

Cayman Islands Monetary Authority

SUMMARY OF PRIVATE SECTOR CONSULTATION AND FEEDBACK STATEMENT



BASEL III – LEVERAGE RATIO

Section of proposed Measures	Industry Comment	Authority’s response	Consequent amendments to the draft Requirements
General Comments	The document could do with an abbreviation section up front or as an Appendix.	Recommendation accepted.	A list of acronyms is included in the measure on page 3.
	What are the consequences for a breach? Assuming that this will include mandatory actions to permanently remedy situation from the Authority but it probably needs to be stated if there will be any punitive action such as a fine. If there are to be fines where would these sit in the Fines Regime?	<p>The breach of the leverage ratio requirements constitutes a breach of the capital requirements under section 10 of the Banks and Trust Companies Law (2018 Revision) (BTCL). A breach of section 10 enables the Authority to take such actions against a regulated entity that it is empowered to as stipulated in section 18 of the BTCL.</p> <p>Once the Rules and Guidelines are in a final form, the Authority may discuss any appropriate amendments to the Administrative Fines Regulations with the Ministry of Financial Services and Home Affairs.</p>	<p>The following has been included in the Introduction section of the measure:</p> <p><i>These Rules and Guidelines are being issued in line with Section 10(1) of the Banks and Trust Companies Law which states:</i></p> <p><i>“A licensee holding a licence for the carrying on of banking business and incorporated under the Companies Law (2018 Revision) shall not, at any time, have a capital adequacy ratio of less than ten per cent (or such other percentage as may be determined by the Authority from</i></p>

			<i>time to time) as calculated in accordance with such form, content and manner as may be prescribed."</i>
Section 3.2	Can the Authority indicate how much discretion it is going to potentially exercise (as a rough indication)? e.g 1%, 2%, 3%? Presumably, this would have to be accompanied with some justification? If there are any uplifts in the leverage ratio for any institution will this also affect Pillar 2 calculation and be included there as an add-on?	The Authority's discretion will be exercised on a case-by case basis, the scope of which will depend on the specific circumstances under consideration.	No amendments required.
Section 5	Overall the rate of section 5 seems fine. It is the lowest that can be applied and most of the institutions here should be well above the 3% minimum. The likes of Bermuda, Jersey and Singapore have opted for higher rates but 3% gives us enough wiggle room in recessionary scenarios.	Not applicable.	No amendments required.
Section 5.1. (d)	Does 'off-balance sheet items' include assets under management?	<p>Banks should be guided by the clarification of the term "off-balance sheet item" which is provided on page 12 of the measure. Additionally, the term is defined on pages 99 and 100 of the <i>Guidance Notes for the Completion of the Basel II Forms and the Quarterly Prudential Returns</i> issued in December, 2010 as follows:</p> <p><i>1. Potential claims that would arise from the drawing down in full of undrawn advised facilities, whether revocable or irrevocable, conditional or unconditional, which the Bank has committed itself to provide, and claims that the Bank has committed itself to purchase or underwrite, including:</i></p> <ul style="list-style-type: none"> • <i>sale and repurchase agreements;</i> • <i>forward asset purchase agreements;</i> • <i>buy back agreements;</i> • <i>forward deposits placed (i.e. where a bank contracts to make a deposit with another party at a future date at a pre-determined rate); and</i> • <i>the unpaid part of partly-paid shares;</i> 	No amendments required.

		<p>2. <i>Contingent liabilities arising in the normal course of business, and those contingent liabilities that would arise from the drawing down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) that the Bank has committed itself to provide. These include:</i></p> <ul style="list-style-type: none"> • <i>direct credit substitutes (including guarantees, standby letters of credit serving as financial guarantees, bills accepted but not held by the Bank, „per aval“ and equivalent endorsements);</i> • <i>claims sold with recourse, where the credit remains with the Bank;</i> • <i>transaction-related contingent items not having the character of direct credit substitutes (including tender and performance bonds, bid bonds, warranties, standby letters of credit relating to particular transactions, retention money guarantees;</i> • <i>undrawn documentary letters of credit issued or confirmed; and</i> • <i>those arising from similar transactions entered into by the Bank;</i> <p>3. <i>Assets, and assets which the Bank has committed itself to purchase or underwrite, the value of which depends wholly or mainly on a counterparty performing its obligations, or the value of which otherwise depends on that counterparty’s financial soundness but which does not represent a claim on the counterparty.</i></p>	
Section 6.	There is no real issue with settlement date being preferred in favour of trade date accounting but this will affect some institutions. E.g. for those that account on a trade date it mandates a settlement date adjustment be undertaken before arriving at a final number for on balance sheet exposures.	Comment noted. It is necessary to ensure that the results are standardised for submission to the Authority.	No amendments required.
Annex	A reference to the document from which the Minimum Capital Requirements would be useful.	The Authority’s <i>Rules, Conditions and Guidelines on Minimum Capital Requirements (Pillar I)</i> are referenced in the introduction to the measure and for purposes of clarity will be	Line 1 of the Annex (Page 13) was amended to read as follows:

		included in the Annex to the document.	"This Annex includes the relevant provisions from the <i>Rules, Conditions and Guidelines on Minimum Capital Requirements (Pillar I)</i> (Minimum Capital Requirements) applicable..."
Paragraph 9	What determines "high quality" capital? I presume this is just Tier 1 capital? Should this be defined?	The capital measure for the leverage ratio is the Tier 1 capital of the risk-based capital framework. The term "high quality capital" is not used in the Rules and Guidelines.	No amendments required.
	Off balance sheet exposures – need to detail what this will include – will guarantees/collateral be taken into account? Will this follow the Basel III guidelines or will there be a specific approach? Basel III allows is not definitive on the approach to be taken and either can be done.	This Leverage document should be read in conjunction with the <i>Rules, Conditions and Guidelines on Minimum Capital Requirements (Pillar I)</i> , and the <i>Guidance Notes for the Completion of the Basel II Forms and the Quarterly Prudential Returns</i> . Section 5.35 of the measure states: "OBS items are converted under the standardised approach for credit risk into credit exposure equivalents through the use of credit conversion factors ("CCFs")."	No amendments required.
	Will the credit conversion factor be applied to these Off Balance sheet items? Or will this be excluded as described in Para. 13.	Section 5.35 of the measure states: "OBS items are converted under the standardised approach for credit risk into credit exposure equivalents through the use of credit conversion factors ("CCFs")." Additionally, Section IV of the Annex to the measure provides detailed guidance on the application of the CCFs.	No amendments required.
	Will the specific general provision be excluded from ratio?	The measure provides guidance on the treatment of specific and general provisions in sections 5.5 and 5.37 which are presented below: "On-balance sheet, non-derivative assets are included in the leverage ratio exposure measure at their accounting values less deductions for associated specific provisions. In addition, general provisions or general loan loss reserves, as defined in paragraph 12 of the <i>Statement of Guidance on Credit Risk Classification, Provisioning and Management</i> , which have reduced Tier 1 capital, may be deducted from the leverage ratio exposure measure."	No amendments required.

		"In addition, specific and general provisions set aside against OBS exposures that have decreased Tier 1 capital may be deducted from the credit exposure equivalent amount of those exposures (i.e. the exposure amount after the application of the relevant CCF). However, the resulting total off-balance sheet equivalent amount for OBS exposures cannot be less than zero."	
	What will the impact on cash pooling be? Need to determine a detailed approach	The measure presents detailed guidance on the treatment of cash pooling arrangements in section 5.7. ¹	No amendments required.
	Need to detail the requirements for a capital add on.	The add-on factors are presented in the Authority's <i>Rule and Guidelines on the Pillar 1 – Minimum Capital Requirements</i> and these remain applicable to this measure.	No amendments required.
Paragraph 13	What are the differences in the Cayman Islands regulatory framework? How will it deviate from the standard approach? What is the impact of this of not implementing the updated Standardized Approach for Counterparty Credit Risk? Will a credit conversion factor still be applied?	The capital framework for the banking sector in the Cayman Islands is currently based on the standardised approach of the Basel II framework. This framework presents guidance for banks in converting OBS items into credit exposures equivalents through the use of credit conversion factors. The capital framework is presented in the Authority's <i>Rules, Conditions and Guidelines on Minimum Capital Requirements (Pillar I)</i> . Additionally, Section IV of the Annex to the referenced measure provides detailed guidance on the application of the CCFs.	No amendments required.
	What determines the case by case basis?	The Authority's discretion will be exercised on a case-by case basis, the scope of which will depend on the specific circumstances under consideration.	No amendments required.
Paragraph 14	When is the expected implementation date?	The implementation date of the referenced measure will be revised from the previously proposed 1 July, 2019 to 1 December, 2019.	No amendments required.
	Will the minimum requirement of 3% be on all banks or will there a segmented approach as was done in Australia?	The minimum ratio of 3% is applicable to all banks, except in specific cases where the Authority, in its sole discretion, decides that different leverage ratio requirements should be set.	No amendments required.
BCP 16 – Capital	Need to detail the calculation is on a gross exposure not a net exposure	Section 5.2 of the measure states:	No amendments required.

¹ The Basel Committee on Banking Supervision has published some clarification on this and other issues in the document – *Frequently asked questions on the Basel III Leverage ratio framework* <https://www.bis.org/bcbs/publ/d364.pdf>

Adequacy		<i>"The exposure measure for the leverage ratio generally follows gross accounting values."</i>	
	Will the specific provision be deducted from Capital requirements? Need to detail the impact IFRS 9 may have.	The measure provides guidance on the treatment of specific and general provisions in sections 5.5 and 5.37. All data should be provided based on accounting standards as applicable at the reporting date.	No amendments required.
	Need to detail the effective notional amount measurement and how this will be incorporated into the calculation of the Tier 1 capital with respect to the credit derivatives as per the Basel III guidance.	Sections 5.18 to 5.23 of the measure provide detailed guidance on obtaining the effective notional amount and the related capital calculations.	No amendments required.