



**THE CENTRAL BANK OF THE BAHAMAS**  
**IMPLEMENTING BASEL III:**  
**CAPITAL REQUIREMENTS**

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DISCUSSION PAPER

29<sup>th</sup> August, 2018

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## 1. INTRODUCTION

### 1.1 Overview

The Central Bank of The Bahamas (“the Central Bank; the Bank”) is responsible for the licensing, registration, regulation and supervision of credit unions, banks, and trust companies operating in and from within The Bahamas. Additionally, the Central Bank has the duty, in collaboration with supervised financial institutions (SFIs), to set prudent and appropriate capital adequacy requirements that reflect the risks SFIs undertake and the markets in which they operate. In 2016, the Central Bank finalized and released its Basel II reforms<sup>1</sup>. These reforms introduced the ‘*three pillars*’ approach – minimum capital requirements, supervisory review and market discipline – for determining the capital requirements for credit risk, market risk and operational risk.

In December 2010, the Basel Committee on Banking Supervision (“the Basel Committee”) issued its initial Basel III reform package in response to the 2007 – 2009 financial crisis entitled “*Basel III: A global regulatory framework for more resilient banks and banking systems*” (“BCBS June 2011”<sup>2</sup>). These reforms:

- improved bank capital quality by placing a greater focus on loss-absorbing capital in the form of Common Equity Tier 1 (CET1) Capital;
- increased capital requirements to improve the banking sector’s ability to absorb shocks arising from financial and economic stress;
- introduced an international liquidity risk framework through the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR);
- Introduced a leverage ratio requirement as a complement to the risk-weighted capital requirements; and
- added macro-prudential elements to the regulatory framework by (i) introducing capital buffers, (ii) establishing a large exposure regime and (iii) putting in place capital to address externalities created by systemically important banks.

Although the 2011 Basel III reforms largely focused on the capital side of the capital ratio calculation (i.e. the numerator), the recently issued December 2017 reforms<sup>3</sup> concentrate on revisions to the risk weighted capital framework (i.e. the denominator).

### 1.2 Central Bank Policy Objectives

The Central Bank intends to complete, but more importantly to simplify the Bahamian Basel II and III frameworks, consistent with the proportionality principles set out by the Basel Committee<sup>4</sup>. This completion and simplification will be achieved by a new regulation: *Bank and Credit Union Capital Requirements*. The requirements in this regulation are statutorily enforceable under section 17 of

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<sup>1</sup> [Guidelines for the Management of Capital and the Calculation of Capital Adequacy \(Revised: December 2016\)](#)

<sup>2</sup> [Basel III: A global regulatory framework for more resilient banks and banking systems \(Revised June 2011\)](#)

<sup>3</sup> [Basel III: Finalising post-crisis Reforms \(December 2017\)](#)

<sup>4</sup> [FSI Insights: Proportionality in banking regulation: a cross-country comparison \(August 2017\)](#)

the *Banks and Trust Companies Regulation Act, 2000* and section 5(2) of the *Bahamas Co-operative Credit Unions Act, 2015*.

Somewhat contrary to local and international experience, the Central Bank intends that its Basel III regime will reduce regulatory compliance costs, relative to the current capital regime, and greatly reduce costs relative to the typical international implementation of Basel III. This is in keeping with the Central Bank's intent to develop prudential policies and regulations that balance safety, efficiency and competitiveness in the Bahamian banking system, while promoting financial system stability.

The Central Bank's approach to the Basel framework is premised on the following Bahamian conditions:

- banks operating in the domestic and international sector pursue relatively simple business models;
- banks maintain high capital levels (usually comprised entirely of common equity); and
- existing regulatory policies and standards are generally more conservative than those of the international community.

### **1.3 What reforms must be deployed to become Basel III compliant?**

After this round of reforms, Bahamian bank regulations will be fully compliant with the current Basel Committee rules texts. The Bahamas will become one of the first non-Basel Committee member jurisdictions in the western hemisphere to achieve full Basel III compliance. To achieve this result, the Central Bank proposes to:

- Simplify capital definitions;
- Implement a capital buffer regime;
- Implement a leverage requirement;
- Revise our approach to recovery planning and ICAAPs; and
- Implement new calculations for converting a bank's risks to risk-weighted assets.

Once the capital regulations are in place, the Central Bank's "[Guidelines for the Management of Capital and the Calculation of Capital Adequacy](#)" ("[Capital Guidelines](#)") and the "[Guidelines for the Internal Capital Adequacy Assessment Process for Licensees](#)" ("[ICAAP Guidelines](#)") will be withdrawn.

The Central Bank also proposes to implement fully Basel-compliant liquidity and disclosure regimes, which are the subject of separate discussion papers.

## 2. PURPOSE AND APPLICABILITY

Good regulatory practice requires each national authority to carefully consider the costs and benefits of the revised framework, in the context of national priorities and their domestic banking systems. This paper describes the Central Bank's proposed regulation for capital adequacy. This proposal, and subsequent refinements arising from stakeholder consultation, are intended to create the optimal capital regime for the Bahamian banking system.

The Central Bank invites comments and/or questions from industry stakeholders and the general public on these proposals. Feedback on this Discussion paper is requested by **31<sup>st</sup> October, 2018** and should be submitted to the following address:

**Policy Unit**  
**Bank Supervision Department**  
[policy@centralbankbahamas.com](mailto:policy@centralbankbahamas.com)

### 2.1. Who will be affected?

These requirements will apply to credit unions, banks, and bank and trust companies incorporated in The Bahamas. These proposals do not include pure trust companies and foreign branches of banks and/or trust companies, nominee trusts, non-bank money transmission businesses, or payment service providers.

#### **Basel III: Credit Union Supervision**

The Central Bank assumed responsibility for supervising and regulating credit unions with the enactment of *The Bahamas Co-Operative Credit Unions Act, 2015* and *the Central Bank of The Bahamas (Amendment) Act, 2015*. This legislative framework empowers the Central Bank to impose such terms and conditions as it considers necessary to ensure the stability of the Bahamian financial system.

Credit unions until now have been regulated under a capital regime that differs from the Basel framework. The Central Bank is taking this opportunity to consolidate its supervisory arrangements, such that credit unions and banks will be subject to the same capital regulation. When the proposed new capital regulation is in place, Section 65(2)(b) of the *The Bahamas Co-Operative Credit Unions Act, 2015* will be repealed and replaced.

## **2.2 Intended and likely capital impact**

The Central Bank does not intend that Basel III adoption will lead to banks holding materially more or less bank capital than is the case under the current capital requirements. Banks currently hold small amounts of capital that are not common equity. It is likely that all or nearly all this capital will be repaid or converted to common equity over time.

The Central Bank has conducted a preliminary assessment of the likely capital impacts of the proposed Basel III regime, using information already to hand from SFI filings. Preliminary results suggest that all or nearly all Bahamian banks will be able to adopt the new Basel III rules with very little (if any) change to their balance sheets. Where an SFI expects that its capital ratios will materially decrease, we invite the SFI to submit its capital results (or quantitative impact analysis) for further discussion with the Central Bank.

The impact of this regulatory reform may be larger for credit unions than for banks. The Central Bank is particularly interested in consulting with any credit union that forecasts a material increase in capital requirements or decrease in capital ratios as a result of this reform.

### **3. CAPITAL DEFINITIONS**

#### **3.1. Overview**

The current prudential capital definition has been in effect for all banks from 2016. The Central Bank now proposes to substantially simplify and strengthen the prudential capital regime. These simplified definitions should have little impact upon the Bahamian banking industry. 98% of prudential capital is already Common Equity Tier 1 (CET1), the highest quality capital.

Bahamian banks have traditionally been well capitalized, amidst increasingly stringent global capital requirements. The ratio of total capital to risk weighted assets for all public reporting banks stood at 47% (as at March 2018), and the average CET1 capital ratio stood at 46% for the same period. These capital ratios are much higher than is the case for the great majority of banks headquartered in the Basel Committee member countries.

Global experience demonstrates that CET 1 Capital, which broadly speaking is common equity, is the best form of capital. The current Bahamian capital framework, however, only requires banks to maintain at least 75% of their capital in the form of Tier 1 Capital (i.e. CET1 Capital + Additional Tier 1 Capital).

The Central Bank proposes to require CET1 as the **only** capital component for determining Total Regulatory Capital. There will be no recognition of Additional Tier 1 (AT1) Capital or Tier 2 Capital for the purposes of calculating total regulatory capital. As previously announced, the Central Bank also proposes to remove loan loss general provisions from prudential capital calculations, and also to remove any minimum requirement for loan loss general provisions.

The Basel III capital framework requires approximately 28 pages to describe the global capital definition framework. The Central Bank expects that the new Bahamian capital regulation will require approximately two pages to achieve the same result.

#### **3.2. Characteristics of Capital**

To be eligible for inclusion in Bahamian regulatory capital, the SFI's capital must display the following characteristics:

- (a) Provide a permanent and unrestricted commitment of funds;
- (b) Be freely available to absorb losses;
- (c) Not impose any unavoidable servicing charges against earnings; and
- (d) Rank behind all claims of depositors and other creditors in the event the bank is wound up.

#### **3.3. Definition of Common Equity**

There is a widely accepted definition of common equity on which accounting standards are based. For the purposes of this section, the terms "common equity" or "ordinary shares" are defined as (a)

equity instruments that are subordinated to all other classes of equity instruments<sup>5</sup>, or (b) such other definition consistent with international accounting standards.

