Central Bank of The Bahamas' Responses to the Comments and Questions on the Basel III Discussion Papers on Capital, Minimum Disclosures, and D-SIBs

Institution	Section	Questions/Comments Received	Comment Type	Response
Implementing Basel III: Capital Requirements				
AIBT	7.1. Allowable Credit Risk Mitigation Techniques	*"The following credit risk mitigants will be recognized for regulatory capital purposes: collateral, guarantees and netting"* Netting would need to be further addressed in the proposal	Suggestion	The netting concept remains consistent compared to our current guidance. The Central Bank has outlined the requirements on netting in our draft Capital Regulations.
AIBT	7.2.1. Eligible Collateral and Guarantees	Equities or Mutual funds are not mentioned by the Central Bank as eligible collateral (to be included in this proposal)	Suggestion	The Central Bank notes your feedback and advises that Equity investments in Funds will be subject to the Look-Thru Approach (LTA).
AIBT	7.2.1. Eligible Collateral and Guarantees	The following section should be formatted to include the title 'Excluded Collateral' (e.g. Excluded Collateral: Claims secured or collateralized in other ways (e.g. by put options, forward obligations or other derivative contracts or agreements) will not be considered as eligible collateral).	Suggestion	Your comments are duly noted, however, the Central Bank's preference is to identify eligible collateral. All others will be considered ineligible.
AIBT	7.2.2. Treatment of Collateral	The following should be included: **Characteristics of Lombard Lending** • The Credit Commitments must be secured by a pledge agreement over the assets used as collateral.	Proposal	We have given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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		• The pledge agreement gives the lender the right to « liquidate » the collateral in a timely manner in the event of unacceptable collateral ratios or an anticipated default situation. • Qualifying collateral must comprise of investment securities which are regularly revalued. • Marketable investments must be priced at least daily enabling the lender to calculate the aggregate market value of the collateral. • The Bank must have a formal approval process at the initiation of the credit commitments to ensure that the underlying collateral is appropriately evaluated and relevant documentation signed by the borrower before any credit commitment is extended. • The Bank must also have a formal structure (Credit Risk Control Unit) to monitor lending to collateral ratios and credit limit violations on a daily basis. It must be able to identify deficiencies in the collateral position and take remedial actions as necessary (including liquidation of the collateral).		
AIBT	6.1. External Credit Assessment Institutions (ECAIs)	The following should be added to this section: **Lending Value** • In accordance with the Basel Standard Supervisory principles, a « haircut » is applied to the market value of the collateral to	Proposal	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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		determine the appropriate risk-based Lending Value. • A « haircut » will be applied to the market value of the security and the size of the « haircut » will depend on the type of investment, the type of transaction, the frequency of marking to market and re-margining. • A predetermined « haircut » framework will address the rating quality of the underlying securities which is often determined by an External Credit Assessment Institution **Types of Credit Commitment** • Current account overdrafts and advances • Fixed-term loans • Guarantees and sureties • Payment commitments • Security Collateral for third parties • Uncovered options and financial futures • Uncovered forward or spot foreign exchange transactions (including uncovered OTC transactions) • Commitments to subscribe to private equity investments		
AIBT	7.2. Treatment of Collateral and Guarantees	Suggested Criteria applicable to Licensees (for Central Bank's consideration) • Has the Bank been managing a collateralised loan business for several years with a proven	Suggestion	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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		track record and without incurring loan losses? • Does the Banking Group manage its credit exposure using a « standardized credit process and directives »? • Does the Bank use a refined risk management system that has proven to be reliable? • Has the Bank incurred loan losses in the past 5 years? (If so, the Bank should provide details of the loss history to the Central Bank).		
AIBT	6.3. Home-Host arrangements for assigning risk weights	In accordance with Basel proportionality principles, the Central Bank should allow licensees to adopt Parent Company Rules to calculate capital requirements. The Parent must reside in a Basel III compliant jurisdiction. • The secured portion of claims collateralized by the market value of qualifying collateral receive the risk weight applicable to the collateral instrument. • In cases where the credit commitment risk is adequately covered by eligible collateral after deducting the appropriate "haircuts" within a pre-defined framework, the ratio applied to the asset risk weighting can be reduced to the minimum 20%.	Feedback	The Central Bank is evaluating the feasibility of an arrangement where Parent company rules are used. Your comments are duly noted.
AIBT	7.2.1. Eligible Collateral and Guarantees	Additionally, we ask The Central Bank to kindly note the following:	Suggestion	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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		• Basel III provides for banks to use “internal” models as long as they are independently approved by the Regulator. • Basel III provides criteria to achieve 100% mitigation of the capital requirement for Credit Risk: (i) where the collateral is marked to market daily; (ii) is subject to daily re-margining and (iii) a 10-day holding period exists. • Banks applying the Regulatory Standard Supervisory Haircuts (KPMG s.209) to qualifying collateral where the resultant collateral covers the credit exposure are exempt from a capital requirement for such credit risk (0% factor applied when calculating the RWA on such credit exposures). • Any portion of Credit Risk which is not supported by qualifying collateral (after application of the agreed Supervisory Haircuts) is treated as “blank” and 100% Risk Weighting Factor applied. • FINMA does allow banks to submit their own credit risk frameworks supported by a proper study and comparison to past default risk per investment rating. This is similar to that used in IFRS 9 - Expected Credit Loss assessment.		

