CENTRAL BANK OF THE BAHAMAS

QUARTERLY LETTER ON REGULATORY AND SUPERVISORY DEVELOPMENTS

BANK SUPERVISION DEPARTMENT
July 1, 2020

QUARTERLY LETTER

You will be unsurprised to read that our focus in the past quarter has shifted to managing the operational and economic fallout from the COVID-19 outbreak. We have also continued our work towards a more hurricane-resilient financial system, and our ongoing work in supervisory analysis and intervention.

Coronavirus (COVID-19)

Early in the second quarter, the Central Bank released its Supervisory Response and Guidance for the Novel Coronavirus (COVID-19). The Central Bank continues to monitor the global and domestic economic impact of the pandemic. In May, we conducted a nine-question survey to gather data across the international banking and trust sector. The survey addressed the financial and operational impact of the global pandemic and the challenges faced by Supervised Financial Institutions (SFIs).

A total of 72 SFIs responded to the survey. The respondent included banks, bank and trusts, and trust companies but did not include domestic commercial banks.

Responses highlighted that business continuity challenges were largely met successfully. Respondents described arrangements in place to execute critical operational activities, which included the use of laptops/tablets and employee home computers to access private networks. Respondents also noted challenges with local utility dependability, which decreased productivity of some work-at-home staff. In some cases, the steps taken were rolled out as a part of a pre-existing business continuity plan, while others quickly adopted measures, which had not been considered in existing established plans. In any event, all internationally active SFIs were able to continue offering reasonable service levels to their clients.

With regard to group structures, respondents described challenges experienced by parent entities similar to those of the subsidiary entities, which mostly related to environmental, economic and market concerns. Virtually all applicable respondents expressed that their parent entities were willing and able to support them should a liquidity need arise.

As for income and capital risk, respondent financial impacts were aligned with their exposures. Those with interest income exposure and fee income based on assets under management reported revenue concerns. Those with substantial asset portfolios, not supported by group structures, reported concerns with asset devaluation.

Many respondents expressed concern over the unknown nature of the future economic conditions, especially those SFIs exposed to market risk (in particular, interest rate risk).

The Central Bank will continue to monitor the environment and will use the information gathered to inform our supervisory efforts. We advise that the aforementioned supervisory guidance remains in force

Foreign Exchange Reserves

The Central Bank has observed occasional public commentary that the BSD/USD peg is under pressure due to falling foreign exchange reserves. The most relevant facts are:

- External reserves as of 30 June 2019 were US$1.56 billion
- Reserves prior to the COVID-19 outbreak (as of 29 February 2020) were US$1.97 billion
- Reserves currently (as of 30 June 2020) were US$2.08 billion.

The COVID-19 outbreak is a substantial economic challenge, but has yet to place appreciable pressure on the external reserves position. The reduction in economic activity since March has materially reduced foreign exchange outflows. There is also the consideration that the Central Bank retains several policy tools, which it will deploy in need, to preserve the external reserves position.

The Central Bank expects to allow some run-down in the external reserves from the current historic highs, to finance necessary imports and to support high-value developments in the tourism sector. These developments will stand the country and economy in good stead when tourist traffic eventually returns to more normal levels.

The Central Bank remains confident that it will retain sufficient reserves to maintain the BSD/USD peg.

Hurricane Preparedness and Lessons Learned from Hurricane Dorian

Hurricane Dorian has changed the boundary for the plausible maximum economic adversity arising from a hurricane. The Central Bank will shortly commence an industry survey on operational readiness to manage the impact and aftermath of a Category 5 hurricane tracking over New Providence. We also intend to release a short paper outlining the financial stability lessons arising from Hurricane Dorian, with some additional early lessons from the COVID-19 outbreak.

Basel II & III Implementation

We continue to develop capital and liquidity regulations to strengthen our Basel III framework, and will shortly issue for a second round of industry consultation, draft Capital Regulations and Guidelines.

Minimum Standard for the Outsourcing of Material Functions Guidelines

We extend our thanks for the feedback received on our proposal to amend the Outsourcing Guidelines and move from an approval regime to one of notification. We have incorporated some of your suggestions, one of which includes developing templates for the Notification and Annual Summary Forms, which will now be included in the final version. We expect to release the Guidelines in final form during the third quarter.

Internal Audit Function

Effective engagement between the Central Bank and internal auditors is an essential element in supervision. We take this opportunity to remind senior management to notify the Central Bank of all planned internal audit reviews, and to provide the audit plan and scope. Additionally, at the completion of the internal audit review, all Internal Auditors, (i.e. group and resident internal auditors) must be available to meet with the Central Bank to discuss the preliminary findings.

The Central Bank is in the process of developing separate Internal Audit Guidelines to focus on this important area and to provide SFIs with our minimum acceptable standards.

Charles Littrell

Charles Littrell
Inspector of Banks & Trust Companies

Any questions regarding this letter should be directed to:

Inspector of Banks & Trust Companies
Bank Supervision Department
Central Bank of The Bahamas
P.O. Box N-4868
Nassau, Bahamas
Email**:** banksupervision@centralbankbahamas.com