As a general observation, it will be obvious to both the Central Bank and to SFIs which instruments qualify as CET1 capital.

### **3.4. Treatment of Credit Union Shares under Basel III**

Credit unions will be required to apply the Basel III capital definitions.

Credit unions typically maintain two types of equity: (i) Qualifying shares, which are the paid-in amounts or more permanent form of capital, and (ii) Equity Shares, which can be cashed in or withdrawn by members of the credit union. Under the Basel III framework, only credit union shares which have a high degree of permanence (i.e. Qualifying shares) and the ability to absorb losses on a going concern basis will qualify as CET1 Capital.

### **3.5. Common Equity Tier 1 (CET1)**

**Common Equity Tier 1** will consist of the following elements:

- (a) Common shares issued by the SFI
- (b) Stock surplus (share premium) resulting from the issue of instruments included in Common Equity Tier 1 Capital;
- (c) Retained earnings;
- (d) General or Statutory Reserves as disclosed on the balance sheet;
- (e) Accumulated other comprehensive income;
- (f) *Less* Regulatory adjustments applicable in the calculation of Common Equity Tier 1 Capital

In order to be classified as CET1 Capital, common equity must:

- Be perpetual;
- Be the most subordinated claim in liquidation;
- Be irredeemable without the Central Bank's prior approval;
- Be fully paid-in;
- Give shareholders a claim on residual assets that is proportional to their share of issued capital;
- Have distributions that are not mandatory, cumulative or subject to a contractual cap; and
- Be classified as equity under relevant accounting standards.

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<sup>5</sup> World Bank – International Financial Reporting Standards, A Practical Guide, Sixth Edition (2016).

### 3.6. Regulatory Adjustments

The Central Bank is proposing to remove the following accounting items from common equity for the purpose of calculating CET1:

- (a) Goodwill and other intangibles;
- (b) Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities;
- (c) Any surplus or deficit in a defined benefit pension fund, where the SFI is the employer-sponsor (if the surplus is an asset on the balance sheet, the asset should be deducted net of any associated deferred tax liability);
- (d) Investment in own shares (treasury stock);
- (e) Non-consolidated equity; and
- (f) Reciprocal cross holdings in the capital of banking, financial and insurance entities.

International regulatory experience has demonstrated that banks make difference regulatory adjustments depending on the country in which they operate. The proposed regulatory deductions have been streamlined to reflect the Bahamian context.

### 3.7. Capital Consolidation

The Central Bank will continue to supervise the capital adequacy of locally incorporated banks (i.e. subsidiaries and stand-alone entities) on both a stand-alone (“solo”) and consolidated (“group”) basis, covering all banking, securities and other financial subsidiaries within the group (except the subsidiaries engaged in insurance and commercial businesses). Thus, majority-owned or controlled financial entities will be fully consolidated and banks must consolidate the financial statements of all of their subsidiaries in accordance with International Financial Reporting Standards for capital adequacy purposes. Exceptions must be approved by the Central Bank.

The Central Bank will no longer adopt the Basel II treatment of minority interest and other capital issued out of subsidiaries to third parties.<sup>6</sup>

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<sup>6</sup> Information to hand suggests that no Bahamian bank reports any minority interests.

### 3.8. Total Loss-Absorbing Capacity (TLAC) Requirement

On 9<sup>th</sup> November, 2015, the Financial Stability Board issued “Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution<sup>7</sup>,” which also included the “Total Loss-absorbing Capacity (TLAC) Term Sheet” that sets out the TLAC standard. The objective of the TLAC standard is to facilitate an orderly resolution of a failed bank, by making debt/equity holders absorb losses, enabling a “bail-in”, instead of using public funds.

Bahamian domestic and international banks do not issue a great deal of unsecured wholesale debt, and have near zero ability to issue bonds with bail-in features. Given our focus on common equity, the Central Bank does not propose to deploy a TLAC regime in The Bahamas.

### 3.9. IFRS 9 and impact on regulatory capital

IFRS 9 is expected to change the recognition of impairment on loans and some debt instruments. It is widely accepted that IFRS 9 will increase the current levels of credit impairment provisions among SFIs. The Central Bank is of the view that given robust Bahamian capital levels, most SFIs should not be adversely impacted. Where any SFI believes their capital adequacy ratio will be deficient due to the adoption of IFRS 9, that SFI should consult with the Central Bank.

Under the new capital standard, the entire amount of provisions under IFRS 9 will be applied as specific provisions for regulatory reporting purposes. This means that SFIs will no longer be able to add back capital (in the form of general provisions) as Tier 2 capital. Given our focus on CET1 capital, Tier 2 Capital will no longer be used for the purposes of calculating total regulatory capital.

## 4. MINIMUM CAPITAL REQUIREMENTS AND CAPITAL BUFFERS

### 4.1. Minimum Capital Adequacy Requirement

The Central Bank currently requires all SFIs to maintain a capital adequacy ratio of at least 8% (exclusive of the capital conservation buffer) at all times. At least 75% of capital must take the form of Tier 1 Capital, thus requiring SFIs to maintain a minimum Tier 1 Ratio of 6%.

The predominant form of Tier 1 capital must be met with common equity, resulting in SFIs also being required to maintain a minimum Common Equity Tier 1 (CET1) Ratio of 4.5% of Risk Weighted Assets (RWA). The aforementioned requirements are determined based on the calculations below.

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Eligible Capital (Tier 1 Capital plus Tier 2 Capital)}}{(\text{Credit RWA} + \text{Market RWA} + \text{Operational RWA})^*}$$

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<sup>7</sup> [Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution \(November 2015\)](#)

$$\text{Minimum Tier 1 Ratio} = \frac{\text{Tier 1 Capital}}{(\text{Credit RWA} + \text{Market RWA} + \text{Operational RWA})^*}$$

$$\text{Minimum CET1 Ratio} = \frac{\text{CET1 Capital}}{(\text{Credit RWA} + \text{Market RWA} + \text{Operational RWA})^*}$$

*\*Further details regarding these elements and the calculation of these risk areas are outlined below.*

#### 4.1.1. Trigger and Target Ratios

Some SFIs are subject to additional requirements, referred to as trigger and target ratios. The trigger ratio is the minimum capital ratio that the Central Bank considers the SFI should maintain. The absolute minimum trigger ratio the Central Bank considers to be appropriate is 8% (eligible capital to risk weighted assets). However, where it is judged appropriate, the Central Bank may set a trigger ratio significantly above 8% for individual SFIs.

The target ratio, on the other hand, is to act as a warning that the “cushion” of surplus capital resources normally considered adequate to prevent an accidental breach of the trigger has been eroded. Currently all Commercial Banks are subject to a target ratio of 17% of risk-weighted assets. The relevant requirements are outlined below:

- a) CET1 Capital Ratio = 9.6% of risk-weighted assets
- b) Tier 1 (CET1 + Additional Tier 1) Capital Ratio = 12.8% of risk-weighted assets
- c) Capital Adequacy Ratio (CAR) = 17% of risk-weighted assets

#### 4.2. Basel III – Limits and Minima

Basel III outlines the following minimum capital requirements for SFIs:

- a) CET1 Capital Ratio = 4.5% of risk-weighted assets at all times.
- b) Tier 1 (CET1 + Additional Tier 1) Capital Ratio = 6.0% of risk-weighted assets at all times.
- c) Capital Adequacy Ratio (CAR) = 8.0% of risk-weighted assets at all times.

In addition to the minimum capital requirements outlined above, the Basel Committee recommends the implementation of additional Capital Buffers. For most Basel III-compliant countries, the practical minimum CET1 ratio is 7% and the minimum total capital ratio is 10.5%.

##### 4.2.1. Capital Conservation Buffer

Basel III introduced a capital conservation buffer, designed to ensure that SFIs build up capital buffers which can be drawn down when losses are incurred. Basel III established a 2.5% capital conservation buffer, comprised of Common Equity Tier 1.

#### 4.2.2. Countercyclical Buffer

The Basel III countercyclical buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which SFIs operate. It is intended to be deployed by national jurisdictions when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future potential losses.

The Basel Committee recommends a countercyclical buffer that varies between zero and 2.5% of total risk weighted assets. Banks are expected to meet this buffer with Common Equity Tier 1 or other fully loss absorbing capital, or be subject to the restrictions on distributions set out in paragraphs 146-148 of the Basel III paper<sup>8</sup>. The buffer that will apply to each SFI should reflect the geographic composition of its portfolio of credit exposures.

Further details regarding the Basel Committee's proposed Capital Buffers are outlined in paragraphs 122-150 of the Basel paper titled *Basel III: A global regulatory framework for more resilient banks and banking systems*" ("BCBS June 2011").

#### 4.2.3. D-SIB Buffer

For systemically important banks, the Basel Committee prescribes a 'higher loss absorbency' (HLA)<sup>9</sup> requirement for banks identified as domestic systemically important banks (D-SIBs). The purpose of the HLA requirement for D-SIBs is to reduce the probability and impact of failure on the domestic financial system. The level of HLA calibrated (or additional capital buffer) will be commensurate with the degree of the SFI's systemic importance. The Bahamian approach to the D-SIB framework will be addressed in a separate paper. In any event, the Central Bank is not proposing a separate D-SIB buffer, but will achieve a similar effect through variances in the proposed regulatory capital buffer.