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AIBT	7.2.2. Treatment of Collateral	The Central Bank takes a considerably more cautious stance by proposing to implement a Risk Weighting Factor "floor" of 20%, irrespective of the risk-adjusted collateral cover. With the implementation of this conservative Risk Weighting Factor "floor", the Regulator should be in position to exercise some latitude by allowing licensees to formulate and validate an internal "lending value framework". Such frameworks are often developed at a Banking Group level and applied consistently within the subsidiary banks of the Group across various jurisdictions.	Suggestion	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.
AIBT	7.2.2. Treatment of Collateral	In view of (i) the prudent approach taken by the Central Bank by introducing a floor (RWA ratio floor at 20%) and (ii) the implementation of IFRS 9 in 2018, the Central Bank should give consideration to allowing bank licensees to adopt an internal lending framework. If deemed acceptable by the Central Bank, the internal lending framework would provide flexibility whilst adhering to the Basel III Standard Supervisory Guidelines. • Perhaps the Central Bank can gain comfort by reviewing a licensee's lending framework and past lending practices. • Finally, a review of a licensee's track record of loan losses would be an important measurement yardstick in light of the introduction of IFRS 9.	Suggestion	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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AIBT	Treatment of Collateral	Simulated Investment Portfolio Lending Value after applying Supervisory Haircuts - Appendix 2 (compared to FINMA approved Basel III framework for collateral Haircuts)	Proposal	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.
AIBT	Treatment of Collateral	**Lombard Lending - High Concentration Collateral** In applying a risk-based approach, banks engaged in Lombard Lending will have to implement specific rules to deal with cases where available collateral is concentrated and limited to a specific investment holding rather than the collateral provided by a diverse investment portfolio. This is particularly important in cases where the collateral is in the form of a "single-stock" portfolio. **Rules applicable to collateral in the form of a "single-stock" portfolio** Due to the volatility of equities when compared to high quality bonds, a different approach needs to be adopted in treating this type of situation – collateral concentrated in a single-stock position. Additional measures need to be implemented in each bank's framework which considers a "single-stock" collateral situation. A "single-stock" situation arises if more than 50% of the loan-to-value of assets pledged as collateral comes from a single position. Under such circumstances, an adjustment can be made and the lending value of this single-stock position is reduced by a further 50%, so that it never	Proposal	The Central Bank has given consideration to your proposals and have outlined our requirements for Lombard Lending in the draft Capital Regulations.

