Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
Remove the preferential 50% risk weight for mortgage portfolios where loan to value (LTV) ratios are not maintained for all residential mortgage facilities held in the portfolio	Clause 12 (3) which allowed for a 50% risk weight being applied to an entire portfolio of residential mortgage loans where loan to value ratios are not maintained for all facilities in the portfolio has been deleted and replaced with Clause 12 (2c) which applies a risk weight of 100% if the financial organization has no loan-to-value information for residential mortgage loans. Additionally, there is the requirement for annual property valuations. We would like to recommend the following: (a) The original clause be retained, and/or (b) The requirement for annual reviews be limited to facilities where the loan to value ratio exceed 80%.	The existing provision is not a Basel II recommendation. It was a preferential treatment applied by the Central Bank that maintained the status quo for residential mortgage exposure. Upon further review this treatment is not prudent and could be significantly understating capital requirements. Further, based on sound underwriting principles, institutions are expected to maintain LTV ratios. It is prudent that the LTV ratios upon which risk weights are determined are periodically reviewed. This should be part of the institution's comprehensive risk management framework. Clause 12 (6) (b)-Schedule 2 requires this review of the LTV ratios "at a minimum every three years for residential real estate".

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
	The removal of the 50% risk weighting option in favour of a 100% risk weighting where no LTV data on residential mortgages is maintained, is a considerable change and will no doubt have a material negative impact on the capital adequacy ratio of the industry. While we understand the need for the change we believe that entities will require time to update their systems and processes to retain and capture the required information.	
	Please specify what criteria the CBTT will consider which constitutes "a sound valuation methodology to apprise and monitor the valuation of the property".	The Central Bank will not prescribe the valuation methodology to be employed by institutions. However, the expectation is that institutions develop and maintain comprehensive procedures and information systems to monitor on an on-going basis the quality of its portfolio of mortgages. The system adopted should be commensurate with the size, nature and complexity of its operations.

Central Bank of Trinidad & Tobago

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

<table>
<tr><th>Issue</th><th>Comment/Question</th><th>CBTT Response</th></tr>
<tr><td>Remove Asset Revaluation Reserve from Tier 2 capital</td><td>Regarding the elimination of the Asset Revaluation Reserve from Tier II capital base calculation, it is our belief since this reserve represents the value of gains and losses that will potentially be crystallised in the future, and eventually flow into retained earnings, that it should be considered part of an entity's capital base. Given this, we are of the view that the existing limitation of the reserve to 20% of core capital is prudent and recommend that this element of capital be maintained accordingly.</td><td rowspan="2">Given that the Central Bank is incorporating several key elements of Basel III (e.g. CET 1 ratio, leverage ratio, capital conservation buffer and D-SIB capital charge) it is imperative that the definition of capital be aligned to the Basel III standard. The definition of capital under Basel III does not allow for the inclusion of asset revaluation reserves in Tier II Capital.