### 4.3. Central Bank's Proposed Minimum Capital Requirements

The appropriate buffer regime for The Bahamas should be much simpler, and for domestic banks appreciably more conservative, than the Basel III approach.

The Bahamian banking system comprises domestically licensed commercial banks, which are not internationally active, and a much larger internationally licensed banking system, which is internationally active but only minimally exposed to the Bahamian financial system.

The Bahamian domestic financial system's access to additional capital is limited by small and relatively illiquid capital markets. Many internationally licensed banks have access to additional capital through much larger foreign parents.

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<sup>8</sup> [Basel III: A global regulatory framework for more resilient banks and banking systems \(Revised June 2011\)](#)

<sup>9</sup> [A Framework for Dealing with Domestic Systemically Important Banks \(October 2012\)](#)

Accordingly, the Central Bank’s capital buffer strategy varies significantly between the domestically licensed and internationally licensed banks. In particular, the Central Bank considers that domestically licensed institutions must be able to carry sufficient capital to meet not only current requirements, but to absorb material economic adversity, without any need for recapitalization. When the need arises to deploy this pre-raised capital, however, it will be important that high fixed capital requirements do not impair a Bahamian banking and economic recovery.

There is also the consideration that the Bahamian domestic financial system and economy is permanently exposed to exogenous shocks, such as a major hurricane or U.S. recession. The probability of these shocks cannot be reduced through a domestic counter-cyclical buffer. These considerations suggest that the best capital strategy for Bahamian domestic banks is to require both a high minimum capital requirement and a high buffer, but with considerable flexibility to deploy the buffer in adverse times.

For Bahamian international banks, the Central Bank considers that deploying a CET1-only capital regime is adequately super-equivalent to the international Basel III standards, so buffers larger than the international minimum are not required.

#### 4.3.1. Proposed requirements

The Central Bank intends to replace the current capital adequacy requirements, including trigger and target ratios imposed on SFIs. We are proposing that all SFIs to whom the guidelines are applicable, will be required to maintain a **minimum Common Equity Tier 1 (CET1) Capital Ratio of 8%** of risk weighted assets (RWA). For the purpose of calculating this requirement, the SFI’s CET1 Capital will be *net* of regulatory adjustments.

$$\text{CET1 Ratio} = \frac{\text{CET1 Capital (net of regulatory adjustments)}}{(\text{Credit RWA} + \text{Market RWA} + \text{Operational RWA})}$$

The Central Bank does not anticipate that the revised minimum capital requirement will have a major impact on the majority of SFIs in the jurisdiction, due to the fact that a significant portion of SFIs’ total eligible capital base is currently comprised of CET1 Capital. As at 31<sup>st</sup> March, 2018 approximately 98.8% of the reporting SFIs’ capital base was comprised of CET1 Capital.

Rather than maintaining three separate buffer regimes for capital conservation, counter-cyclicality, and systemic importance, the Central Bank is proposing to impose a much simpler single buffer regime. This Additional Capital Buffer will range from 2.5% - 8% of RWA depending upon the SFI. The Central Bank anticipates that the additional capital buffer will always meet and sometimes exceed the requirements associated with the Basel III Capital Conservation Buffer, the Countercyclical Buffer, and the D-SIB buffer.

To give an idea of the relative complexities of the Basel and the Bahamian approaches, the Basel rules texts require 14 pages to describe the buffer framework. Our expectation is that the Bahamian capital regulation will require approximately one page.

The proposed capital buffers are outlined in Table 1 below:

**Table 1**

<b>Minimum Capital Adequacy Requirements and Buffers</b> <i>(proposed)</i>				
	<b>Commercial Banks</b>	<b>Credit Unions</b>	<b>International Banks (Home) &amp; Other Domestic Banks</b>	<b>International Banks (Host)</b>
Minimum CET1 Capital Ratio	8%	8%	8%	8%
Additional CET1 Capital Buffer	8%	2.5%	4%	2.5%
<b>Minimum Requirement</b>	<b>16%</b>	<b>10.5%</b>	<b>12%</b>	<b>10.5%</b>

**4.3.2. Capital Buffer**

The revised capital approach is more focused on reinforcing a regime that allows domestic SFIs to maintain a significant amount of capital that is accessible in the event of unexpected losses or a financial crisis. The Central Bank expects that these buffers will maintain simplicity, whilst being super-equivalent to Basel’s standards. Once the capital buffer regime is in place, the current trigger and target ratio framework of 14% and 17% will fall away.

The Basel III standards would require SFIs to maintain a CAR ranging from at least 10.5% - 13% at all times. An appreciable minority of this requirement could be met from lower quality capital. This is inclusive of both the capital conservation and countercyclical buffers. The Central Bank’s proposal for The Bahamas includes the 8% minimum imposed by Basel, which we term as the minimum CET1 Capital, as well as the Additional Capital Buffer.

**Table 2**

<b>Basel III Capital Requirements</b>	=	Minimum Capital Requirement 8%	+	Capital Conservation Buffer 2.5%	+	Countercyclical Buffer 0%-2.5%	=	10.5%-13%
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**Table 3**

<b>Central Proposed Requirements</b>	=	<b>Bank’s Capital</b>	+	Minimum Capital Requirement 8%	+	Additional Capital Buffer 2.5%-8%	=	10.5%-16%
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The Additional Capital Buffer will be determined by the Central Bank, based on the type of SFI and the level of risk (systemic, reputational, etc.) that the SFI poses to the Bahamian jurisdiction. The highest value in the range, i.e. 8%, will be imposed on domestic commercial banks. These SFIs dominate the domestic banking system.

The domestic commercial banks require a larger buffer to ensure financial stability of the domestic banking system. The Additional Capital Buffer for international SFIs should reflect the lower risk these institutions pose to the Bahamian jurisdiction.

Home-supervised (i.e. headquartered in The Bahamas with no offshore parent) SFIs would be required to maintain a higher capital buffer than Host-supervised SFIs. There is a higher Bahamian reputational risk associated with the failure of a Home-supervised SFI. Also, as a general rule, Home-supervised SFIs enjoy less access to additional capital under stress, compared to Host-supervised SFIs.

The implementation of the additional capital buffer would require SFIs to maintain a minimum CET1 ratio ranging from 10.5% - 16% of RWA, at all times. For the March 2018 quarter, the industry largely complies with these requirements. The table below provides a further breakdown by type of SFI<sup>10</sup>, of the Minimum CET1 ratios for reporting SFIs as at 31<sup>st</sup> March, 2018.

**Table 4**

<b>Population of Commercial Banks with Minimum CET1 Capital ratio of 16% or higher</b>	<b>Population of Home Int. SFIs &amp; Other Domestic SFIs with Minimum CET1 Capital ratio of 12% or higher</b>	<b>Population of Host Int. SFIs with Minimum CET1 Capital ratio of 10.5% or higher</b>
100.0%	100.0%	96.3%

**4.3.3. What happens when an SFI’s Capital Buffer falls below the Minimum?**

The Basel rules text prescribes complex calculations for determining restrictions on distributions when a bank’s capital ratio falls within the buffer<sup>11</sup>. The Basel rules text prescribes even more complex requirements for each bank to maintain recovery and resolution plans<sup>12</sup>. These arrangements are too complex for Bahamian conditions. Under the principle of proportionality, happily, The Bahamas may implement a simpler approach, provided that it is at least as conservative as the Basel approach.

Accordingly, the Central Bank proposes to implement the following rule: SFIs with a capital ratio lower than the minimum plus buffer requirements must immediately suspend all capital distributions on CET1. They may resume distributions when they reach an agreement with the Central Bank on an appropriate capital recovery plan. The idea here is that banks with temporary capital constraints will quickly reach agreement with the Central Bank and continue near-normal operations, including capital distributions. Banks that are seriously or permanently impaired, by contrast, will not be allowed to resume capital distributions, until the troubled bank’s position is resolved.

<sup>10</sup> Under the proposed Basel III rules, there is appreciable uncertainty in the CET1 capital adequacy calculation for Credit Unions, which the Central Bank intends to address during the consultation period for this paper.

<sup>11</sup> Basel III: A global regulatory framework for more resilient banks and banking systems (Revised June 2011)

<sup>12</sup> Guidelines for identifying and dealing with weak banks (July 2015)

#### **4.4. Pillar 2 adjustments**

As is the case in the current capital regime, the Central Bank will reserve the right to increase minimum capital requirements or buffers for any SFI, or any class of SFI, based upon unusual or excessive risks or inadequate risk management presented by one or more SFIs.

### **5. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP) AND THE SUPERVISORY REVIEW PROCESS (SREP)**

The Basel Committee’s ICAAP approach presumes that the relevant banks are internationally active, with a number of alternatives to raise additional equity or lay off risks. Bahamian banks lack this capital access and risk management flexibility, so appropriate ICAAP arrangements are simpler than those expressed in the Basel Framework.

As per the current Guidelines for the Internal Capital Adequacy Assessment Process for SFIs (“ICAAP Guidelines”)<sup>13</sup>, SFIs are required to conduct an ICAAP based on their size, complexity and business mix, as well as when there are any significant changes in an SFI’s risk exposure. SFIs are to maintain suitable systems to identify, measure, and manage the risks associated with their activities, and to hold capital adequate for their overall risk profile. As part of the process, SFIs are expected to maintain and implement capital management plans setting out the overall strategy for managing capital resources over time. Internal target and trigger capital ratios should be set to alert management of, and avert, potential breaches to the minimum capital ratios.

