CENTRAL BANK OF TRINIDAD & TOBAGO

Financial Institutions Supervision Department
Comments on the draft Financial Institutions (Capital Adequacy) Regulations, 2018
September 2018

Specific Proposal/Regulation	Comment/Question	CBTT Response
Risk Weighting of On-Balance Sheet Exposures	Section 3.2, paragraphs 25, 31, 33, 36 and 37 indicate that a risk weight of 150% be applied to exposure with a Credit rating below B- while 'Unrated' exposure carries a more favorable risk weight of 100%. The application of a 150% risk weight will penalize the bank to an amount in excess of the exposure, while a 100% risk weight for unrated exposure further contradicts the proper application of credit risk to an exposure. We therefore recommend that this policy be reviewed.	The risk weights are preset by the Basel Committee for Banking Supervision (BCBS) under the Basel II Standardized Approach for Credit Risk. National supervisors may introduce measures which are more conservative to those introduced by the BCBS. However, the BCBS establishes minimum standards.
Minimum Common Equity Ratio	Section 6.3 provides the calculation for the Minimum Common Equity Tier 1 Ratio but does not define "Common Equity". In the absence of a definition for "Common Equity" our independent research indicates that this represents "Share Capital + Retained Earnings". To ensure consistency in interpretation across institutions, we recommend that the definition of "Common Equity" be included within the policy document.	Common Equity is defined at regulation 10 (2) of the draft Financial Institutions (Capital Adequacy) Regulations, 2018.

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Claims on Corporates	Section 3.2, paragraph 44 states that a risk weight of 100% can be applied to exposure to corporate customers without regard to external ratings, but this must be done consistently, whether ratings are available or not. This measure does not allow for the relief of a reduced risk weight for customers that have a credit rating. We recommend that an interim period be given to allow corporate customers to attain a Credit Rating. In the meantime, banks should be allowed to use the respective weights for those customers that are rated and the 100% weighting for those that are unrated. When a customer attains a rating, the risk weight can then be updated accordingly.	There are two options available. The default option is the application of risk weights based on credit ratings as per the risk weight table on page 18. In accordance with this table, unrated corporate are to be risk weighted at 100%. The blanket application of the 100% risk weight for all corporate claims, subject to the approval of the Central Bank, is optional. Where this is adopted however, institutions must apply the 100% risk weight uniformly whether or not ratings are available.
Claims secured by residential property	Section 3.2 paragraph 50(c) indicates that one of the criteria to secure a 35% risk weight for claims secured by residential property is the maintenance of a loan to value (LTV) ratio of 80% on an individual basis. This requirement seems onerous as it does not give allowance for the fact that the LTV ratio will change over the life of loan as the loan balance will decline while the property value will tend to increase. As a result, in the first five years of the life of a loan, the LTV will exceed 80%, but then gradually decline as the loan ages.	In keeping with the directions under the Basel II framework the Central Bank incorporated the LTV recommendation as part of its strict prudential criteria for the application of the preferential risk weight. The requirement seeks to ensure that the preferential risk weight applies to exposures for which the licensee holds a substantial margin of additional security over the amount of the loan based on strict valuation rules. This is an incentive for financial institutions to improve their risk management processes if seeking to obtain capital benefits from application of a lower capital charge.

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	Schedule 2 paragraph 12 (3)-Where a residential mortgage loan secured by the residential property satisfies paragraph 12(1)(a) and 12(1)(b) but the financial organization holds no loan to value information for its individual exposures, a 50 per cent risk weight shall be applied to the entire portfolio of exposures. Please clarify whether the 50 per cent risk weight applies to the entire portfolio when any one or more residential mortgage does not have loan to value information (but satisfies 12(1) (a) and 12(1) (b).	To qualify for the 35% risk weight the company must have LTV's for each individual residential mortgage exposure. Where the company does not have LTVs for all residential mortgage exposure, the institution will be required to apply the 50% to the entire portfolio (provided that these exposures are not past due more than 90 days and the property is either occupied by the borrower or rented). The 50% is applied notwithstanding that some of the exposures in the portfolio may have satisfied the criteria for the 35% risk weight. Past due residential real estate is to be risk weighted at 100%, whether or not the LTV is less than 80%.
	Schedule 2 paragraph. 12 (6)-For the purposes of this paragraph, a financial organization in determining the loan to value ratio shall - *(a) have in place a sound valuation methodology to apprise and monitor the valuation of the property;* *(b) monitor the value of the property on a request basis and at a minimum annually for residential real estate;* This is not commercially practical or feasible on an individual property basis.	It is expected that licensees monitor the LTVs associated with residential property. This, however, does not generally require external valuations except where the asset is impaired. Licensees are expected, at a minimum, to implement an appropriate internal system of review which may, for example, include reviews of property prices by property type and geographic location.