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		represents more than 50% of the loan-to-value of assets pledged. Other criteria required to qualify a "single-stock" as acceptable collateral: • Only shares of companies whose market capitalisation is more than USD 1 billion are eligible; • The historic volatility and liquidity levels of the stock are considered when applying a lending value ratio. Similarly, where a portfolio lacks diversification and is intended to provide collateral for credit commitments, the bank's framework should apply additional haircuts to ensure mitigation of the additional risk posed by this type of scenario.		
Bank A	3.5. Common Equity Tier 1 (CET1)	Existing Capital Guideline Section 35 (d) states: *"one of the components for CET1 was 'Accumulated other comprehensive income and other disclosed reserves'"* Per Discussion Paper Section 3.5 (d) States: *"General or Statutory Reserves as disclosed on the balance sheet; and (e) Accumulated other comprehensive income"* Is there any change in the classification/criteria from 'other disclosed reserves' to 'general or statutory reserves' that may affect what is currently included as other disclosed reserves be excluded as general or statutory reserves?	Clarification	There was no material change in the criteria for CET1 Capital. An adjustment was made to clearly distinguish the component 'Accumulated other comprehensive income' from 'other disclosed reserves'. The term 'other disclosed reserves' refers to published reserves that have passed through the profit and loss account, and have been accepted by the Central Bank, to have the same intrinsic value as published retained earnings. For example, General or Statutory Reserves.

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Bank A	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures)	Is there a definition or criteria for what is 'not materially dependent'?	Clarification	The Basel Committee has not defined, or provide a threshold/criteria for what is “materially dependent” or "not materially dependent". Under the Standardised Approach risk weights are differentiated based on whether the loan is materially dependent on cash flows generated from the property. While the risk weights would still vary based on the exposure’s LTV ratio, an SFI would assign a higher risk weight to the exposure if repayment of the loan was significantly dependent on the cash flow generated by the real estate property.
Bank B	3.6. Regulatory Adjustments	With the removal of goodwill and other intangibles from the calculation of CET1, does this also mean that the risk weighting of this asset will change as it pertains to the credit on-balance sheet risk?	Clarification	This treatment of deducting Goodwill from CET1 is consistent with our current capital guidelines. See section 37 of the Guidelines for the Management of Capital and the calculation of Capital Adequacy. In the cases where assets are deducted from capital in the capital adequacy calculation, there is no risk weighting of that item since it is deducted directly from capital.
Bank B	4.2. Basel III – Limits and Minima	Is there an estimated timeline for when the new total capital ratio increases (between 10.5%-16%) will be implemented; i.e. is this intended to be a partial percentage increase per quarter until target ratio achieved in 2020?	Clarification	The Central Bank does not plan to adopt phase-in requirements for banks who are currently above the minimum capital ratio. If a bank anticipates having trouble meeting the new requirements, they are encouraged to contact the Central Bank.

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Bank B	7. Credit Risk Mitigation	As it relates to Lombard lending, we suggest allowing Banks to develop internal models for credit risk mitigation. The Banks should present to the Central Bank their internal credit risk mitigation models before implementing.	Suggestion	Your suggestion is noted. We are evaluating options that would allow for some level of standardization with regards to controls over the Lombard lending process.
Bank B	7.2.1. Eligible Collateral and Guarantees	Where life insurance contracts are stated, is the Central Bank considering cash surrender values, face values, etc.? We suggest further clarification being given on this terminology.	Clarification	The Central Bank has reviewed this issue and has concluded that consideration to the use of Life Insurance contracts as collateral would not be prudent at this time, given the myriad of issues to be considered surrounding ongoing validation of insurance contracts. Our proposed Capital Regulations reflect this position.
Bank B	7.2.1. Eligible Collateral and Guarantees	The section mentions gold only as an eligible collateral. Are other precious metals also considered eligible? Further clarification needed.	Clarification	Under the Basel standards, gold would be the only precious metal allowed.
Bank C	8.2. The Central Bank's proposed approach to operational risk capital	Does 'Total Gross Income' reflect prior year income or does this remain the three Year Average of Total Gross Income used in the existing Basic Indicator Approach?	Clarification	The Central Bank has decided to implement The (new) Standardized Approach for calculating operational risk. The proposed capital charge calculation is the SFI's Total Gross Income multiplied by a 12% Business Indictor (BI), the new proxy for operational risk. The BI is based on variables such as interest income and expenses, fees and profits (i.e. gross income) drawn from a SFI's financial accounts or financial statements. The SFI's gross income is calculated averaged over a three-year period.