The ultimate responsibility for the ICAAP rests with the Board of Directors and Senior Management of the SFI. They are responsible for regular assessments of capital adequacy to ensure that capital resources are appropriate for the level and nature of all the risks to which the SFI is exposed. An SFI’s ICAAP Report and Capital Management Plans must be approved by the SFI’s Board of Directors, with a copy submitted to the Central Bank within 180 days of the end of each calendar year.

#### **5.1.1. Supervisory Review Evaluation Process**

Currently, upon receipt of the ICAAP report, the Central Bank will conduct periodic reviews and assessments of SFI’s ICAAP through its Supervisory Review and Evaluation Process (“SREP”). The SREP involves a quantitative review of the SFIs Pillar 2 inherent risk exposures, and other important factors which SFIs need to take into account in arriving at its overall capital targets. The Central Bank assesses both the adequacy of SFI’s capital targets and their strategies and the capacity for achieving and maintaining these targets. The SREP is also the basis of ongoing discussions between the Bank and SFI, and forms an integral part of the overall supervisory approach.

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<sup>13</sup> [Guidelines for the Internal Capital Adequacy Assessment Process \(2016\)](#).

The current requirement that SFIs conduct an ICAAP and produce a report documenting that process is in line with the Basel Committee’s Supervisory Review Process. Acknowledging that each financial institution is unique, the Basel Committee framework requires that financial institutions not only comply with the Basel minimum capital requirements, but are actively involved in allocating additional capital given their specific risk profile. Financial institutions must understand their risk profile, develop internal strategies to monitor and control their risks, as well as set capital targets to cover risks that may materialize. Supervisors are required to evaluate financial institutions’ ICAAPs. If it is determined that a bank’s capital is inadequate given its risk profile, appropriate supervisory action, inclusive of requiring more capital, should be taken.

#### **5.1.2. Central Bank’s proposal for streamlining the ICAAP**

We propose to strengthen and simplify the link between ICAAP outcomes and capital recovery planning. We also propose to simplify the Bahamian ICAAP process.

The proposed capital regulation will explicitly incorporate the ICAAP report as integral in determining the SFI’s capital adequacy. The ICAAP requirements will be augmented to require that SFIs document how breaches in internal target and trigger capital levels will be remedied. SFIs would be required to detail clearly their capital recovery plan, which must include strategies/actions to be taken in the event capital falls below target levels.

The Central Bank will assess the ICAAP report, inclusive of the recovery plan, and may write to the Board providing results of the assessment. This letter would advise whether the SFI’s ICAAP is considered to be appropriate; reasons for any capital adjustments and limits, if any; and where necessary, what supervisory actions the Central Bank may take if it is not satisfied with the results of the SFI’s own risk assessment and capital allocation.

Minimum elements in a SFI’s ICAAP and recovery plan must include:

- 1) A summary of how the SFI identifies and estimates its risks, and converts these estimates into capital targets.
- 2) A target capital position must include a target range for the CET1 ratio. The minimum of this range must exceed the SFI’s buffer requirement imposed by the Central Bank, including any Pillar 2 add-ons.
- 3) A contingency plan to restore the CET1 ratio to the target range, should it fall outside (and particularly below) this range.
- 4) Contingency plans for restoring the target capital position for host-supervised SFIs must include consideration of the circumstances in which the SFI would seek additional capital from its parent, and the degree of confidence the SFI possesses that such a capital request would be met by the parent.
- 5) Contingency plans for home-supervised SFIs must include triggers for when the SFI would look to be acquired by another SFI, or otherwise seek a major capital injection.

The Central Bank intends to issue more guidance on ICAAPS and recovery planning in 2019. Broadly, we would like to see the industry produce short, sensible, and actionable plans that are likely to be effective in the Bahamian context.

### **5.1.3.Proposal for Reporting of ICAAP**

Giving consideration to proportionality, the Central Bank proposes to reduce the reporting frequency of the ICAAP report. The ICAAP review cycle (or SREP) will be conducted every 2 years for domestic banks, and every 4 years for other SFIs. During this process, the Board must be kept abreast of any changes in the risk profile that would warrant adjustments to capital levels.

Additionally, the Central Bank may require an ICAAP update from any SFI at any time.

## 6. THE NEW STANDARDISED APPROACH FOR CREDIT RISK

Under the Basel II framework, banks were permitted to choose between two broad approaches for calculating their risk based capital requirements for credit risk: the Standardised Approach (SA), and the Internal Ratings-Based approaches (IRB).

Like most jurisdictions around the world, The Bahamas uses the simpler Standardised Approach for measuring credit risk. This will continue under the revised Basel III framework. Under the SA, banks do not use their internal models to calculate risk weighted assets. Instead, supervisors establish the risk weights that banks apply to their exposures to determine risk weighted assets.

The Central Bank proposes to at least match but substantially simplify the Basel III schedule of risk weights for calculating the capital requirements for credit risk.

### 6.1. External Credit Assessment Institutions (ECAIs)

Under the revised standardised approach for credit risk, bank exposures will now be risk weighted based on two broad methods:

- (a) **External Credit Risk Assessment Approach (ECRA)** – for exposures with external ratings that are allowable for regulatory purposes; and
- (b) **Standardised Credit Risk Assessment Approach (SCRA)** – for unrated exposures of banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes.

For regulatory capital purposes, the Central Bank will continue to recognize the following ECAIs:

- Moody’s Investors Service;
- Standard and Poor’s (S&P);
- Fitch Ratings; and
- Other ECAIs recognized by Basel Committee member countries.

No other rating agencies are currently recognized. The Central Bank will consider recognizing additional ECAIs upon application from the SFI.

### 6.2. Due Diligence

Credit risk accounts for the bulk of most domestic SFI risk, and is the largest source of risk for international SFIs. Under the Basel III reforms, banks must perform due diligence to ensure that they have an adequate understanding, at origination and thereafter (at least annually), of the risk profile and characteristics of their counterparties (borrowers).

SFIs are expected to maintain a credit risk framework that allows for adequate analysis for any asset or group of assets with exposure to credit risk. The use of external ratings does not preclude the SFI from performing due diligence on the risk of an asset/exposure. Where the due diligence

analysis reflects higher risk characteristics, the SFI is required to assign a risk weight that is at least one bucket higher than the “Base” risk weight determined by the recognized external rating.

### 6.3. Home-Host arrangements for assigning risk weights

**Proposal for consideration: Adoption of home country risk weights by host-supervised banks**

The Central Bank intends to greatly simplify its regulatory approach to capital, both for capital definitions and for determining risk-weighted assets. In simplifying its approach, the Central Bank is considering whether it should allow host-supervised institutions (i.e. subsidiaries) to apply home-country (i.e. parent) capital rules. In the context of this proposal, host-supervised institutions would still be required to follow a CET1-only capital regime in The Bahamas, but might be allowed to deploy the parent company definition of CET1. Additionally, and likely more substantively in a computational sense, the Central Bank is considering whether it should allow host-supervised subsidiaries to deploy their parent capital definitions to determine Bahamian risk assets. Such an approach would only apply for the parent company’s calculations under the Standardized Approach.

The exact method of adoption of parent company rules is yet to be determined. It is anticipated that the adoption of home country capital rules will improve the ease of data transfer and reconciliations from head office, and promote consistency in the computation of risk-sensitive capital adequacy within the group. The resultant reduction in operating costs should enhance the competitiveness of The Bahamas as an international banking center.

There are some non-trivial issues for the Central Bank to consider if it adopts this approach, including more complexity in its statistical collections and its supervision. If Bahamian host-supervised SFIs make a strong case to be allowed to deploy their parent capital definitions and risk weight calculations, then the Central Bank will closely consider this initiative. Otherwise, the Central Bank will continue with its current approach, which is to require all SFIs to deploy the Bahamian definitions and risk weight calculations for capital adequacy purposes.

### 6.4. Exposures to Sovereigns

The treatment for exposures to sovereigns will remain weighted as follows:

**Table 5**

Credit Assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	0%	20%	50%	100%	150%	100%

Through use of national discretion, the Central Bank will continue to allow a 0% risk weight for exposures to The Bahamas government.

### 6.5. Exposures to Non-Central Government Public Sector Entities (PSEs)

Treatment of PSEs will be unchanged. Using national discretion, claims on domestic PSEs will be assigned a risk weight using the following three criteria below:

**Table 6**

<b>Domestic PSEs</b>	<b>Criteria</b>	<b>Risk Weight</b>
<b>Treated as a Sovereign</b>	Claims of domestic PSEs which are guaranteed by central government. The guarantee must be explicit, unconditional, legally enforceable and irrevocable.	0%
<b>Treated as a Bank</b>	Claims of domestic PSEs which are not guaranteed by central government and the PSE does not participate in a competitive market will be assessed an equivalent risk weight as a bank.	See risk weights for claims on Banks
<b>Treated as a Corporate</b>	Claims of domestic PSEs which are not guaranteed by central government and the PSE participates in a competitive market will be assessed an equivalent risk weight as a corporate.	100%

### 6.6. Exposures to Multilateral Development Banks (MDBs)

The Central Bank proposes the following treatment for exposures to MDBs. Highly rated MDBs that meet the eligibility criteria (outlined by the Basel Committee) and are rated AAA to AA- will be risk weighted at 20%. All other MDB exposures will be risk weighted at 100%.