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	We note that the requirement for valuation of residential real estate requires clarification and lacks sufficient granularity. The policy document indicates valuations be done every 3 years whilst the draft regulations indicates valuations be done annually.	The Central Bank will amend the draft regulations consistent with the policy document to require valuations of residential property at a minimum every three (3) years.
Collateral-The Simple Approach	Section 3.4, paragraph 78, states that the eligible collateral should be revalued every six months. This seems onerous and impractical, especially in the local environment. Our recommendation is a period of every three years which seems more practical.	Financial collateral is subject to the vagaries of market conditions and regular revaluation is therefore important. Further, the revaluation of collateral every six (6) months is a requirement under the Basel II framework. It should be noted that only financial collateral, as directed on page 30-31 of the PPD, is eligible for the purposes of capital relief.
Short Term Claims on Banks	*Schedule 2 paragraph 8 (2)-Claims with a maturity of three months or less: "A claim will be treated as a short-term claim where it has an original maturity of three (3) months or less* Does maturity here refer to original maturity or time left to maturity (TTM)? How should an asset with an original maturity of more than three months but a TTM less than or equal to three months be assessed; Long-Term or Short Term? Which credit assessment is applicable?	An asset may be classified as short term only where its **original** maturity is less than three months. Any other asset, including assets with a TTM of less than three (3) months should be classified as Long Term and risk weighted in accordance with the directions under "***Claims with a maturity of more than three months***". Exposures which are expected to be rolled over, or are restructured in any way, resulting in an effective maturity of longer than three (3) months, are not to be risk weighted as a short term claim.

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	Schedule 2 paragraph 8 (4)-Short term claims on banks which are rolled over or are restructured in any way, resulting in an effective maturity of longer than 3 months, shall not be risk weighted as a short term claim. Please clarify the basis on which a claim with an original term to maturity of less than 3 months will be determined to not be a short term claim if "rolled over" for a subsequent period 3 months and under.	The draft regulations will be amended to state: *Short term claims on banks which are 1) expected to be rolled over or 2) restructured in any way, resulting in an effective maturity of longer than 3 months shall not to be risk weighted as a short term claim.*
Claims on PSEs	Please clarify whether the definition of public sector entity includes state-owned or majority-controlled banks e.g. First Citizens	The definition of "Public Sector Entity" includes state owned/majority owned other financial institutions.
Claims on Multilateral Development Banks	*"multilateral development bank" means **means** a supranational institution chartered by two or more countries for the purpose of providing financial support and professional advice for economic and social development activities in developing countries;* Remove the duplication of the word "means"	The Regulations will be amended.

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Claims in the Regulatory Retail Portfolio	The criteria for a claim to be considered "retail" should be a function of its characteristics and not its size per se. In that regard, the criteria is well captured in 2 (a) and 2 (b) (i) – (iii). An aggregate exposure limit of 0.2% of the overall regulatory retail portfolio as cited in 2(c) appears restrictive, especially if related counterparts are considered. For example, a person can have a high value car loan, high value residential mortgage, a high value credit card, etc. If their spouse or other family member also has a high value car loan and a high value credit card, the aggregate exposure can easily accumulate. In any event, 2(c) appears to be inconsistent with 2(d). It should be either one or the other, not both.	The criteria for inclusion in the "Regulatory Retail" portfolio are part of a Standardized Methodology which the Central Bank has adopted. The preferential risk weight of 75% is applied in view of the lower risk profile of the borrower that satisfies all of the criteria set out. Criterion (d) is the absolute threshold for exposures to be included in this portfolio notwithstanding that for the purposes of establishing granularity the 0.2% threshold is considered.
Operational Risk	*Schedule 3 paragraph 4 (6)- Financial organizations shall have techniques for creating incentives to relevant employees to improve the management of operational risk.* Such incentives are particularly challenging to create and appear onerous to put into legislation.	This regulation will be deleted.

