

CAYMAN ISLANDS MONETARY AUTHORITY

PRIVATE SECTOR CONSULTATION



RULE AND STATEMENT OF GUIDANCE ON MANAGEMENT OF CREDIT RISK AND PROBLEM ASSETS

A. INTRODUCTION

1. Section 34(1)(a) of the Monetary Authority Law (2013 Revision) (as amended) ("MAL") states that –

After private sector consultation and consultation with the Financial Secretary, the Authority may –

- (a) *issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;*
2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

When this Law requires private sector consultation in relation to a proposed measure –

- (a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*
 - i. an explanation of the purpose of the proposed measure;*
 - ii. an explanation of the Authority's reasons for believing that the proposed measure is compatible with the Authority's functions and duties under section 6;*
 - iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
 - iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
 - v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3));and*
- (b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.*

3. This paper proposes amended measures to provide transparency, certainty and enhanced guidance to banks, credit unions, building societies and development banks, collectively referred to as credit risk holders.
4. The Cayman Islands Monetary Authority ("Authority" or "CIMA") seeks consultation and comment from the private sector associations concerning the following:
 - a. Draft Rule on Credit Risk and Problem Asset Management; and
 - b. Replacement of the below listed existing Statements of Guidance ("SOGs") with Draft SOG on Credit Risk Classification, Provisioning and Management:
 - i. Statement of Guidance on "Credit Risk Management";
 - ii. Statement of Guidance on "Credit Risk Asset Classification";
 - iii. Statement of Guidance on "Loan Loss Provision".

The proposed Rule and Statement of Guidance are attached.

B. BACKGROUND

5. Between 2005 and 2006 the Authority issued SOGs in relation to the governance of credit risk. Since the issuance of these SOGs there have been various developments to local conditions and the regulatory landscape. The Basel Core Principles for Effective Banking Supervision (BCP) have been amended. Therefore, there is a need to address the regulatory changes.
6. Currently there are three SOGs to guide credit risk with applicability only to banks. It is proposed that all three SOGs be consolidated into a single measure and the scope expanded to include banks, credit unions, building societies, and development banks.

C. PURPOSE OF PROPOSED RULE AND REPLACEMENT OF EXISTING SOGS WITH PROPOSED AMALGAMATED SOG

7. The purpose for the amalgamation of the SOGs is to conform with changes to the relevant regulatory requirements and to modify industry practices. The proposed SOG aims to provide more clarity, certainty and uniformity to the treatment of credit risk and problem assets in the jurisdiction. It also outlines what the Authority expects when dealing with asset classification and provisioning.
8. The proposed Rule is designed to streamline the management of credit risk and problem assets. The proposed Rule requires the credit risk holders to adversely classify assets when contractually in arrears and to document the rationale of provisioning as part of a sound credit risk and problem asset management framework.
9. The proposed Rule is designed to better align the jurisdiction's practices with BCP 18, which governs problem assets, provisions and reserves. Supervisors are required to determine that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of

adequate provisions and reserves. The Authority concluded that its adherence to this core principle was materially non-compliant.

10. Additionally the proposed Rule aims to control the acquisition or allocation of adversely classified assets.
11. Both of the above proposals are aimed to satisfy the Authority's regulatory functions as stipulated in section 6 (3) (a) and (c) of the Monetary authority Law.
12. Section 6(3) the MAL states that

In performing its regulatory functions and its co-operative functions, the Authority shall, in addition to complying with the requirements of subsection (2):

- (a) *endeavour to promote and enhance market confidence, consumer protection and the reputation of the Islands as a financial centre;*
- (c) *recognize the principle that a burden or restriction which is imposed on a person or activity should be proportionate to the benefits, considered in general terms...*

D. IMPLEMENTATION IN OTHER JURISDICTIONS

13. Table 1 shows whether the elements of the proposed Rule are implemented in other jurisdictions. All elements are present except for the prohibition or allocation of adversely classified assets because this element is uniquely designed to address certain issues relevant to the Cayman Islands.

Table 1: Comparison of Elements of Proposed Rules by Jurisdiction

	USA	UK	Jamaica	Bahamas
Credit Risk Environment (board approval)	✓	✓	✓	✓
Sound credit granting process	✓	✓	✓	✓
Measure, Monitor and Control of Credit Risk	✓	✓	✓	✓
Credit Risk Asset Classification System	✓	✓	✓	✓
Identifying and Managing Problem Assets	✓	✓	✓	✓
Determining Provisions	✓	✓	✓	✓
Use of Risk Mitigants	✓	✓	✓	✓
Disclosure to Board	✓	✓		✓
Prohibition on Purchase or allocation of adversely classified assets				
Refinancing and	✓	✓	✓	✓

Rescheduling				
Reclassification	✓	✓	✓	✓
Write -offs	✓	✓	✓	✓

E. SIGNIFICANT COSTS AND BENEFITS

14. Table below shows the costs and benefits of the proposed Rule and Regulatory Policy.

Person	Costs	Benefits
CIMA	<ul style="list-style-type: none"> • Gazette and publication of new measures • Amend supervisory manuals • Training of Banking Supervision staff 	<ul style="list-style-type: none"> • Uniformed credit risk and problem asset framework. • Alignment with Basel Core Principles • Fewer problems
Cayman Islands	<ul style="list-style-type: none"> • Contraction of industry may occur with less opportunities for arbitrage 	<ul style="list-style-type: none"> • Financial stability • Uniform measurement of credit risk • Early detection of problem assets • Enhanced reputation of jurisdiction
Credit Risk Holders	<ul style="list-style-type: none"> • Credit Risk holders may have to hold higher provision for poorer quality assets. • Cost of implementing and amending current practices and policies 	<ul style="list-style-type: none"> • Clarity and certainty on the regulatory expectations • Enhanced guidance on the requirements for credit risk and problem assets • Slighter possibility of adverse findings of qualified opinion for establishing extra provisions • Better risk management practices

F. COMMENTS AND CONSULTATION

15. The Authority seeks consultation through written comments and representations from the private sector associations concerning

- Draft Rule Management of Credit Risk and Problem Assets; and
- Draft SOG on Credit Risk Classification, Provisioning and Management

16. The Authority must receive representations by **17H00hrs on December 19, 2014.**

17. Comments and representations must be addressed to

The Managing Director
Cayman Islands Monetary Authority
P.O. Box 10052
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Elizabethan Square
Grand Cayman KY1-1001
Cayman Islands
Tel: 345-949-7089
Fax: 345-946-5611
Email:
Consultation@cimoney.com.ky
and copied to j.myles@cimoney.com.ky

18. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.