### 6.7. Exposures to Banks

6.7.1. For externally rated exposures to banks, the Central Bank proposes to adopt the Basel III treatment and apply the following:

**Table 7**

<b>External rating of counterparty</b>	<b>AAA to AA-</b>	<b>A+ to A-</b>	<b>BBB+ to BBB-</b>	<b>BB+ to B-</b>	<b>Below B-</b>
"Base" risk weight	20%	30%	50%	100%	150%
Risk weight for short-term exposures	20%	20%	20%	50%	150%

If due diligence analysis reflects higher risk characteristics than that determined by the external rating bucket (above), the SFI must assign a risk weight higher than the “base” risk weight.

6.7.2. For exposures to banks that are **unrated**, the Central Bank proposes to adopt the Basel III treatment and apply the following:

**Table 8**

<b>Credit risk assessment of counterparty</b>	<b>Grade A</b>	<b>Grade B</b>	<b>Grade C</b>
“Base” risk weight	40%	75%	100%
Risk weight for short-term exposures	20%	50%	100%

The counterparty bank must satisfy all of the requirements outlined in Basel III standards for Grade A, Grade B and Grade C classifications<sup>14</sup>.

- **Grade A** refers to exposures to banks, where the counterparty bank has adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions.

**Note:** The Central Bank considers that Bahamian Dollar-denominated exposures among domestic Bahamian banks should all be classified as Grade A at the moment, though banks will need to continue monitoring their counterparty exposures for any signs of deterioration.

- **Grade B** refers to exposures to banks, where the counterparty bank is subject to substantial credit risk, such as repayment capacities that are dependent on stable or favourable economic or business conditions.
- **Grade C** refers to higher credit risk exposures to banks, where the counterparty bank has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments.

## 6.8. Exposures to Securities Firms

Treatment for Securities Firms will be unchanged. Claims on securities firms will be treated as claims on banks, provided that these firms are subject to supervisory and regulatory arrangements comparable to those under the Basel II/III framework (including risk-based capital requirements). Where these requirements are not met, such claims will be risk weighted as claims on corporates and the risk weight of 100% will apply.

<sup>14</sup> [The classification requirements for Grade A, B and C can be found at paragraphs 22 thru 31 of the Basel III: Finalising post-crisis reforms \(December 2017\).](#)

## 6.9. Exposures to Corporates

Treatment for Corporates will be unchanged. All unsecured corporate exposures (rated and unrated) will be subject to a risk weight of 100%:

1. Claims on corporates (excluding venture capital and private equity investments);
2. Claims on insurance companies; and
3. Claims on securities firms that do not qualify for treatment as claims on banks.

## 6.10. Retail Exposures

Retail exposures are exposures to an individual person or persons, or to regulatory retail SMEs (i.e. small businesses). The treatment for unsecured regulatory retail exposures under the Basel II framework will be maintained at a 75% risk weight. The Central Bank proposes to redefine “Regulatory retail SMEs” as corporate exposures where the borrower’s reported annual sales are less than BSD\$5 million.<sup>15</sup> Retail exposures that meet all of the criteria below will be classified as “regulatory retail” exposures and risk-weighted at 75%.

- **Product criterion:** the exposure takes the form of any of the following: revolving credits and lines of credit (inclusive of credit cards, charge cards, and overdrafts), personal term loans and leases (e.g. instalment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments.
- **Low value of individual exposures:** the maximum aggregate exposure to one counterparty does not exceed an absolute threshold of BSD\$2 million.
- **Granularity criterion:** to ensure satisfactory diversification, no aggregated exposures to one counterparty can exceed BSD\$2 million of the overall regulatory retail portfolio.

The net effect of these changes, relative to the current Bahamian capital regime, is that more business lending should qualify for the 75% rather than the 100% risk weight for credit risk.

## 6.11. Exposures secured by Residential Real Estate (Mortgage Exposures)

Residential Real estate exposures will be tied to a Loan to Value (LTV) ratio where the “Loan amount” will be the current exposure amount and “Value” would be determined using the lower of the valuation that the bank holds or the net sale price.

- (a) Risk weights for residential real estate, where the repayment is **not materially dependent** on cash flows generated by the property will be determined as follows:

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<sup>15</sup> Under the Basel III framework corporate small and medium entities (SMEs) are defined as corporate exposures where the reported annual sales for the consolidated group is less than or equal to €50 million.

**Table 9(a): Basel III Standard**

Risk weight table for residential real estate exposures						
	LTV≤50%	50%<LTV≤60%	60%<LTV≤80%	80%<LTV≤90%	90%<LTV≤100%	LTV>100%
Risk Weight	20%	25%	30%	40%	50%	70%

**Table 9(b): Central Bank Proposal**

	LTV≤60%	60%<LTV≤80%	LTV>80%
Risk weight	25%	50%	100%

(b) Risk weights for residential real estate where the repayment is **materially dependent** on cash flows generated by the property<sup>16</sup> will be determined as follows:

**Table 10(a): Basel III Standard**

Risk weight table for residential real estate exposures						
	LTV≤50%	50%<LTV≤60%	60%<LTV≤80%	80%<LTV≤90%	90%<LTV≤100%	LTV>100%
Risk Weight	30%	35%	45%	60%	75%	105%

**Table 10(b): Central Bank Proposal**

	LTV≤60%	60%<LTV≤80%	LTV>80%
Risk weight	25%	50%	100%

In determining the risk weights above, the Central Bank has significantly simplified the treatment of residential real estate exposures relative to the Basel framework, and has taken into account historical rates of default for exposures collateralized by residential real estate in The Bahamas. In light of this, the risk weights are greater than those proposed under the Basel III reforms, which present rates based on studies of jurisdictions with historically lower default rates.

There is also the consideration that Bahamian real estate transaction costs are high relative to equivalent costs in Basel Committee member countries. These higher costs generate a lower de facto loan to value ratio than is reported using standard valuations or sales prices.

**Criteria for residential real estate loans:**

For a loan to be concessionally weighted using these requirements:

- The property must be fully completed and fit for occupation;

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<sup>16</sup> As defined under section 2 of the Homeowners Protection Act, 2017, "property" means real property.

- Any security claim on the property must be legally enforceable;
- The lending bank must hold a first lien over the property; and
- The loan must have been appropriately underwritten, with the borrower’s ability to repay evaluated within the bank’s policies.

**Loan Amount**

The loan amount includes the drawn amount along with any undrawn committed amounts related to the loan. The loan amount must be calculated gross of any provisions.

**Value**

Value is the lower of the valuation that the bank holds, or the net acquisition price for the property (not including closing costs such as commission, taxes, or lawyer fees). The bank’s valuation of the property must be appraised independently using prudently conservative valuation criteria. The value amount in the Loan to Value ratio is expected to be refreshed periodically (revaluated) at an interval considered reasonable given market movements. There is no requirement to refresh the valuation, however, for performing loans in the absence of any reason to believe that the property’s value has been materially reduced.

SFIs must refresh valuations when a loan is materially amended, for example by refinancing, equity release, or an increase in the loan to finance renovations.

SFIs may not increase valuations (and therefore reduce loan to value ratios and capital requirements) by assuming a general increase in a property’s value. Only values supported by a valuation or sale are valid.

The Central Bank may require any SFI to reduce its valuation for any property or group of properties, based upon economic or other conditions applicable at the time.

**Loan to Value Ratio**

The loan to value ratio is the amount of the loan divided by the value of the property.

**6.12. Exposures secured by Commercial Real Estate**

The Central Bank proposes to change the risk weight applicable for exposures secured by commercial real estate (currently 100% - See Part 3 of the *Capital Guidelines*). The risk weights would be as outlined in the table below:

- (a) Risk weights for commercial real estate exposures, where repayment is **not materially dependent** on cash flows generated by property.

**Table 11**

Risk Weights for Commercial Real Estate Exposures ( <i>Repayment is not materially dependent on cash flows generated by property</i> )	
	LTV>60%
	LTV≤60%

Risk weight	Lower of 60%, or the risk weight of the counterparty	Lower of 100%, or the risk weight of the counterparty
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(b) Risk weights for commercial real estate exposures, where repayment is **materially dependent** on cash flows generated by property.

**Table 12**

Risk Weights for Commercial Real Estate Exposures (Repayment is materially dependent on cash flows generated by property)			
	LTV ≤ 60%	60% < LTV ≤ 80%	LTV > 80%
Risk weight	70%	90%	110%

The Central Bank notes that as a matter of international regulatory conformance, commercial real estate exposures above an 80 per cent loan to value ratio will be risk weighted at 110 per cent, to match the Basel rules text. As a supervisory matter, however, the Central Bank is dubious that such exposures are prudent in the Bahamian context. Any SFI originating stand-alone commercial real estate exposures exceeding 80 per cent loan to value ratios should expect a supervisory response, including Pillar 2 adjustments.

### 6.13. Land acquisition, development and construction exposures

The Central Bank proposes to clarify its treatment under the Basel III reforms for land acquisition, development and construction exposures.

6.13.1 Bahamian experience suggests that residential borrowing for land, with the immediate intent to build a dwelling, is not notably more (or less) risky than borrowings for completed residences. Accordingly, residential land and construction exposures should be risk weighted using Table 10.

6.13.2 Commercial land acquisition, development and construction lending will generally be risk-weighted at 150%. When the property is completed, which includes not only physical completion but occupancy by tenants, the risk weight should be taken from Tables 11 or 12, as appropriate.