Asset revaluation reserves are defined in regulation 6 (f) of the Financial institutions (Prudential Criteria) Regulations to include:
asset revaluation reserves arising from-
(i) the formal restatement of the balance sheet; or
(ii) the revaluation of real estate or other fixed assets ascertained as at a balance sheet date and supported by an independent professional valuation conducted within one year before or three months after that balance sheet date;</td></tr>
<tr><td></td><td>Kindly clarify the definition of "asset revaluation reserves" that will be excluded from Tier 2 Capital. In addition, we would appreciate CBTT's clarification of what elements constitute Common Equity Tier 1 Capital, Tier 1 Capital and Total Capital.</td></tr>
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Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
Remove the preferential 20% risk weight for exposures to local public sector entities[1]	The removal of clause 6 (2) of the Regulations which provides for preferential treatment for Public Sector Entities (PSE's) in Trinidad and Tobago, will result in the risk weight of 20% increasing to 100% due to the downgrading of Trinidad & Tobago by both S&P and Moody's. This change does not consider facilities that are guaranteed by the Government of Trinidad & Tobago. We recommend that claims on PSEs in Trinidad and Tobago which are funded and denominated in TTD and guaranteed by the Government of Trinidad & Tobago, attract a risk weight of 0%.	Notably, the Phase 1 policy proposal document provides for the treatment of PSE exposure to be reviewed by the Central Bank. Specifically, footnote 10 states: *The preferential risk weight applied to sovereign and PSE exposures will be kept under constant review (and are subject to change) as these are applied in light of the Trinidad and Tobago sovereign rating of A by S&P.*
	It is our view that the proposed treatment of the Public Sector Entities (PSEs) is overly conservative given that the Government of T&T maintains an investment grade rating by 2 of the 3 rating agencies (S&P – BBB/Stable outlook June 2019, CariCRIS – AA+/Stable outlook June 2019). Further, changes to this methodology will significantly impact the marketability and attractiveness of instruments issued by the PSEs. These PSEs are the major players in the domestic capital market ((NIF, HDC, TTMF, HMB, TPHL) where there is already a dearth of new issuances.	Since 2014, Trinidad and Tobago has had several rating downgrades and currently has a BBB rating from S&P, a Cari AA+ rating from Caricris, and a Ba 1 rating from Moody's which attract a risk weight of 50%, 50% and 100%, respectively. Consequently, the blanket 20% risk weight for local PSE exposure that is not government guaranteed is not a prudent measure and does not reflect the risk of the PSE exposure.

[1] Funded and denominated in TTD

Issue	Comment/Question	CBTT Response
	Based on the preceding, there is potential for negative fall-out on the further development of the local bond market. Would CBTT consider a reinstatement of the clause should the sovereign credit rating of Trinidad & Tobago be upgrade to "A" by Standards and Poors?	However, it should be noted that local PSE exposures that are guaranteed by the government of Trinidad and Tobago and meet the requirements under the Credit Risk Mitigation (CRM) Framework would be eligible for the preferential treatment as set out in the rules governing guarantees. As per the risk weight table for PSEs, the risk weight would be linked to the risk rating of the sovereign. Any adjustment in the rating of the sovereign would have the follow on effect for the PSE (be it positive or negative).
ICAAP	Regulation 6 (paragraphs 3 and 4) refer to the Inspector imposing on a financial organization, a target capital adequacy ratio that is higher than the minimum capital ratios set out in Regulation 5, based on the Inspectors' ongoing risk assessment of the organization. We recommend that the process which results in	Currently, in accordance with section 16 (6) and 17 (7) of the Financial Institutions Act, 2008 (FIA), financial institutions may be required to “provide additional capital in cash or approved securities” to satisfy the Inspector that the capital base is adequate

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	this higher minimum capital ratio, be established within set parameters to allow for transparency of the issues considered and applied in the process. Those parameters should also be included within the Financial Institutions (Capital Adequacy) Regulations and be made available for review and comments by the financial sector.	in accordance with capital adequacy requirements. This power to require a higher capital requirement, though not hard coded, has been invoked on a number of occasions after taking into account the risk profile of the institution and stability of the banking system. Regulation 6 therefore does not introduce a new power but supports the existing supervisory process. The ICAAP guidance document in fact puts greater formality to the process around which the Inspector may require a higher capital ratio including details on issues that must be considered when quantifying risk exposure and determining capital adequacy.
	Section 9.2 indicates a reporting period of 1 year for domestic systemically important banks (D-SIB) and financial holding companies (FHC), and 2 – 3 years for other banks and non-banks. While we understand and support the principle of proportionality, we believe that a 1-year reporting period should be sufficient for	The proposed frequency of reporting the ICAAP to the Central Bank seeks to reflect the principle of proportionality. These are, however, minimum requirements. Regulation 6 (2) of the draft Regulations also provides for the ICAAP to be requested more frequently where,

