already taken steps necessary for the implementation of Basel II. However, most banks appear not to have developed a roadmap for the implementation.
- 10% of respondents had either begun, or had fully implemented Basel III at the consolidated parent level.
- 71% of the respondents indicated that their parent bank/ head office chose to implement the standard approach for credit risk capital measurement.
- 60 % of the respondents indicated that the Basic Indicator Approach will likely be used with respect to the measurement of operational risk.
- 28 % of the respondents indicated that the Standardized Approach with respect to operational risk would likely be used.
- 95% of respondents were of the opinion that the implementation of advanced approaches is not likely to negatively affect the industry's relative competitive edge within the region.
- 88% of the respondents do not expect to see a material change in their capital levels as a result of Basel II and III implementation.

To view the full Survey findings, click here.

Quantitative Impact Study (QIS)

During April 2015, the Central Bank conducted a quantitative impact study (QIS) to assess the impact of the new Basel II/III requirements on the quality and level of capital assuming full implementation. This involved applying the Basel III capital structure and Pillar I capital measures for Credit, Operational and Market Risk.

A total of sixteen (16) banks were selected to participate in the study; these banks were selected based on their asset size and systemic importance. The banks were requested to submit data as of December 31, 2014. The results are based on survey results from six (6) commercial banks and (8) international banks (referred to as 'the Group').

The analysis primarily examined:

1. Changes to the definition of capital (based on the Basel III framework noting any capital shortfalls for the CET1 minimum requirement;
2. Changes in overall risk weighted assets and its impact/ correlation on banks' capital adequacy levels; and
3. Banks' capital allocations for operational risk and its impact on overall capital adequacy levels.

Major Takeaways

- Capital levels appear robust under the Basel II/III framework.
- Capital levels for the Group of selected banks fell by 2.53% when calculated under the Basel III framework.
- Under Basel III, the Group's Capital Adequacy Ratio stood at 24.4%, approximately a 3 percentage point decline from Basel I.
- The average Common Equity Tier 1 (CET1) ratio for the Group stood at 22.8%, and suggests safe levels of CET1 capital in the banking sector.
- Under the Basel III framework, the Group's average Tier 1 Capital stood at 23.4%, representative of a 8.5% decline from the Basel I framework.
- The results of the analysis show that licensees within the Group would meet the regulatory requirements in respect of minimum capital adequacy ratios as defined by Basel III at the level of 4.5% (CET1), 6% (Tier 1 Capital) and 8% (Tier 1 + Tier 2 Capital).
- Implementation of the new Basel III requirements and the resulting change in the definition of capital did not appear to have a significant impact on the capital position of the surveyed Group using the Dec. 2014 figures.
- Total risk weighted assets increased across the entire Group by 16%. The main drivers of this increase relate to changes in the credit risk weighted assets and the operational risk capital charge.

To view the full QIS findings, click here.

Progress for the Caribbean!

Over the past two years there has been significant progress in banking regulation, and particularly so for territories within the Caribbean region. The Technical Working Group (TWG) for Basel II implementation, with the assistance of the Caribbean Regional Technical Assistance Centre (CARTAC), made substantial progress in developing, reviewing and finalizing the Basel II Capital Guidance for the Caribbean. Given the focus on consistency in implementation, the Basel II Capital Guidance seeks to ensure the harmonization of standards and also efficiently leverage the limited resources in order to create a better synergy for the region.

In February of this year, the Guidance was issued to all participating countries/regulators of the TWG, for onward development and implementation, with the view that specific adaptation may be made to accommodate local circumstances. Areas covered in the Guidance comprise of the following: Credit Risk, Credit Risk Mitigation and Securitization (Trinidad and Tobago Central Bank); Market Risk (Barbados Central Bank); Interest Rate Risk in the Banking Book (The Central Bank of The Bahamas); Pillar II – Supervisory Review Process (Barbados Central Bank and Bank of Jamaica); Operational Risk (Eastern Caribbean Central Bank); Pillar III – Market Discipline (British Virgin Islands); National Discretions (Cayman Islands Monetary Authority); Prudential Information Reporting Form (Turks and Caicos Islands Financial Services Commission). It was generally agreed by member countries that they would focus on implementing the simpler approaches under the Basel framework.