6.13.3 The boundary between residential and commercial real estate exposures will be determined as follows. A residential real estate exposure is an exposure secured by a mortgage on residential property that is or will be occupied for housing purposes, or residential property under construction, provided the loan is for a one to four family residential housing units or condominium. All other real estate exposures secured by a mortgage on property will be treated as commercial real estate exposures.

#### **6.14. Capital Requirements for Equity Investments in Funds**

The Central Bank does not consider that investment in third party equities is a normal banking exposure, and accordingly, such investments will be a deduction from a SFI's CET1.

Effective 1 January 2017, the Basel Committee issued a new standard on "*Capital Requirements for banks' equity investments in funds*"<sup>17</sup>. The Central Bank proposes to adopt this minimum standard for treatment of investment funds held in the banking book.

The new standard introduced three approaches (with varying degrees of risk sensitivity) for calculating capital requirements for equity exposures to funds: The "Look-Through Approach", the "Mandate Based Approach" and the "Fall-back Approach". The Central Bank proposes to allow only the Look-Through Approach, given equity investments in funds is not a normal banking business.

- **The "Look-Through Approach" (LTA)** is the most granular. Subject to meeting the conditions set out for its use, banks employing the LTA must apply the risk weight of the fund's underlying exposures as if the exposures were held directly by the bank.

Under the Look-Through Approach, the RWA treatment will depend on the underlying investment type(s) or exposures.

All other Investments in equity or other regulatory capital instruments (of other entities) should be deducted from CET1 Capital.

#### **6.15. Defaulted and Past Due Exposures**

The Central Bank's treatment for defaulted exposures and past due loans will remain unchanged.

##### ***Unsecured Portions of Past Due Loans***

The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions, including partial write offs, will be risk-weighted as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan.
- 100% risk weight when specific provisions are equal to or greater than 20% of the outstanding amount of the loan.

##### ***Secured Portions of Past Due Loans***

Banks should apply the same risk weight on the secured portion of past due loans secured by eligible collateral or guarantees, as if they were not past due, provided the credit risk mitigation criteria continues to be satisfied.

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<sup>17</sup> [Basel Committee final policy framework for Capital requirements for banks' equity investment in funds, December 2013.](#)

Past due loans fully secured by collateral not recognized under the Credit Risk Mitigation framework are to be risk-weighted at 150%.

Qualifying residential mortgage loans that are past due for more than 90 days will be risk weighted at 100%, net of specific provisions.

**Proposal for Consideration: Treatment of Secured Portions of Non-Performing Loans**

The Central Bank is considering the introduction of time based provisioning for non-performing secured loans. This approach will encourage SFIs to move more quickly than has historically been the Bahamian experience in resolving non-performing loans, which are often secured by real estate. As a result, the banking system as a whole should become more resilient, as backlogs of non-performing loans will on average be reduced, on both a net and a gross basis.

The proposed approach is that secured non-performing loans will be subject to minimum specific provisioning based on the duration of the default:

- From zero to two years, the minimum specific provisioning will be 20 per cent; and
- At two years and each year thereafter through five years, the minimum specific provision will increase by 20 per cent per year.
- Among other things, this means that every secured non-performing loan older than five years will be completely provisioned.

The Central Bank expects that banks are already provisioning and writing off unsecured loans much faster than would be the case on the above schedule.

To the extent that a SFI's financial accounts under IFRS 9 require lower specific provisioning than that in the above schedule, the SFI would be required to deduct the difference between its financial provisions and its required regulatory provisions from CET1.

**6.16. High Risk Categories**

Exposures to Higher Risk Categories, such as venture capital and private equity investments, will be deducted from the SFI's CET1 capital. The Central Bank does not consider that such assets form a normal part of Bahamian banking business, so should be funded with shareholder equity rather than with deposits or other debt.

## 6.17. Securitizations

The Basel framework for risk weighting exposures to securitization vehicles is highly complex<sup>18</sup>. The Central Bank’s view is that Bahamian SFIs who are investing in SFIs should focus only upon the simplest and least risky tranches of such vehicles. Typically, the top or most senior tranche.

The proposed risk weights for securitization exposures are summarised in Table 13.

**Table 13**

<b>Credit Assessment</b>	AAA to AA- (A-1/P-1)	A+ to A- (A-2/P-2)	BBB+ to BBB- (A-3/P-3)	BB+ to BB-	B+ and Below	Unrated
<b>Risk Weight</b>	20%	100%	CET1 Deduction			

The Central Bank does not propose to create a Bahamian prudential framework for securitization originations at this time, as very few banks, if any, report these types of exposures. Any SFI interested in originating assets into a securitization vehicle should first consult with the Central Bank.

## 6.18. Other Assets

- (a) A 0% risk weight will apply to:
  - Cash;
  - Gold Bullion, held in the institution’s own vaults or on an allocated basis to the extent backed by bullion liabilities; and
  - Exposures collateralized by cash deposits.
- (b) A 20% risk weight will apply to:
  - Cash items in the process of collection
- (c) A 100% risk weight will apply to:
  - Premises, plant, equipment and other fixed assets, when used for the SFI’s own business;
  - Gold Bullion – other;
  - Silver Bullion, Precious Metals and Gemstones; and
  - All other assets not included elsewhere.

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<sup>18</sup> Basel III: Revisions to the Securitisation framework (Revised: July 2016)

## 6.19. Off-Balance Sheet Items

Similar to Basel II, Basel III requires SFIs to apply credit conversion factors (CCFs) to off-balance sheet exposures. The categories of off-balance sheet items include guarantees, commitments, and similar contracts whose full notional principal amount may not be reflected on the balance sheet.

The Central Bank does not propose to create a risk weight regime for derivative exposures, given that these exposures are immaterial for Bahamian banks. We note that an SFI's financial accounts may include a small item for derivative assets and liabilities, and under the proposed capital regime, derivative assets under this financial accounting will be risk weighted at 100%. On the information to hand, this item is immaterial for every Bahamian bank.

The Central Bank's current treatment for off-balance sheet items will largely be retained, save for a change in the CCF for unconditionally cancellable facilities. As such, Off-Balance sheet exposures will attract the following CCFs:

**Table 14**

Off-Balance Sheet Exposure	Credit Conversion Factor(CCF)
i. Commitments that are unconditionally cancellable at any time by the bank without prior notice or that effectively provide for automatic cancellation due to the deterioration in a borrower's credit worthiness.	10%
i. Commitments with an original maturity up to one year. ii. Short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralized by the underlying shipment).	20%
i. Commitments with an original maturity exceeding one year, including underwriting commitments and commercial credit lines. ii. Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions). iii. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs).	50%

Off-Balance Sheet Exposure	Credit Conversion Factor(CCF)
<ul style="list-style-type: none"> <li>i. Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).</li> <li>ii. Sale and repurchase agreements.</li> <li>iii. Asset sales with recourse where the credit risk remains with the bank.</li> <li>iv. Forward asset purchases, forward deposits and partly-paid shares and securities, which represent commitments with certain drawdown.</li> <li>v. Lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/ reverse repurchase and securities lending/securities borrowing transactions).</li> </ul>	<b>100%</b>

## 6.20 SUPERVISORY ADJUSTMENTS TO RISK WEIGHTS

**Pillar 1 Adjustments:** In its new capital regulation, the Central Bank proposes to reserve the right to adjust the risk weightings for any SFI, if it considers the standard calculation insufficient. The Central Bank will also have the right to direct a deduction from capital, as oppose to adjustments to risk weighted assets, for exposures that the Central Bank considers unduly risky for inclusion on a Bahamian bank's balance sheet.

## 7. CREDIT RISK MITIGATION

Banks use a number of techniques to mitigate the credit risks to which they are exposed. Additionally, banks may net loans owed to them against deposits from the same counterparty. The Central Bank proposes to maintain the simple approach to credit risk mitigation for banking book exposures, as outlined in the current *Capital Guidelines*, with minor modifications.

### 7.1. Allowable credit risk mitigation techniques

The following credit risk mitigants will be recognized for regulatory capital purposes: **collateral, guarantees** and **netting**. Exposures secured by credit derivatives will no longer be recognized by the Central Bank as a credit risk mitigant. In order for banks to obtain capital relief in respect of a credit risk mitigation technique used, the following minimum standards must apply:

#### 7.1.1. General requirements

- (a) No transaction where credit risk mitigation techniques are used should receive a higher capital requirement than the same transaction where such techniques are not used.
- (b) The effect of credit risk mitigation must not be double-counted. That is, no additional recognition of credit risk mitigation for regulatory capital purposes will be permitted for exposures where the risk weight applied already reflects that credit risk mitigation.
- (c) SFIs must employ procedures and processes satisfactory to the Central Bank to control residual risks (e.g. legal, operational, liquidity, market and other roll-off risks). Where these risks are not adequately controlled, the Central Bank may impose additional capital charges or take other Pillar 2 supervisory actions where appropriate.
- (d) For credit risk mitigation techniques to provide protection, the credit quality of the counterparty must not have a material positive correlation with the employed credit risk mitigation technique or with the resulting residual risk. For instance, debt securities issued by a counterparty provide little protection as collateral and are thus ineligible. The exception to this rule is that in some instances, a firm's own real estate may serve as collateral for credit risk mitigation.
- (e) Where the SFI has multiple credit risk mitigation techniques covering a single exposure (e.g. where the SFI has both collateral and a guarantee partially covering an exposure), the SFI must subdivide the exposure into portions covered by each type of credit risk mitigation (i.e. the portion covered by collateral and the portion covered by guarantee).