Issue	Comment/Question	CBTT Response
	all banks and non-banks to adequately perform and report on ICAAP. More importantly, the fundamental purpose of the ICAAP (to promote better internal capital management among institutions) loses value if some institutions are only performing said process every 2 – 3 years (much can change during a 2 – 3 year period, even for small institutions). In keeping with the principle of proportionality, we believe that the breadth and depth of the ICAAP will naturally capture size and complexity of financial institutions. Smaller financial institutions while less systemically important are no less prone to idiosyncratic or systemic shocks to their balance sheet, and as such should be no less encouraged towards improved and consistent internal capital planning and supervision. Finally, we recommend that CBTT reconsider and extend the 4-month reporting window for ICAAP. Typically Audited Financial Statements are finalized approximately four months after the financial year ends. Given these time constraints, competing priorities and the additional time required to complete an ICAAP, it would be extremely challenging to complete an ICAAP within four months of the year end. We would recommend a period of 6 months after the financial year ends for completion and submission of the ICAAP.	there are "changes in the business, strategy, nature, scale or complexity of operations or operational environment". At introduction all licensees and financial holding companies will be required to submit the ICAAP document to the Central Bank within four (4) months of their financial year end. Subsequent to the first submission, the Central Bank may review the timeframe for the submission of the ICAAP.

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
D-SIBs Capital Charge Add-on of 1%-2.5%	We have no objections to this proposal, and welcome the addition as it is in line with Basel III recommendations. We await CBTT's announcement of which financial institutions will be classified as a D-SIB. More importantly, we would also recommend that the CBTT outlines and publishes a methodology that will be used to classify D-SIBs, as is performed under the Basel III framework. This will aid in internal capital management as banks will know when they may be entering or exiting the position as a D-SIB.	The Central Bank is working to finalize the D-SIB framework and guidelines which will treat with both the methodology/criteria for deeming an institution as systemically important and outline the enhanced supervisory framework for D-SIBS.
	Please clarify whether the D-SIB surcharge is additive to the overall minimum Tier 1 Capital and Total Capital requirements. In the specific case of a D-SIB whose total Common Equity Tier 1 Capital is at least 9.5%, would there still be a need for additional Common Equity Tier 1 Capital to constitute a 1% to 2.5% D- SIB surcharge?	The D-SIB charge is an additional charge in excess of the regulatory minimum capital requirements. For example, assume that an institution is required to meet a 2.5% D-SIB charge. Where the institution holds 9.5% CET1 capital and assuming that the minimum Tier 1 and minimum CAR are met (i.e. includes additional Tier 1 and /or Tier 2 capital), the minimum CET1 (4.5%), CCB (2.5%) and D-SIB charge (2.5%) would be met.

Issue	Comment/Question	CBTT Response
		Where the institution holds 10% CET1 only (i.e. no additional Tier 1 or Tier 2 capital), this would be sufficient only to meet minimum capital requirements. None of the buffer requirements would have been met.
Grandfathering	We recommend that the regulation provide leeway for licensees to "grandfather" residential mortgages and exposures to local public sector entities at a lower risk rating than that proposed in the amended regulation to allow licensees time to adjust to the new regulation.	Given the long term nature of residential mortgages and the fact that the Central Bank had signaled that the PSE risk weight can be reviewed, "grandfathering" of these exposures will not be adopted by the Central Bank. Grandfathering will not effectively address the risk inherent in these exposures. The Central Bank will however include a transition period to treat with the impact of the changes.
The treatment of real estate deemed semi-commercial or vice versa semi-residential	Residential real estate is accorded a more favourable weighing that commercial real estate; typically residential real estate is accorded a weighting as low as 35% and high as 75% based on certain criteria, while commercial real estate is accorded 100%. However, the regulation makes no specific provision for semi-	Commercial real estate is defined under clause 1-Schedule 2 to include multipurpose commercial premises. Typically residential mortgages are less risky than commercial