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Bank C	10. Leverage Ratio Requirement	The Discussion Paper states that, '*The Central Bank proposes to include a Leverage Ratio to supplement SFI's risk-based capital adequacy requirements*' Would the introduction of the Leverage Ratio replace the current Deposits-to-Capital requirements?	Clarification	No. The Central Bank does not intend for the Leverage Ratio to replace the current Deposits-to-Capital requirements/reserve requirements. The leverage ratio is intended to be a non-risk based measure of SFI's on and off-balance sheet leverage.
Bank D	5.1.3. Proposal for Reporting of ICAAP	"…*Central Bank may require an ICAAP update from any SFI at any time*". We suggest that details should be added on the timeline for submission of any ICAAP update requests.	Suggestion	The Central Bank recognizes that annual submissions of ICAAPs are unnecessary for SFIs who consistently update their risk profiles. In the proposals, there are set intervals or cycles for domestic banks and all other SFIs to submit their ICAAPs. The timeline or intervals for submissions will be directly communicated to each SFI. However, there may be times where the Central Bank, in its discretion, requires an ICAAP at any time. The proposed requirements for ICAAPs have been set out in the draft Capital Regulations.
Bank D	6.7. Exposures to banks	Tables 8 and 9, 'short term' should be defined.	Suggestion	Your suggestion is noted and the Central Bank will make the appropriate updates. In the interim, we advise that short-term exposures will be defined as having an original maturity of 3 months or less.

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Bank D	6.20. Pillar 1 Adjustments	For transparency, we suggest that the Central Bank provides details on the conditions under which Pillar 1 adjustments will be required.	Suggestion	Pillar 1 provides details of how banks must calculate their minimum capital requirements. In light of the wide range of risks arising from industry innovations and market related activities (e.g. crypto-asset trading, securitization etc.), there may be times when the minimum capital requirements under Pillar 1 are not sufficient, and the Central Bank must exercise supervisory discretion to adjust the calculation in the interest of the SFI and the banking system. Such conditions have been broadly outlined in Part 4 of our draft Capital Regulations.
Bank D	7.2.2. Treatment of Collateral	The document states that the risk weight on the collateralized portion will be subject to a floor of 20%. Has the Central Bank removed the exceptions to the risk weight floor for loans secured by cash or sovereign/PSE securities?	Clarification	The Central Bank has reviewed this issue and has reconsidered its position on exceptions to the risk weight floor. Of note, a 0% risk weight may be applied where the exposure and the collateral are denominated in the same currency and the collateral is cash on deposit.

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Bank D	7.2.2. Treatment of Collateral – Proposal for Consideration: Lombard Lending	We do not believe that large exposure waivers for Lombard lending would be appropriate unless the following pertains: • Collateral for exposure is cash or the counterparty is rated A or better rated by reputable external rating agency and collateral is very liquid. • Collateral is legally perfected (not just right of set-off). • Collateral is controlled / segregated placed in custody (separate bank / FI account or reputable repository) and accessible to the FI. • For any non-cash collateral LTV allows for sound haircut both with respect to time for margin call / liquidation time & costs. (Cash LTV of 100% acceptable once collateral and credit exposure are in the same currency). • Guidance on the Maximum Lombard Lending for any one FI that the Central Bank will normally allow; periodic publication by Central Bank of the outstanding quantum of Lombard Lending per FI (without naming the borrowers).	Suggestion	The Central Bank has given consideration to your proposal regarding Lombard Lending as the detailed in our draft Capital Regulations.

