

Comments Received on the Basel II and III Consultation Papers

Areas of National Discretion																				
Section of the Consultation Paper	Comment Received	Central Bank's Response																		
<p>Paragraph 54 <i>Lower risk weights (RW) to claims on sovereign (or central bank) in domestic currency if funded in that country (see paragraph 201).</i></p>	<p>The Central Bank adds the wording “<i>Banks with exposures to sovereigns meeting this criteria may also use the preferential risk weight assigned to those sovereigns by their national supervisors</i>”. Elaborating further should bring clarity to the wording in paragraph 201 of the International Convergence of Capital Measurement and Capital Standards as well as how to treat other sovereigns other than The Bahamas and OECD's Zone A countries in light of the Central Bank's position being that the 'risk weight should remain at 0%, as is currently the practice'.</p>	<p>“<i>Banks with exposures to The Bahamas Government</i>” will have a risk weighting of 0%. All other sovereign exposures will follow the treatment set out in paragraph 53.</p> <p>Paragraph 53 of the International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Basel II Framework) indicates that the risk ratings for Claims on Sovereigns are as follows:</p> <table border="1"> <thead> <tr> <th>Credit Assessment</th> <th>AAA to AA-</th> <th>A+ to A-</th> <th>BBB+ to BBB-</th> <th>BB+ to B-</th> <th>Below B-</th> <th>Unrated</th> </tr> </thead> <tbody> <tr> <td>Risk Weight</td> <td>0%</td> <td>20%</td> <td>50%</td> <td>100%</td> <td>150%</td> <td>100%</td> </tr> </tbody> </table> <p>The terms Zone A countries will no longer be used in the capital framework.</p>					Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated	Risk Weight	0%	20%	50%	100%	150%	100%
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<p>Paragraphs 60-63 <i>Claims on banks: Option 1, RW one category less than sovereign; Option 2, RW based on the bank's external credit assessment.</i></p>	<p>We need further clarity for the selection of Option 1: “<i>Claims on banks will be rated one category less favourable than the sovereign. This will allow all banks to be assessed using a level playingfield.</i>”</p>	<p>The Basel II Framework allows two (2) options for Claims on Banks. The Central Bank has opted to use Option 1. Under Option 1, all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of that country, except for countries rated BB+ and below and those which are unrated. Option 1 is illustrated below:</p> <table border="1"> <thead> <tr> <th>Credit Assessment of Sovereign</th> <th>AAA to AA-</th> <th>A+ to A-</th> <th>BBB+ to BBB-</th> <th>BB+ to B-</th> <th>Below B-</th> <th>Unrated</th> </tr> </thead> <tbody> <tr> <td>Risk Weight for Banks Under Option 1</td> <td>20%</td> <td>50%</td> <td>100%</td> <td>100%</td> <td>150%</td> <td>100%</td> </tr> </tbody> </table> <p>Using risk ratings based on the credit rating of a country versus the zone of a country (i.e., Zone A and Zone B), as is currently done, will achieve a level playing field.</p>					Credit Assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated	Risk Weight for Banks Under Option 1	20%	50%	100%	100%	150%	100%
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<p>Paragraphs 69-70 <i>Set a numerical limit for</i></p>	<p>The Central Bank's position to set a limit on the overall retail portfolio to \$100,000 for exposures to single counterparties</p>	<p>The limit on the overall retail portfolio of \$100,000 for exposures to single counterparties</p>																		

<p><i>granularity criterion in the retail portfolio (e.g. limit of 0.2% of the overall retail portfolio).</i></p>	<p>seems low when compared to limits set in similar markets within the region.</p> <p>For “low value of individual exposures”, some supervisory authorities allow that the maximum aggregate retail exposure to one counterparty cannot exceed an absolute threshold. Small business loans extended through or guaranteed by an individual are subject to the same exposure threshold. However, The Bahamas is proposing to set the limit on the overall retail portfolio at \$100,000 for exposures to single counterparties. The Central Bank is materially lower as compared to thresholds established by the Basel Committee. This will result in treating all exposures > \$100,000 as corporate and a 100% risk weight will be applied instead of 75% applicable for retail exposures. In our view, the threshold appears low compared to other jurisdictions and, respectfully, we request that consideration be given to increasing the threshold to ensure a level playing field. Clarification was sought on the statement: “<i>However, the Central Bank will place reliance on the risk management framework of licensees</i>”.</p>	<p>applies to the consumer loan portfolio only (and excludes the residential mortgage portfolio). Also, based on our Basel Readiness survey results, commercial banks indicated that the current limit is \$75,000.</p> <p>The statement “<i>However, the Central Bank will place reliance on the risk management framework of licensees</i>”, implies that licensees should also be guided by their internal policies. ‘Banks with exposures to The Bahamas Government’ will have a risk weighting of 0%. All other sovereign exposures will follow the treatment set out in paragraph 53 of Basel II Framework (see table above).</p>
<p>Paragraph 72 <i>Increase preferential RWs for claims secured by residential properties, based on default experience.</i></p>	<p>Some supervisory authorities allow a risk weight of 35% for mortgages on residential property that is or will be occupied by the borrower, or that is rented. In contrast, the Central Bank proposes to maintain the current practice, that is, 50% risk weight on claims fully secured by mortgages on residential property. In the interests of harmonization, it is suggested that a risk weight more in line with other jurisdictions should be implemented.</p>	<p>The Central Bank accepts the positions stated in the referenced paragraphs and is of the view that the current state of the economy does not warrant a risk weight of 35% even on a restrictive basis. Further, due to the level of the default experience currently in The Bahamas, the risk weight remains at 50% until such time as the Central Bank re-assesses the risk.</p>
<p>Paragraph 75 (& Footnote 30) <i>Reduce RWs to 50% on unsecured portion of past due loans when specific provision is ≥ 50% of the outstanding amount of the</i></p>	<p>It is not clear what the Central Bank is proposing for unsecured portions of past due loan.</p>	<p>The Central Bank will not be adopting these areas of national discretion. Instead, the Central Bank will require that the unsecured portion of past due loans be risk weighted as outlined in paragraph 75 of the Basel II Framework and below:</p> <ul style="list-style-type: none"> • 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan; • 100% risk weight when specific provisions are no less than 20% of the outstanding

