THE CENTRAL BANK OF THE BAHAMAS

QUARTERLY LETTER ON REGULATORY AND SUPERVISORY DEVELOPMENTS

BANK SUPERVISION DEPARTMENT
January 25, 2017

QUARTERLY LETTER

At the outset

The year past has marked the Central Bank's interactions with the industry on a frequent and regular basis on matters that are pertinent to the banking and trust industry, the supervisory community and more importantly, to the jurisdiction. We expect and will endeavour to sustain and enhance, as appropriate, our dialogue with licensees through 2017.

Global and Domestic Perspectives

The top priority of global regulatory bodies has been ensuring that international financial institutions can weather financial and economic stresses. The future stability of the global banking sector depends, in part, on international standard setters completing their regulatory reform agenda and ensuring its implementation.

The year 2017 will see a culmination of the progressively phased-in Basel III capital and liquidity standards. It has been a long journey that saw a shift from pre-crisis standard of one regulatory measure of a risk-weighted capital ratio to post-crisis framework with multiple complementary metrics that now include risk-weighted ratio (with more capital of higher quality), capital conservation and countercyclical buffers, leverage ratio, large exposures regime, additional supervisory requirements for systemically important banks, liquidity coverage ratio for mitigating liquidity risk and net stable funding ratio for mitigating maturity transformation.

Against this backdrop of increased funding requirements for new capital and liquidity, the sector has endured a challenging 2016. Over the past few years, many of the structural shifts in the banking environment have continued to impact the traditional business and operating models of our licensees resulting in consolidation of banking entities through mergers and acquisitions or changes in beneficial ownerships, portfolio sales, asset transfers, constraints on access to correspondent banking, outsourcing and restructuring. The various segments of our banking sector in The Bahamas appear to reflect these global markers.

Of the many challenges faced by firms in 2016, the macroeconomic risks on a global scale, continued regulatory pressures and cybersecurity have been some of the more impactful and concerning trends. No doubt, these challenges will continue into 2017. Given the emerging and continuing risks – strategic or tactical – the Bank's supervisory and regulatory work plans for the year are built on the cognizance of these indicators and the industry's measures to manage and mitigate the underlying risks.

Hurricane Matthew – Lessons Learnt

In the last Quarterly Letter, the Bank committed to sharing the summary results of the lessons learnt from Hurricane Matthew's impact on licensee's business continuity plans (BCPs). We would first like to thank all licensees that participated in the BCP survey and provided great feedback on the robustness of their BCPs, the lessons learnt and the enhancements to their disaster recovery efforts.

In general, licensees fared well and 83% have formalized BCPs in place that were tested annually. As a result, the BCP's were enacted in advance of the storm off-island and on-island, staff and data preparations were finalized in a timely manner, and contacts were made with clients and parent companies to ensure that they were able to maintain operations during and after the storm. The loss and the delay in resumption of electricity, even though it was managed through the use of secondary power sources (generator), was a source of concern for most licensees.

Lessons learnt in this regard, include:

- considering in advance the deployment of staff family members;
- proactively managing travel costs;
- maintaining a dedicated off-island site for continued operations and data recovery; and
- keeping critical generator parts on hand and assessing the sourcing of generator fuel.

Given that the ability to effectively continue business in the event of a disaster directly impacts the soundness of our financial system, the Central Bank commends licensees for the efforts made to meet the requirements stipulated in the Business Continuity Guidelines and encourage all to use the lessons learnt to make further enhancements to their BCPs, as required.

Basel II & III: International Regulatory Framework for Banks

With the posting of the Guidelines for the Management of Capital and the Calculation of Capital Adequacy, Guidelines on Minimum Disclosures, and the revised Guidelines for the Management of Interest Rate Risk, the Central bank has effectively implemented Pillar I, Pillar II and Pillar III of the Basel II framework. The Pillar I framework focuses on the capital adequacy ratio requirements, Pillar II focuses on the ICAAP (the guidelines in relation to the ICAAP was released in August, 2016) and Pillar III relates to Minimum Disclosures.

The Central Bank has rolled out the capital component of the Basel III framework and in 2017, will focus on implementing other elements namely, the Capital Buffers, the Leverage Ratio, the Net Stable Funding Ratio and the Liquidity Coverage Ratio. It should be noted that the Basel implementation timeline with respect to these ratios extends to 2018. As has been our practice, we will continue to engage the industry and seek your feedback on any new or revised guidelines stemming from this work stream.

Correspondent Banking Survey

Our monitoring of emerging risk affecting correspondent banking relationships in the jurisdiction continues and since our last quarterly letter, we have been in communication with international and regional bodies including the CARICOM Committee of Central Bank Governors, who together are working towards the development of a Strategy and Action Plan to address the continuing threat of loss of correspondent banking services. On the domestic front, we have also reached out to several licensees with follow-up questions to the second correspondent banking survey. As we continue our outreach, we encourage your full co-operation as we work to counter this growing threat.

On-site Examinations

During 2017, we will continue the integration of the onsite examination process with that of the ongoing risk assessments and mitigation plans communicated to licensees, while also incorporating emerging risk issues from a local and international perspective. In the near to medium term, AML/CFT/KYC issues will continue to play a significant role in our examination process as we continue to review all supervised financial institutions to ensure that our expectations as well as that of the global standards setters, in particular the FATF are maintained and are effective. Further, horizontal reviews will also be conducted across several risk areas within the domestic commercial and international firms, to ensure the frameworks are robust, aligned with best practices and the Central Bank's expectation and can identify any potential systematic issues within the sector.

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