### 7.1.2. Legal requirements

In order for SFIs to obtain capital relief for any use of credit risk mitigation techniques, all documentation used in the collateralized transactions, on-balance sheet netting agreements or guarantees, must be binding on all parties and legally enforceable in all relevant jurisdictions.

## 7.2. Treatment of Collateral and Guarantees

Under the simple approach, the risk weight of the counterparty is replaced by the risk weight of the collateral instrument collateralizing or partially collateralizing the exposure. The Central Bank will only deploy the Basel Framework's Simple Approach, as this approach best fits the nature and complexity of SFIs in the Bahamian jurisdiction.

### 7.2.1. Eligible Collateral and Guarantees

The proposed requirements for eligible collateral are substantially unchanged. Collateral instruments eligible for recognition under the simple approach are:

- Cash;
- Gold;
- Rated Debt securities;
- Unrated Debt securities;
- Eligible Guarantors:
  - Government of The Bahamas, local governments in other countries; sovereign entities<sup>19</sup>, international banking agencies, central banks, public sector entities (PSEs) in the Bahamas and overseas, public bank and trust companies, credit unions, and other multilateral regional development banks (where these guarantors have a lower risk weight than the counterparty).
  - Other entities rated A- or better.
- Life Insurance contracts.

Claims secured or collateralized in other ways (e.g. by put options, forward obligations or other derivative contracts or agreements) will not be considered eligible collateral.

### 7.2.2. Treatment of Collateral

A collateralized transaction is one in which:

- banks have a credit exposure or potential credit exposure; and

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<sup>19</sup> These include the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community, as well as those MDB recognized by the Basel Committee.

- that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by a counterparty<sup>20</sup> or by a third party on behalf of the counterparty.

For collateral to be eligible collateral, it must be pledged for at least the life of the exposures, and it must be marked to market with a minimum frequency appropriate to the nature of the asset (for example, liquid treasury securities should be valued daily, while real estate exposures should be valued at least annually). The secured portion of claims collateralized by the market value of recognized collateral, receive the risk weight applicable to the collateral instrument. The risk weight on the collateralized portion will be subject to a floor of 20%. The uncollateralized or unsecured portion of a claim will be assigned to the risk weight appropriate to the original counterparty.

There will be no exceptions to the 20% risk-weight floor under the simple approach.

A capital charge will be applied to banks on either side of the collateralized transaction. For example, both repos and reverse repos will be subject to capital charges. Likewise, both sides of a securities lending and borrowing transaction will be subject to explicit capital charges.

Additionally, where the SFI, acting as an agent, arranges a repo-style transaction (i.e. repurchase/reverse repurchase and securities lending/borrowing transactions) between a customer and a third party and provides a guarantee to the customer that the third party will perform on its obligations, then the risk to the bank is the same as if the bank had entered into the transaction as a principal. In such circumstances, the SFI will be required to calculate capital requirements as if it were itself the principal.

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<sup>20</sup> In this section “counterparty” is used to denote a party to whom a bank has an on- or off-balance sheet credit exposure or a potential credit exposure. That exposure may, for example, take the form of a loan of cash or securities (where the counterparty would traditionally be called the borrower), of securities posted as collateral or of a commitment.

### **Proposal for consideration: Lombard Lending**

Lombard lending is a borrowing arrangement where a bank's client pledges an asset or portfolio of assets, such as securities, against credit granted by the bank. In the case of banks that engage in this practice, the rules set out in 'Treatment of Collateral' above still apply; as well as the types of collateral permitted by the Central Bank, as detailed under 'Eligible Collateral and Guarantees.'

In the Bahamian context, the Central Bank often receives requests for large exposure waivers associated with Lombard lending. As part of its Basel III reforms, the Central Bank is seeking feedback from interested stakeholders on the following issues.

- Is it feasible and advisable to adopt a Bahamian minimum standard for risk management of Lombard lending? Risks in this context include ensuring perfection of collateral, setting conservative advance ratios against various classes (and possibly debt ratings) of collateral, regular marking to market, and proactively realizing collateral should the security ratio drop below a trigger level.
- If we can develop such a Bahamian standard for safe Lombard lending, then what relaxations from the default prudential rules should the Central Bank contemplate for such lending? Two items seem particularly relevant. First, under a robust Lombard lending regime, it is likely that the Central Bank could become more comfortable with large exposures—but how should we translate “more comfortable” into sound regulations? Second, the risk weighting against a mixed collateral pool must be considered.
- For host-supervised institutions, there is also the consideration that large exposures to the parent banks (or large layoffs of risk) may emerge from Lombard lending.

In summary: the Central Bank would like to evolve a more standardised approach to Bahamian Lombard lending, and seeks stakeholder feedback on the best approach to achieve that result.

### **7.2.3. Treatment of Guarantees**

A substitution approach will be applied whereby only guarantees issued by or protection provided by entities with a lower risk weight than the counterparty will lead to reduced capital charges. The protected or secured portion of the counterparty exposure is assigned the risk weight of the guarantor or protection provider, whereas the uncovered portion retains the risk weight of the original counterparty.

### **7.2.4. Corporate and Retail SME exposures secured by real estate**

Unsecured corporate and retail SME exposures are proposed to be risk weighted at 100% and 75% respectively. Where these exposures are fully or partially secured by residential or commercial real estate, the Central Bank proposes to allow the lender to risk weight the exposure at 60%, for up to 60 per cent of the value of this real estate. This concession only applies when the exposure meets the conditions for real estate risk weighting, including a first lien on the properties in question.

## 8. NEW STANDARDISED APPROACH FOR OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Basel II framework offered four methods for calculating operational risk related capital charges.

Of the four methods permitted under the Basel II framework, the Central Bank allowed SFIs to choose one of the two simpler methods. Banks are expected to select the approach that is commensurate with their operational risk profile and risk management capacity:

- a) *The Basic Indicator Approach* – The default approach. Used by SFIs with a simple business model. Under this approach, banks use a single indicator, i.e. gross income, as a proxy for their overall operational risk exposure. Most Bahamian banks used this method.
- b) *The Standardized Approach* – Under this approach, SFIs are required to express their operational risk exposure across eight (8) business lines. Within each business line, gross income was again used as a proxy to indicate the scale of their business operations.

Under both methods, SFIs are not required to collect operational loss data, but are required to have effective risk management frameworks for operational risk.

### 8.1 Basel's (New) Standardised Approach for Operational Risk

As part of the Basel III reforms, the Basel Committee sought to simplify the framework by replacing the four approaches with a single Standardised Approach for operational risk. The Central Bank proposes to adopt this approach, deploying national discretion to generate the simplest possible Bahamian application.

The operational risk capital requirement under Basel's new method can be summarized as follows:

**Operational Risk Capital = Business Indicator Component (BIC) X Internal Loss Multiplier (ILM)**

$$\text{Operational risk capital} = \text{BIC} \times \text{ILM}$$

Where:

- The Business Indicator Component (BIC) =  $\sum (\alpha_i \cdot BI_i)$
- The Business Indicator (BI) is the sum of *three* components: (1) the interest, leases and dividends component; (2) the services component; and (3) the financial component (the average over three years)
- The ILM (Internal Loss Multiplier) is a function of the BIC and the Loss Component (LC), where the latter is equal to 15 times a bank's average historical losses over the prior 10 years. The ILM increases as the ratio of LC/BIC increases. Under national discretion, the ILM can be set to 1, and essentially removed from the calculation. The Central Bank proposes to deploy this national discretion.
- $\alpha_i$  is a set of marginal coefficients that are multiplied by the BI based on three buckets ( $i = 1, 2, 3$  denotes the bucket), as given below:

**Table 15**

<b>BI Bucket</b>	<b>BI range<sup>21</sup></b>	<b>Marginal BI Coefficients (<math>\alpha_i</math>)</b>
1	$\leq \text{€1 bn}$	0.12
2	$\text{€1 bn} < \text{BI} \leq \text{€30 bn}$	0.15
3	$>\text{€30 bn}$	0.18

For example:

Where a SFI has a Basic Indicator (BI) of €4 billion, the BIC would be calculated as:

- BI Bucket 1: 12% x €1 billion; plus
- BI Bucket 2: 15% (€4b – €1b) = €0.57 billion = BIC

*Operational risk Capital Charge* = €0.57 billion (BIC) x ILM

*Operational Risk Equivalent Assets* = €0.57 billion x 12.5 = €19.63 billion

## **8.2 The Central Bank’s proposed approach to operational risk capital**

International regulatory experience over many years has demonstrated that the current state of the art for determining operational risk capital is less satisfactory than the calculations associated with other elements of the capital framework. Given the absence of a fully satisfactory calculation method, the Central Bank proposes to implement the simplest and cheapest operational risk capital calculation that will comply with the Basel framework.

The Central Bank proposes to adopt the new Standardized Approach for calculating operational risk. Under the new approach, SFIs’ operational risk capital requirement will be based solely on the measure of the bank’s income or business indicator (BI) component (using financial statement-based data as a proxy). For simplicity, the Central Bank proposes to apply the marginal BI coefficient of 0.12 to all SFIs, for the purpose of calculating the operational capital charge. Exercising national discretion, the Central Bank also proposes to exclude a bank’s internal loss history from the calculation method.

