The Central Bank of The Bahamas

BANK SUPERVISION DEPARTMENT

Quarterly Letter to All Senior Officials 03/12

Senior I: Name **Email: Email Address**

Licensee: Name

Dear Senior Official,

Over the past quarter, the Bank Supervision Department continued to concern itself with various regulatory and supervisory initiatives, aimed at ensuring the proper oversight of our regulated entities.

During the month of February, we met with representatives from the various commercial banks to discuss the implications of Basel III, in particular, the shift in the composition of regulatory capital and, importantly, the need for banks to begin to prepare themselves for implementation of these capital rules by 1st January, 2013. The changes proposed under Basel III are aimed at raising the quantity, quality, international consistency and transparency of the capital base, through stricter rules on eligibility of instruments to be included in capital and introduction of a new core Tier 1 ratio, termed "Common Equity Tier 1" (CET1).

As you are aware, under our current Basel I capital rules, the 8% minimum capital risk-adjusted ratio is evenly split between Tier 1 capital and Tier 2 capital. With the changes under Basel III, Tier 1 capital will increase to 6% of risk weighted assets and Tier 2 capital will diminish to 2% of risk weighted assets by 1st January, 2015. Tier 1 capital will consist of: common equity (ordinary shares) which is considered the highest quality of capital, and would need to be maintained at least 4.5% of the risk-weighted assets or 75% of this Tier I component.

Our commercial banks are well-capitalized with quality CET1 and Tier 2 capital, and are currently subjected to trigger and target ratios of 14% and 17%, respectively--well above the levels proposed under Basel III. This is largely due to banks' own countercyclical recognition of the need for a stable level of loss absorbing capital, prior to the crisis, and CBOB's regulatory initiatives early in the crisis to cement the level through implementation of higher capital ratios and supplemented by forward looking provisioning requirements.

While most of our international licensees are a part of the group of G20 countries, the Central Bank is of the view that subsidiaries will have already adopted the approach taken by their parent in the wake of the stated timeline. Overall, the discussions proved to be successful in assisting banks to become more familiar with requirements for Basel III, and to point out that there is very little national discretion.

Some of the other key points emanating from the discussions included:-

- Phasing out preference shares immediately or over a ten-year period, which would no longer qualify as any form of capital.
- Restrictions to dividends, if the ratio for CET1 capital is not maintained.
- The importance of accountability and transparency of capital ratios and deductions to capital.

We would like to draw your attention to the passage through Parliament of the amendments to the **Banks and Trust Companies (Large Exposures) (Amendment) Regulation Act, 2012** and the **Banks and Trust Companies (Liquidity Risk Management) Regulations, 2012,** which came into force on 2nd March, 2012. The regulations provide the framework for the large exposures and liquidity risk management regimes. We have posted the revised **Large Exposures Guidelines** and the **Guidelines for the Management of Liquidity Risk** on the website. We have also made revisions to the **Guidelines for Managed Branches** and the **Guidelines for Managed Licensees**, which are now available on the website. Additionally, we have revised the **Guidelines for the Minimum Physical Presence for Banks and Trust Companies Licensed in The Bahamas** to permit employees of licensees to provide written translations of documents in response to on-site examination requests and to specify the timeframe licensees must adhere to for the retrieval of records/documentation.

We continue to make progress on the implementation of the **risk-based supervisory framework (RBSF**). Risk assessments have now been completed for all of the twenty-four [24] firms from the first and second round. Work is well underway for the fifteen [15] firms from the third round, and has begun for the forty-five [45] firms from the fourth round. To ensure that the process advances smoothly, we require your cooperation in providing timely and complete submission of all requested information, including the **Risk Assessment Questionnaire & Products and Service Offering Template**. We are now incorporating core control expectations into the assessment of firms. We have decided to have the pre-discovery meeting as an optional requirement, depending largely on the completeness of the information received from the licensees. Further, we are in the final testing stages of an IT system that will automate and enable us to better monitor our deliverables at each stage of the risk assessment process.

We would like to thank the respondents to our **Market Risk Survey**. Your responses have allowed us to make an initial determination of those licensees who will be required to report on their trading book activities and be subject to the market risk capital charge. We have currently identified less than ten firms that will be subject to the market risk reporting and recognize that the majority of our licensees have less complex business models with virtually no market risk exposure. As a preliminary step, we will engage a few of the affected licensees in the coming weeks to be a part of a pilot exercise for the testing of our market risk reporting forms. It is our intent to incorporate the market risk reporting forms into the Bank's Excel Reporting System (ERS) to facilitate reporting by all of the affected licensees commencing with the June 2012 quarterly reporting. The reporting forms will be supported by instructional guidance. Further, the Central Bank will issue its revised draft **Market Risk Guidelines**, for a two week consultation period, in May 2012.

Finally, in preparation for the upcoming Financial Sector Assessment Program (FSAP), now slated for July 2012, we are organizing a forum with the commercial banks on the Bank's stress testing framework, on 26th April, 2012. Discussions will be centered around the:-

- the Central Bank's broad expectations of stress testing;
- general expectations for the FSAP;
- expectations of firms for the FSAP; and

  timelines for implementation.

It is expected that this session will be informal, yet informative, and provide for a useful exchange of information between the Central Bank and the participating commercial banks.

On a concluding note, you will notice a new name as the signatory to this quarterly letter. Effective 13th February, I moved to The Bahamas to join the Central Bank as the new Inspector of Banks and Trust Companies to become an integral member of the Bank Supervision team. My wife and I truly appreciate the warm welcome extended to us in The Bahamas, my own settlement process within Central Bank and the opportunities to meet with several of you and your colleagues over the past few weeks. In this context, I look forward to continued interactions and dialogue with the industry. Any questions regarding this letter should be directed to:

Inspector of Banks & Trust Companies
Bank Supervision Department
Central Bank of The Bahamas
Market Street
P.O. Box N4868
Nassau, Bahamas
Tel: (242) 302-2638
Fax: (242) 356-3909
Email**: banksupervsion@centralbankbahamas.com**

Sincerely,

Abhilash D. Bhachech
Inspector of Banks & Trust Companies