



SUPERVISORY AND REGULATORY GUIDELINES: 2003-2
Letters of Comfort and Parental Guarantees
Issued: 15th August 2003
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**GUIDELINES ON THE MINIMUM STANDARDS FOR LETTERS OF
COMFORT AND PARENTAL GUARANTEES**

1. INTRODUCTION

- 1.1. The Central Bank of The Bahamas (*"the Central Bank"*) is responsible for the licensing, regulation and supervision of banks and trust companies operating in and from within The Bahamas pursuant to The Banks and Trust Companies Regulation Act, 2000 (Chapter 316), and the Central Bank of The Bahamas Act, 2000 (Chapter 351). Additionally, the Central Bank has the duty, in collaboration with financial institutions, to promote and maintain high standards of conduct and management in the provision of banking and trust services.
- 1.2. All licensees are expected to adhere to the Central Bank's licensing and prudential requirements and ongoing supervisory programmes, including periodic on-site examinations, and required regulatory reporting. Licensees are also expected to conduct their affairs in conformity with all other Bahamian legal requirements.

2. PURPOSE

- 2.1. These Guidelines specify the criteria that the Central Bank will apply in assessing the acceptability letters of comfort and parental guarantees from an *issuer* to its *beneficiary*.

3. APPLICABILITY

- 3.1. This supervisory guideline applies to the use of letters of comfort and parental guarantees issued to all bank and/or trust licensees.

4. ACCEPTANCE CRITERIA

- 4.1. LETTER OF COMFORT

- 4.2.1. By issuing a letter of comfort, the *issuer* signifies its willingness and commitment to provide such support as the *beneficiary* may need, should unforeseen contingencies affect its ability to maintain adequate capital and liquidity levels to meet its obligations and regulatory requirements.
- 4.2.2. In order for a letter of comfort to be acceptable, The Central Bank of The Bahamas must be satisfied that the *issuer* has, and will continue to have, a strong commitment to support the *beneficiary* and is financially sound enough to fulfill its commitment under the letter.
- 4.2.3. As the letter of comfort is not a guarantee, it is particularly important to ensure that the following criteria are met on a continuing basis:
- a) The *issuer* is a licensed financial institution from a jurisdiction which supervises banks in compliance with the Basel Capital Accord and Core Principles for Effective Banking Supervision;
 - b) The issuer is a controller of the *beneficiary*, normally a majority shareholder controller but possibly a minority shareholder controller;
 - c) The letter of comfort is issued under a resolution of the Board of Directors of the issuer;
 - d) The home supervisory authority of the issuer is aware of the letter of comfort and does not object to its issue by the issuer;
 - e) The issuer has and will continue to have, the financial strength to support its obligations under the letter of comfort;
 - f) The issuer exercises effective oversight over the *beneficiary's* large exposures; and
 - g) The home supervisory authority supervises the capital adequacy and large exposures of the issuer on a consolidated basis and the position of the *beneficiary* is taken into account in such supervision.

4.2. PARENTAL GUARANTEES

- 4.2.1. Parental guarantees are legally binding agreements where the *issuer* commits to provide support should the capital or liquidity levels of the *beneficiary* be negatively impacted.
- 4.2.2. Parental guarantees must meet the following criteria in order to be acceptable by the Central Bank:
- a) The *issuer* is a licensed financial institution from a jurisdiction which supervises banks in compliance with the Basel Capital Accord and Core Principles for Effective Banking Supervision;

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- b) The *issuer* is a controller of the *beneficiary*, normally a majority shareholder controller but possibly a minority shareholder controller;
 - c) The parental guarantee is issued under a resolution of the Board of Directors of the *issuer*;
 - d) The home supervisory authority of the *issuer* is aware of the parental guarantee and does not object to its issue by the *issuer*;
 - e) The home supervisory authority supervises the capital adequacy and large exposures of the issuer on a consolidated basis and the position of the *beneficiary* is taken into account in such supervision.
 - f) The parental guarantee should be legally enforceable by the *beneficiary* in the relevant jurisdictions and should prevent the *beneficiary's* capital from becoming deficient as a result of experiencing a loss on such an exposure (as confirmed by a legal opinion addressed to the *beneficiary*);
 - g) The parental guarantee must be an explicit, unconditional, irrevocable and direct agreement;
 - h) The *issuer* is prepared to assume the full amount of the exposure and not just the amount in excess of the large exposure limits;
 - i) The *issuer* is, in the opinion of the Central Bank, a continuing source of financial strength for the bank and can at any time assume the exposure itself without exceeding its own large exposure limits;
 - j) The aggregate of all exposures covered by a parental guarantee should not exceed 25% of the *issuer's* regulatory capital base; and
 - k) The Central Bank approves the guarantee.

5. FORM AND CONTENT

5.1. There is no specific format for letters of comfort and parental guarantees, but there are essential elements that should feature in their contents:-

- a) Acknowledge the purpose and should express clearly the nature and extent of the *issuer's* commitment to support the *beneficiary*;
- b) Set out the shareholding relationship between the *issuer* and the *beneficiary*;
- c) The *issuer* should undertake to inform the Central Bank immediately of any change in the relationship with the *beneficiary* and to consult with the Central Bank in advance of any proposed decrease in the percentage of shares held in the *beneficiary*;

- d) Confirm that the *issuer* exercises effective oversight over the *beneficiary's* large exposures and will ensure that it is informed of all exposures covered by either the letter of credit, letter of comfort or parental guarantee on a timely basis; and
- e) State that the letter has been authorized by a resolution of the Board of Directors of the *issuer* and a copy of the Resolution should be included.

6. FACTORS FOR CONSIDERATION

- 6.1. The Central Bank will take into account the following factors when assessing the acceptability of letters of comfort or parental guarantees:
- a) The financial strength and background of the *issuer*. The financial strength of the *issuer* will be assessed in the light of, *inter alia*, its consolidated shareholder's funds.
 - b) The extent to which the *issuer's* capital adequacy and credit risk profile (including those of the *beneficiary*) are subject to consolidated supervision by its home supervisory authority and the degree of oversight and control exercised by the *issuer* over the *beneficiary's* large exposures;
 - c) The financial strength of the *beneficiary*; and
 - d) The sources of funding of the *beneficiary* and the degree of its reliance on deposits from the public to fund its operations.

7. CONDITIONS

- 7.1. The Central Bank may attach conditions to the letter of credit, letter of comfort or parental guarantee, either generally or in any particular case, if appropriate.

8. REVIEW BY THE CENTRAL BANK OF THE BAHAMAS

- 8.1. To monitor whether the *issuer* of a letter of credit, letter of comfort or parental guarantee continues to be financially sound and able to honour its obligations, the Central Bank will conduct a review of the financial condition of the *issuers*, at least annually.
- 8.2. To facilitate the annual review, the issuer of a letter of comfort, letter of credit or parental guarantee must submit annually its latest audited financial statements, along with a letter of good standing from its home supervisor, to the Central Bank.

9. CANCELLATION OR VARIATIONS IN THE TERMS OF THE LETTER OF COMFORT

- 9.1. The *beneficiary* of a letter of comfort should notify The Central Bank within 7 working days of (a) the cancellation, or (b) any variations in the terms, of a letter of credit, letter of comfort or parental guarantee issued on its behalf.

The End