loan.		<p>amount of the loan;</p> <ul style="list-style-type: none"> • 100% risk weight when specific provisions are no less than 50% of the outstanding amount of the loan.
<p>Paragraph 108 <i>Allow use of unsolicited ratings in the same way as solicited ratings.</i></p>	<p>Some supervisory authorities allow only for solicited ratings but provide an exception where the asset is a sovereign exposure and solicited ratings are not available. The unsolicited rating must not be inferior to the general quality of solicited ratings. However, The Central Bank only allows solicited ratings. We suggest that the Central Bank consider a more flexible position to allow for unsolicited ratings in specified circumstances.</p>	<p>The Central Bank's position remains unchanged.</p>
<p>Paragraph 154 <i>Licensees to calculate haircuts using their own internal estimates of market price volatility and Forex volatility (paragraph 154).</i></p>	<p>Some supervisory authorities may permit banks to calculate haircuts using their own internal estimates of market price volatility and foreign exchange volatility. Permission to do so will be conditional on the satisfaction of minimum qualitative and quantitative standards. The Central Bank proposes to allow only the use of supervisory standard haircuts. We respectfully request that licensees be allowed to use their own estimates based on meeting minimum standards as per other jurisdictions.</p>	<p>The Central Bank's position remains unchanged.</p>
Operational Risk		
<p>Paragraph 2.5 <i>Gross income is defined as net interest income plus net non-interest income. It is intended that this measure should:</i></p> <ol style="list-style-type: none"> a. <i>be gross of any provisions (e.g. for unpaid interest);</i> b. <i>be gross of operating expenses, including fees paid to outsourcing service providers;</i> 	<p>To avoid inconsistency with interpreting the definition given for "gross income" it would be useful if the Central Bank provides an example in the appendices tabling, the different components of the profit and loss statement that will be acceptable.</p>	<p>The Central Bank will outline the definition of net interest income and net non-interest income, which make up gross income, in the guidance notes for completing the ERS. We believe this will provide greater clarity for licensees in determining the amount of gross income to report.</p>

<p>c. <i>exclude realized profits/losses from the sale of securities in the banking book;</i> and, d. <i>exclude extraordinary or irregular items, as well as income derived from insurance.</i></p>		
<p>Paragraphs 2.15 – 2.20</p>	<p>In addition to the Basic Indicator Approach and the Standardized Approach, some supervisory authorities permit use of AMA contingent on model application and do not permit the use of ASA. However, The Central Bank allows the use of Basic Indicator Approach, the Standardized Approach and ASA. The ASA is a special variation of the Standardized Approach, which aims to provide a more risk sensitive approach to calculating operational risk for the institutions whose main activities are related to retail and commercial banking. We will have to use the Standardized Approach, which may be more punitive. We request that the Central Bank give consideration to the use of AMA as a fourth methodology for the calculation of operational risk capital charges.</p>	<p>Given the evolving nature of licensees’ experiences in establishing and sustaining advanced operational risk management frameworks in The Bahamas and also, the limited compilation of operational risk loss data history (internal or otherwise), the Central Bank has chosen not to consider AMA at this time. Further in this context, while we do have licensees with approved AMA regimes in their home jurisdiction, we have not seen the evidence of mature AMA-compliant risk management practices being implemented in their operations in The Bahamas. However, going forward, we will review the evolution of licensees’ practices underlying the implementation of AMA for operational risk at some point in the future.</p> <p>In the event a bank is actively considering a plan for implementing hybrid AMA to its operational risk management in The Bahamas, we would be glad to have discussions with the licensee on the suitability of its capital allocation mechanisms/outcomes from the proposed hybrid AMA models; the familiarity of the local licensee management to core AMA components; and the appropriateness of the AMA for the licensees’ operational risk characteristics in The Bahamas. In this regard, as expected, we would be guided by BCBS document entitled Principles for home-host supervisory cooperation and allocation mechanisms in the context of Advanced Measurement Approaches (AMA), particularly Section III - Hybrid AMA and allocation mechanisms. (http://www.bis.org/publ/bcbs135.pdf).</p> <p>In the interim, CBOB will allow licensees to implement either of the default BIA or TSA for operational risk management; as well as, assess licensees’ adherence to the principles for the sound management of operational risk as adopted in the Central Bank’s draft guidelines on the Calculation of the Capital Charge for Operational Risk.</p>
<p>Paragraph 2.14 f. <i>The licensee’s</i></p>	<p>External audit reviews of an institution’s operational risk assessment system are not mandated by some supervisory</p>	<p>The Central Bank will accept reviews of the institutions’ operational risk systems by either of the bank’s internal audit function or its external auditors. In any event, as the national</p>