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Bank D	8.1. Proposed Approach to Operational Risk Capital	It is not clear how the operational risk capital will be calculated. Will the calculation involve gross income for one year or the average over a specified number of years? Is gross income on a fiscal year basis? Clarity should be provided on the level of details to be provided in reporting on operational risk loss events.	Clarification	See Central Bank's response provided above on the operational risk capital calculation. On the issue of reporting on operational risk loss event, while a SFI's loss data will not feature prominently in the operational risk calculation, SFIs will be expected to collect and report on operational losses above a specified threshold to the Central Bank. The level of details to be provided will vary on a case by case basis, owing to the nature and materiality of the event.
Bank E	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures)	We note that the bank generally supports the implementation, however, there are areas we will not be able to comply with immediately as it will represent a new build for the Bank. In the interim we would have to continue to represent our reporting using the more conservation risk weights, noted below, which are currently applied: • LTV separation • Reporting of secured (excluding residential mortgages)	Feedback	The Central Bank acknowledges that the new proposals may require some operational and (IT) system enhancements for some SFIs. Our current expectation is that these modifications, while necessary, should not require the development of new costly information systems. The Central Bank is of the view that there will be sufficient lead time for SFIs to implement these proposals.
Bank E	6.10. Retail Exposures	In assessing the lending book, the following new areas are now available for banks to report on: • Regulatory Retail SME: RBC does not currently capture this information on its banking platform in order to enable identification; and	Feedback	See Central Bank's response provided above.

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		• Land loans (residential) - These are currently treated as mortgages		
Bank E	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures)	Loan to Value: The LTV ratio is critical to determining the appropriate risk weight for Residential and Commercial Mortgages • LTV currently is not a data capture for the bank • To calculate the LTV at origination is a solution that will have to be built by the bank. Timelines to deliver this metric would have to be determined and approved by executives • In the interim, the bank will have to apply the most conservative risk weight- - 100%	Feedback	While the Central Bank acknowledges certain system enhancement may be required, we believe that LTV information would be a useful data metric for SFIs to implement for assessing loan loss in the current domestic environment.
Bank E	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures)	An ongoing assessment of LTV and the dependency of rental income to meet loan payments (6.10 - 6.12) is not something that we have available. The bank is of the view that it may be less costly if this assessment can perhaps be done at origination and remain as designated for the remainder of the loan.	Feedback	As noted in the Discussion Paper (at page 25), the LTV used will be at loan origination, only in cases where the loan has been materially amended. There is no requirement to refresh valuations for performing loans in the absence of any reason to believe the property's value has been materially reduced.
Bank E	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures) 6.12. Exposures secured by	Collateral values are not currently within the Bank's core banking system (RIBS) and may be a challenge to be revaluated independently.	Feedback	The Central Bank has reviewed this issue and is of the view that it is both prudent and advisable for SFIs to have in place appropriate risk management systems and controls for managing its collateralised loan book. As such, the Central Bank will need more discussion to obtain additional clarity on the challenges noted,

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	Commercial Real Estate			and is willing to work with SFIs to move in this direction, particularly given our collective effort to reduce NPL exposures.
Bank E	6.11. Exposures secured by Residential Real Estate (Mortgage Exposures) 6.12. Exposures secured by Commercial Real Estate	New loan type fields (system enhancements) would be required to capture data in the prescribed format (6.10 - 6.12).	Feedback	The Central Bank acknowledges that the new proposals may require some operational and (IT) system enhancements for some SFIs. Our current expectation is that these modifications, while necessary, are not unduly cost prohibitive. The Central Bank is of the view that there will be sufficient lead time for SFIs to implement these proposals.
Bank E	6.15. Defaulted and Past Due Exposures	Time Based Provisioning: The Bank supports this, however we note that it represents a new build for the Bank and timelines and funding to automate this process would have to be assessed internally. In the interim, however, RBC is compliant with 100% coverage for our collective book which is secured by real estate aged 5 years and more as we enforce a write off threshold of 2,000 days. CRM: The use of recognized collateral in assessing past due loans: • The reliance on collateral information captured in our systems is minimal	Feedback	The Central Bank acknowledges that the new proposals may require some operational and (IT) system enhancements for some SFIs. However, on this point, we note that your current methodology for assessing past due loans appears largely consistent with our proposals. As previously advised, our current expectation is that these modifications, while necessary, should not be overly burdensome on SFIs from a cost perspective, as there will be sufficient lead time for SFIs to implement these proposals. Once implemented, should create appreciable balancing benefits to the institution, customers and other stakeholders.

