**Central Bank of The Bahamas**

# BASEL II/III QUANTITATIVE IMPACT STUDY RESULTS

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# I. BACKGROUND

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 findings below are based on survey results from six (6) commercial banks and (8) international banks (referred to as 'the Group').

Our analysis of the survey results primarily examined:

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

# II. FINDINGS

## a. Capital Adequacy Ratio (CAR)

- Overall, the findings suggest that banks' capital levels remain robust under the Basel II/III framework. This is attributed to the fact that generally, the banks' Tier 1 and Tier 2 capital consists of common shares, share premiums, reserves, current profits and retained earnings – all largely consistent with the Basel III requirements.

- Capital levels for the Group fell by 2.53% when calculated under the Basel III framework. Under the current Basel I framework, the Group's collective Capital Adequacy Ratio (CAR) stood at 26.9%; under Basel III, the Group's CAR stood at 24.4%.

- CAR levels have decreased for all but five (5) licensees within the Group, but remained above the minimum levels. These decreases were driven principally by increases in total Risk Weighted Assets.

### i. Average level of CAR based on Common Equity Tier 1 (CET1) Capital

Under Basel III, the minimum requirement for CET1 has been raised to 4.5%. 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. The analysis also showed that, assuming full implementation of the capital conservation buffer (CCB) of 2.5%, all banks within the Group met the CET1 requirement of 7% (i.e. 4.5% + 2.5%).

### ii. Average Level of CAR based on Tier 1 Capital

Under the current framework, the average CAR based on Tier 1 Capital stood at 31.9%, while under the Basel III framework, the Group's average Tier 1 Capital stood at 23.4%, representative of a 8.5% decline.

### iii. Total Eligible Capital Base (Tier 1 + Tier 2)

Overall, the results of the analysis show that licensees within the Group would meet the minimum capital adequacy requirements under Basel III, factoring both Tier 1 and Tier 2 capital.

## b. Capital Buffers

*Assuming full adoption of the capital buffers under Basel III***:**

- Our analysis showed that, assuming full implementation of the CCB, all banks within the Group, with one exception, met the CET1 requirement of 7% without the need to increase their capital base. In the case of Total Capital (i.e. minimum of 10.5% = 8% +2.5%), one (1) bank fell short.

- Assuming full implementation of both the CCB and Countercyclical Capital Buffers (CCCB), licensees within the Group, with the exception of four (4) banks, met the minimum 8% requirement, plus the CCB (2.5%) and the CCCB (2.5%) requirement.

## c. Capital Definition

- 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 Group.

## d. Operational Risk & Operational Risk Capital Charge

- The Capital charge related to Operational risk is new under Basel II. This charge increases the required amount of capital to be held. Of the fourteen (14) responses received, twelve (12) licensees use the Basic Indicator approach and two (2) elected to use the Standardized Approach. While banks using the Basic Indicator and Standardized Approaches do not have to collect operational loss data, we observed that six (6) licensees provided such data. The remaining licensees reported no operational losses. The loss category with the most observations (i.e. frequency) of operational risk losses was Execution, Delivery & Process Management.

## e. Risk Weighted Assets

- 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. As a whole, the changes in risk-weighted assets had more impact on overall capital levels than changes to the definition of capital.

## III. CONCLUSIONS FROM QIS

As a result of the requirements of Basel II and III, the overall required regulatory capital levels of licensees increased. The movement was driven by the additional component of Operational risk as well as changes in Risk Weighted Asset factors. There was limited movement in levels of eligible Tier 1 and Tier 2 capital.

The additional requirements of Basel II and Basel III are expected to stress licencees who were already near the minimum capital levels.

## IV. GOING FORWARD

A second Basel QIS is scheduled for 2016. This survey 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 ensure that licensees are prepared for the upcoming 2016 implementation of the Basel II/III regime in The Bahamas.

Questions regarding the results should be directed to:

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