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	Schedule 3 paragraph 4 (11)-The operational risk management processes and assessment system of the financial organization shall be subject to annual validation and independent review by, at a minimum, the internal audit function of the financial organization and the review shall include both the activities of the business units and of the operational risk management function. It is unlikely that an annual review by the internal audit function of the operational risk management function would be worthwhile. A triennial review may be more practical and value-added.	The Regulations will be amended to include triennial review of the operational risk management function.
Market Risk	*Schedule 4 paragraph 1-"ought call option" means a long position;* Misspelling. Replace with "bought call option"	The Regulations will be amended.
	Schedule 4 paragraph 10-The specific risk charge shall be calculated by multiplying the absolute values of the debt position by their respective risk weight as follows (i.e. new specific interest rate risk charge table) The new risk weights add unnecessary complexity to the market risk capital calculation process in a domestic capital market that is relatively unsophisticated.	The change to the calculation to capital charges for specific interest rate risk is intended to ensure consistency in the treatment of exposures under the credit and market risk frameworks.

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	Schedule 4 paragraph 14-"The capital requirements for general risk shall be the sum of – *(a) the net short or long position of the relevant securities;* *(b) a small proportion of the matched positions in each time-band in paragraph 15;* *(c) a larger proportion of the matched positions across different time-bands in paragraph 15; and* *(d) a net charge for positions in options.* "small proportion" and "larger proportion" needs to be defined.	The words "small" and "larger" will be removed as these are not fixed calculations. There is no specific quantum that can be used to define them.
	*Schedule 4 paragraph 15-"*The following time bands and assumed charges in yield shall be utilized in the calculation of the capital charge: Zone 1 : 1 month or less – 1% 1 to 3 months – 1% 3 to 6 months – 1% 6 to 12 months – 1% The sensitivity level of 100 basis points (i.e. 1%) appears onerous for such short maturities.	The sensitivity levels are part of a Standardized Methodology which the Central Bank has adopted. The percentages are therefore preset by the Basel Committee for Banking Supervision.

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IFRS 9	The adoption of IFRS 9 (Financial Instruments) by financial institutions will significantly impact financial reporting and capital levels across the local and international financial sector. We recommend that the policy proposal document be updated to include specific guidance on the application of this standard on the Basel II/III reporting process.	The Central Bank will release guidelines on the treatment of IFRS 9 provisions for regulatory capital purposes.
	How does/will the existing risk weighting framework (currently tied to specific provision as a % of past due loans, be it secured or unsecured) align to IFRS9 given the latter is moving away from general and specific provisioning structure (IAS39) to a "staging" approach centered around SICR and changes in Expected Credit Losses (12-Month and Lifetime ECLs)?	
	Additionally, clarification on the treatment of IFRS 9 is required, as an initial measure we recommend CBTT remove the 1.25% limit on general provisions.	The limit on general provisions of 1.25% of credit risk weighted assets is a requirement under Basel I, Basel II and Basel III.
Pillar 3	*Financial organizations shall disclose such information pertaining to their capital, risk exposures, risk assessment processes, credit risk mitigation and capital adequacy in such time, form, manner and frequency as the Central Bank may specify in a guideline.* The Act should specify whether the disclosure is to the public, Central Bank or both.	The Pillar 3 requirement refers to public disclosure by financial institutions. Notably, this requirement will not be immediately effective when the draft regulations are assented to. However, prior to this regulation becoming effective, the Central Bank will consult with the industry on its expectations for disclosure.

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General	We recommend further consultation between the CBTT and the TWG as we note that there have been further changes/guidance to the policy proposal which should be included in a QIS/parallel reporting prior to going live. Whilst the overall impact of the changes may not significantly impact FIs ability to meet the capital requirements, FIs will need to assess the costs of compiling the additional data.	The parallel reporting period will be extended for a further three (3) to six (6) months given that the reporting template was amended and the revised Regulations are not yet in place.