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		• The Bank would have to adopt the more conservative approach for assessing past due retail and wholesale loans by treating as 'unsecured' and assessing based on stage 3 provision coverage. • Secured residential mortgages would be risk weighted at 100% New Proposal for treatment of secured portions of non-performing loans for 'timed based provisioning': This approach looks to ensure at year 5 and up a non performing real estate secured loan is fully provisioned. • Current methodology supports 100% stage 3 provision at day 2,000 (i.e. 5 years) if the loan is reported as an asset. Write-off threshold for real estate secured loans is day 2,000. • To enable a further breakout of duration of default would require a new build for the Bank. Timelines to deliver would have to be determined and agreed upon. • In the interim the current methodology will support: (a) 35% + TVM cover for real estate secured loans which are 90-1,999 days past due; (b) 100% cover for real estate loans which are 2,000 days past due.		
Bank E	8.1 Basel's (New) Standardized Approach for Operational Risk	Operational Risk Change: Calculation based on gross reporting income (appears to be a simple calculation).	Feedback	Comments are duly noted.

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Minimum Disclosure Requirements Under Basel II and III				
Bank C	3.3 Quantitative data disclosures	The Discussion Paper states that, '*The Central Bank proposes to disclose all data reported by each bank (host and home supervised) and credit unions on their capital and liquidity positions:* • *Risk-based capital* • *The leverage ratio* • *The liquidity coverage ratio (LCR): and* • *The net stable funding ratio (NSFR).*' Any questions we may have relating to LCR and NSFR portions of the Minimum Disclosure are dependent on the framework that the CBOB sets for LCR and NSFR. The definition of HQLA will be important as it highlights a potential risk of LCR disclosures for small banks in the Bahamas.	Feedback	Your comments are duly noted. We welcome any additional comments or questions you may have on the proposed LCR and NSFR framework.
Bank D	10.5 – Disclosure and Reporting	We have reviewed the requirements and see no issues. However, we would like some feedback on the timeline for submission of quarterly reports.	Clarification	Your comments are duly noted. The timeline for submission of quarterly reports under the minimum disclosure framework will not change, and would align with the current prudential reporting requirements.
Bank E		The Bank is generally supportive of the disclosing [of] financial information and capital information on our website.	Feedback	Comments are duly noted. However, as noted in our Discussion Paper, the expectation is that the Central Bank will also disclose necessary financial data on a dedicated and publicly accessible location (on its website) for all reporting SFIs.

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Framework for dealing with Domestic Systemically Important Banks (D-SIBS)				
Bank C		The Discussion Paper for the Framework for dealing with D-SIBs is not applicable for the bank, as it is an International Bank and is not tied to the domestic economy. The bank has no loans and takes no deposits within the Bahamian economy.	Feedback	The Central Bank considers only all domestic retail banks as D-SIBs and others as non-D-SIBs (your institution would fall under the latter). Therefore, this framework would be non-applicable to your institution.
AIBT	3. Proposed D-SIB Approach in The Bahamas	It is proposed that the international licensees under The Central Bank's supervision are generally subsidiaries of international banking groups and are therefore consolidated in the ultimate parent bank's group financial statements – all intergroup bank balances (no matter how large) are eliminated upon Group consolidation. International bank licensees posing a "systemic risk / threat" should be treated differently from the majority of subsidiaries which are unlikely to fall under this classification. For banks considered to pose a "systemic risk", additional capital buffers should be implemented on a case-by-case basis. For the majority of banking subsidiaries not posing a systemic threat, a "Look-Through Approach (LTA)" could be adopted to better understand the Treasury Policies of the Banking Group. Alternatively, a "Comfort Letter" could be obtained from the ultimate Parent Banking Group and validated by the home country	Suggestion	The Central Bank notes your suggestion and advises that the Domestic Systemically Important Banks discussion paper outlines the methodology used for determining systemic importance. These identified institutions would be subject to materially higher capital buffers as determined from time to time in our Capital Regulations. International SFIs (or non-D-SIBs) posing a systemic risk to the financial system, will be subject to additional (i.e. Pillar 2) capital charges above the required minimum (i.e. Pillar 1).

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		Regulator having regulatory oversight of the Consolidated Banking Group.		