An example of how the operational risk capital charge (ORC) is expected to be calculated, is outlined below:

### **Operational Risk Capital Charge = SFI’s Total Gross Income x 12%**

For the purposes of the above calculation, the SFI’s gross income is calculated on the same basis as for the SFI’s financial accounts. The Central Bank will reserve the right to apply a different calculation for SFIs with unusual or negative gross income profiles.

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<sup>21</sup> Although the Basel III framework stipulates the BI bucket ranges in Euros, these would be converted to US Dollars for the purposes of calculating the operational risk capital charge.

The Central Bank proposes that all SFIs subject to the new capital regime will be required to disclose to the Central Bank any operational risk loss event that exceeds \$100,000. This would be a non-public disclosure.

## 9. MINIMUM CAPITAL REQUIREMENTS FOR MARKET RISK

There remains one element of the Basel Committee's post-crisis reforms that has yet to be finished. That element is the market risk framework. This section is only applicable to SFIs that have significant trading book activities.

In 2012, the Basel Committee undertook a fundamental review of the trading book and the market risk framework, to address weaknesses in risk measurement under both the internal models-based and standardised approaches. The Basel Committee issued a consultation paper in March 2018 proposing additional changes to the revised framework.

In The Bahamas, the current approach for calculating capital requirements for market risk is largely based on the *1996 Market Risk Amendment*<sup>22</sup>. Although the Central Bank employs the Standardised Approach, it has also agreed to allow SFIs to utilize their internal models approach when reporting to their Head Office.

### 9.1. Central Bank Proposal

Historically, there is limited trading book activity across the Bahamian banking system. This finding was also observed in our quantitative impact study (QIS) in 2016 to assess the overall capital impact of the Basel II/III framework. This means that banks' general and specific market risk exposures are largely reflected in their banking books, save for those SFIs whose trading book exposures meet a minimum threshold.

In our 2016 study, only five banks reported trading book exposures meeting the *de minimis* threshold. Given the negligible level of trading book activity within the Bahamian banking system, and the Basel Committee's ongoing work, the Central Bank has determined that for the time being, the current Standardised Approach for market risk will be maintained.

### 9.2. Calculation for the Capital Charge for Market Risk

Accordingly, SFIs that have a trading book that meets the *de minimis* threshold will be subject to a market risk capital charge. The threshold is defined as:

- i The SFI's market risk positions are greater than 5% of the total on and off balance sheet assets; or
- ii The SFI's market risk position is greater than US\$100 million; or
- iii In the case of SFIs that are jointly regulated by the Central Bank and the Securities Commission of The Bahamas, the SFI's market risk positions exceed US\$25 million.

SFIs with market risk positions that do not meet any *de minimis* threshold (i – iii. above) will continue to be exempt from complying with the market risk capital requirements.

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<sup>22</sup> Basel Committee's 1996 Amendment to the Capital Accord to incorporate market risks [and Revisions to the Basel II market risk framework \(July 2009\)](#).

## 10. LEVERAGE RATIO REQUIREMENT

In accordance with the Basel III capital reforms, the Central Bank proposes to include a Leverage Ratio to supplement SFI's risk-based capital adequacy requirements.

The definition of the leverage ratio will be determined as CET1 capital (the numerator) divided by the Exposure Measure (the denominator) expressed as a percentage.

$$\text{Leverage Ratio} = \frac{\text{Common Equity Tier 1 (CET1)}}{\text{Exposure Measure}}$$

Under the Basel III framework the minimum leverage ratio requirement is 3%, with a capital buffer where applicable.

Prior to 2005, the Bahamian capital requirements included a Gearing ratio. The gearing ratio minimum was 5% Eligible Capital to Total Assets.

The Central Bank now proposes a 4% minimum leverage ratio, expressed as the ratio of CET1 capital to total exposures, as defined below. The leverage requirement reinforces the risk-based requirements with a simple, non-risk based measure. The Central Bank proposes to apply the leverage ratio as a minimum requirement for all SFIs, excluding branches of foreign banks and trust companies.

Reflecting their systemic importance, the Central Bank proposes to set a 6% leverage ratio requirement for commercial banks.

### 10.1. Capital Measure

The Basel III framework defines the numerator for the leverage ratio as Tier 1 Capital. As discussed in Section 3 of this paper, the Central Bank is proposing a regulatory capital regime based solely on CET1 equity. Accordingly, the Bahamian leverage ratio numerator will be CET1.

### 10.2. Exposure Measure

The exposure measure for the leverage ratio will where feasible follow financial accounting values. The use of accounting-based measures rather than risk-based measures is intended to reduce the complexity and regulatory burden for SFIs. The exposure measure will be the sum of the following:

- (a) On-balance sheet exposures
  - a. Liability items must not be deducted from the leverage ratio exposure measure.
  - b. Items deducted from CET1 Capital and regulatory adjustments (other than those related to liabilities) may be deducted from the exposure measure.
  
- (b) Off-balance sheet items

- a. These items will include commitments (whether or not unconditionally cancellable), direct credit substitutes, acceptances and letters of credit. These items will be converted into the credit exposure equivalent by applying Credit Conversion Factors (CCFs) to the commitment amounts, identical to the treatment of off-balance sheet exposures in the risk-based capital framework.

For simplicity, the Central Bank proposes to include *derivatives* and *securities financing transactions* in the exposure measure as part of total assets.

An example of how the leverage ratio is expected to be calculated, is outlined below:

$$\text{Exposure} = A + B$$

- A. **Total assets** calculated in accordance with International Financial Reporting Standards (including derivatives and securities financing transactions)

**Less:**

- Items deducted from CET1 Capital;
- Specific and general provisions; and
- All other regulatory adjustments deducted from the calculation of CET1 Capital

**Plus:**

- B. **Off-Balance Sheet Assets** (as calculated under the standardised approach for credit risk)

### 10.3. Bahamian Leverage Ratio Impact

Preliminary analysis suggests that the proposed leverage requirement will bind few if any Bahamian SFIs. This is a backstop for future SFI business models, which may generate much lower than typical risk weightings across the SFI's balance sheet.

### 10.4. Buffers and Pillar 2

The Central Bank does not propose to include any buffers in the leverage ratio requirement, but does propose to include a flexible Pillar 2 power to increase the leverage ratio requirement for individual SFIs, all SFIs, or any class of SFIs.

The Central Bank intends to deploy this Pillar 2 power to set a 6 per cent minimum leverage ratio requirement for domestic banks. Based upon information to hand, this requirement will not bind upon any domestic bank, relative to the proposed risk-based capital requirements.

## **10.5. Disclosure and Reporting**

SFIs will be required to satisfy the leverage ratio requirement at all times. Banks will be required to report their leverage ratios to the Central Bank on a quarterly basis. Additionally, the Central Bank may require the calculation of any SFI's leverage ratio at any time, for any business day.

Leverage ratio disclosure will be included in the planned approach to Pillar 3 reporting.

## **11. D-SIB APPROACH**

In October 2012, the Basel Committee finalized "*A Framework for dealing with domestic systemically important banks*" outlining a principles-based minimum framework to identify D-SIBs and the higher loss absorbency (HLA) capital requirements for banks that have been identified as D-SIBs. As with many other aspects of the Basel framework, the international arrangements for D-SIBs are more complex than what is required in The Bahamas.

Under the D-SIB framework, national authorities are to develop a methodology for assessing the degree to which banks are systemically important in a domestic context. Appropriate national discretion is allowed to accommodate structural characteristics of the domestic financial system, recognising that a local authority is best placed to evaluate the impact of failure on its financial system and economy.

Generally, systemically important banks are those whose failure would have significant negative consequences on a given financial system. The Central Bank emphasises that the designation of a bank as a D-SIB does not make it invulnerable. The designation is intended to ensure that banks perceived to be 'too-big-to-fail' are subject to more intense supervisory oversight and have greater capacity to absorb losses.

### **11.1 D-SIBS IN THE BAHAMAS**

The Bahamian banking sector is home to financial institutions including domestic banks, international banks, credit unions, and other entities. International banks operating in the sector are not D-SIBs, because they make few if any loans and take few if any deposits within the Bahamian economy. The Central Bank considers that smaller domestic deposit taking institutions such as credit unions are an important part of the financial landscape, but they are not D-SIBs.

The Central Bank is separately publishing a paper outlining its D-SIB analysis. This paper concludes that the best approach is to deem all the domestic banks, but no other SFIs, as D-SIBs.

The capital impact of this determination is already captured in the proposed buffer regime discussed earlier in this paper. Supervisory aspects are already captured by the relatively greater attention paid to the domestic banks. The Central Bank does not propose to add any other elements of the international D-SIB regime to local arrangements.

## 12. TRANSITIONAL ARRANGEMENTS

The international implementation date for most Basel III reforms is 1 January 2022.

The Central Bank is proposing an appreciably simpler approach from that taken by Basel Committee member countries. Our analysis suggests that all or nearly all Bahamian banks already possess sufficient capital to meet their obligations under the reformed capital regime. These facts suggest that the only need for transition time will relate to the need to update prudential and other reporting systems.

The Central Bank anticipates that it will issue its final regulation on Basel III capital reforms in early 2019.

The Bank anticipates an implementation date of **1 January 2020**. As with all other elements of this paper, the Bank invites comments on the proposed implementation timeline.

End of Document