Insights

The Central Bank wishes to thank those licensees that took the time and effort to express their views and provide feedback to the first round of Basel Consultation Papers.

Comments received and Central Bank responses, may be viewed on our website at www.centralbankbahamas.com -> Bank Supervision -> Basel II and III Implementation -> Consultation Documents.

BIS: Implementation and Progress

On the international front, the Basel Committee ('the Committee') continues to pursue its post-crisis reform agenda. These include major enhancements to the risk-based capital standards; requirements for global and domestic systemically important banks; prudential buffers; liquidity risk regulation; a leverage ratio; and new disclosure requirements.

In 2014, the Committee published a number of final standards and consultative documents, such as revisions of the standardized approaches for credit, market and operational risk. For 2015 and 2016, the Committee's work program has been structured around four main themes:

- Policy development;
- Improving the effectiveness of supervision;
- Ensuring simplicity, comparability and risk sensitivity; and
- Monitoring and assessing implementation of the Basel framework.

These efforts aim to strengthen the international banking system's resilience, improve market confidence in regulatory ratios and promote a level playing field. As part of this work, the Committee is considering how the various regulatory metrics interact with each other and whether the calibration and design of the various elements of the framework are consistent with their intended objectives. For example, there is continued debate on the Leverage Ratio's calibration which is expected to be fully migrated to the Pillar I treatment by January 2018.

Concurrently, there is also greater reliance on stress testing, and the Committee plans to further investigate the role of stress testing in the Basel framework, and how this relates to the Pillar I minimum capital requirements. Other topics under the Committee's review include intra-day liquidity, monitoring of the Liquidity Coverage Ratio, data standards, corporate governance and the effectiveness of supervision and the role of Pillar 2 in the capital framework. The Committee is also taking steps to simplify the regulatory framework to improve consistency and comparability in capital ratios. This includes consolidating the Basel framework into a single volume.

Of central importance is the way in which the Basel standards are being adopted, applied, enforced and monitored at the local level. As a result, a key area of focus for the Committee is implementation and more importantly, the consistency of implementation. This would ensure a level playing field for banks and supports comparability of regulatory ratios, and is crucial to achieving the outcomes intended for international standards.

The Central Bank will continue to actively monitor and engage the Basel Committee on existing and up-coming policy initiatives. While a number of revisions to the Basel II and III framework have been finalized or published for consultation by the Committee, the Central Bank does not envision that these work streams will have a material impact on our Basel Implementation Program. Looking ahead, the Central Bank will turn its attention to the more granular areas under the Basel framework, such as the Liquidity Coverage Ratio, the Net Stable Fund Ratio and the Leverage Ratio. The Central Bank will also continue to monitor the progress made by licensees as they apply these new requirements.

Moving Forward

⇒ The first official reporting under the new Basel framework will be as at **January 31st 2016** for commercial banks, and **March 31st 2016** for international firms.

⇒ A second Basel Quantitative Impact Study (QIS 2) is scheduled for 2016.

⇒ The QIS will be conducted during the first quarter of 2016 based on the December 2015 financial data. The results from these studies will be used to help to ensure that licensees are prepared for the upcoming 2016 implementation of the Basel II/III regime in The Bahamas.

⇒ As part of the QIS, and to enable licensees to become familiar with the new returns, they will be required to conduct parallel reporting of the current ERS return (thru ORIMS) and the QIS reporting forms.

⇒ The Central Bank intends to **host training sessions during the first quarter of 2016** on the new and revised ERS reporting forms.

⇒ At this time, licensees can get clarification on completing the reporting forms by contacting the Central Bank's Policy Unit via email at policy@centralbankbahamas.com . Licensees will be notified separately about the dates and times the sessions will be held.

⇒ Finalized Guidelines will be issued during the first quarter of 2016.

Questions or comments may be addressed to:

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