<p><i>operational risk assessment system (including the internal validation processes) must be subject to regular review by internal and external auditors and/or the Central Bank.</i></p>	<p>authorities. However, The Central Bank requires that a licensee’s operational risk assessment system (including internal validation processes) must be subject to regular review by internal and external auditors and/or Central Bank. It is suggested that external audit reviews of an institution’s operational risk assessment system should be a mandatory requirement.</p>	<p>supervisor, the Central Bank may choose to conduct its own periodic assessment of the bank’s operational risk systems.</p>
Definition of Capital		
<p>Paragraph 2.3</p>	<p>Some supervisory authorities allow consideration of valuation allowance in the calculation of Deferred Tax Asset, whereas The Central Bank does not allow the consideration of valuation allowance in the calculation of DTA. We request that the Central Bank allows for the consideration of valuation allowance as per other jurisdictions.</p>	<p>After further review, the Central Bank recognizes the need for the inclusion of a valuation allowance relative to Deferred Tax Assets. We will amend our position to include the recognition of this contra asset account to reduce the deferred tax asset to its expected realizable value.</p>
Minimum Disclosures		
<p>Section 2.1 <i>These Guidelines apply, as appropriate, to all public licensees of the Central Bank subject to Basel II reporting. However, where licensees are part of international financial groups, the disclosure requirements set out in these Guidelines apply at the top consolidated level. Nevertheless, the Central Bank will still have the discretion to require additional disclosures at a sub-consolidated level,</i></p>	<p>The Central Bank should clarify at which consolidated level the requirements be applicable. Section 2.1 states that “<i>Where licensees are part of international financial groups, the disclosure requirements set out in these Guidelines apply at the top consolidated level.</i>” Please clarify whether this will allow the use of enterprise (global) consolidated capital reporting, without calculations having to be done at the local level.</p>	<p>Those licensees that the Central Bank have approved to report at the top consolidated level will not be required to make the calculations at the local level. However, those licensees designated as Commercial Banks will be required to make these calculations at the local level; as well as any other licensee that the Central Bank may request to make Pillar 3 disclosures at the local level.</p>

<p><i>especially in the case of licensees, which are a part of international financial groups that are already subject to similar disclosure requirements at the top consolidated level. The minimum disclosure requirements are set out in Appendix 1.</i></p>		
<p>Appendix 3 – Financial Statement Disclosures</p>	<p>These requirements are in addition to the Basel II/III Pillar 3, IFRS or other accounting standards accepted by the Central Bank. We seek clarification on the applicability of this requirement, i.e. are these also applicable at the top consolidated level and not necessary at the local level?</p>	<p>Appendix 3 is not intended to require additional financial statement disclosures. The Appendix reflects the minimum standards required for financial statements disclosure, and is to be applied in conjunction with the standards accepted by the Central Bank, such as IFRS, and other prescribed accounting standards. These are not additional disclosures that have to be made beyond the disclosures that are currently made in a bank’s Financial Statements.</p> <p>Section 11.1 will be amended and the words “in addition” will be removed.</p>
<p>Paragraph 4.1 <i>Licensees should include a statement by the Board on the extent of compliance with the disclosure requirements set out in these Guidelines and the reason for any noncompliance in their annual Audited financial Statements or as part of the accompanying information to their financial statements (i.e. the Management’s Discussion and Analysis (MD&A)).</i></p>	<p>These requirements are in addition to the Basel II/III Pillar 3. We seek clarification regarding the applicability of this requirement, is this requirement also applicable at the top consolidated level or local level? Also, please clarify whether the Board is required to make the statement or whether officers may make the statement.</p>	<p>There are no additional requirements which are outside of the Basel II/III Pillar 3 disclosures. The Board is required to make the statement when disclosures are made at the top consolidated level or at the local level.</p> <p>Section 4.1 and 4.2 will be deleted from the proposed Guidelines.</p>