Issue	Comment/Question	CBTT Response
	commercial or semi-residential real estate. Considering our unique circumstances in the Caribbean, most specifically in the Republic of Trinidad and Tobago, coupled with the resilience of our real estate market, we ask that the Central Bank provide exception treatment for commercial real estate as done by several other countries. These exceptions usually reflect the following footnotes as reflected in the table below: ***The Committee, however, recognises that, in exceptional circumstances for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive a preferential risk weight of 50 percent for the tranche of the loan that does not exceed the lower of 50 percent of the market value or 60 percent of the mortgage lending value of the property securing the loan. Any exposure beyond these limits will receive a 100% risk weight. This exceptional treatment will be subject to very strict conditions. In particular, two tests must be fulfilled, namely that (i) losses stemming from commercial real***	mortgages. The approach adopted by the Central Bank takes account of the risk inherent in commercial real estate. Many of the large loan defaults for banks are in the commercial real estate sector. The 2018 Financial Stability Report highlighted that business real estate loans recorded the highest NPL ratio on the commercial banking sector.

Central Bank of Trinidad & Tobago

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
	estate lending up to the lower of 50 percent of the market value or 60 percent of loan-to-value (LTV) based on mortgage-lending-value (MLV) must not exceed 0.3 percent of the outstanding loans in any given year; and that (ii) overall losses stemming from commercial real estate lending must not exceed 0.5 percent of the outstanding loans in any given year. This is, if either of these tests is not satisfied in a given year, the eligibility to use this treatment will cease and the original eligibility criteria would need to be satisfied again before it could be applied in the future. Countries applying such a treatment must publicly disclose that these and other additional conditions (that are available from the Basel Committee Secretariat) are met.	
Regulatory Retail Portfolio- Granularity criterion	One of the four criteria for consideration of retail claims – the granularity criterion indicates that a retail portfolio must be sufficiently diversified to a degree that reduces risk in the portfolio to warrant the 75% weight. The regulation further prescribes that one way of achieving diversification may be to set a numerical limit that no aggregate exposure to one counterpart or related counter party can exceed 0.2% of the regulatory retail portfolio.	The BCBS confirmed the Granularity criterion in the Basel III revised SA which states: "no aggregated exposure to one counterparty can exceed 0.2% of the overall regulatory retail portfolio, **unless national supervisors have determined another method to ensure satisfactory diversification of the regulatory retail**

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
	Considering that our regulatory retail portfolio is in the region of TTD200,000,000 application of the 0.2% numeric limit means that [we] shall be limited to counterpart exposures not exceeding TTD400,000 for consideration in its regulatory retail portfolio. This has far reaching implications insofar for us as it means that our risk appetite for retail loans exceeding the relatively small sum will have be amendment and may see increased cost transferred to the end users. Further, this risk is more inequitable as large banks though carrying more capital will be allowed to carry more retail loans at lower weighing. We note our concerns are also echoed in the September 2019 paper entitled Policy Advice on the Basel III Report: Credit Risk, published by the European Banking Authority [https://eba.europa.eu/sites/default/documents/files/documents/10180/288686	**portfolio.”** The Central Bank has considered the BCBS’s recommendation and is of the view that the 0.2% threshold is appropriate. It is a general principle, however, that where national standards deviate from the BCBS’s recommendations they should be no less prudent. In addition, it should be noted that the 75% is a preferential treatment for qualifying exposures. Institutions are no worse off where facilities do not meet the eligibility criteria and are risk weighted at 100% as this is no less favourable than currently exists under the Basel I rules.

Financial Institutions Supervision Department
Comments on Proposed Amendments to the draft Capital Adequacy Regulations
December 2019

Issue	Comment/Question	CBTT Response
	5/62e63ce7-2e78-445e-be66-5afacf54c7b7/Basel%20III%20reforms%20-%20Impact%20study%20and%20key%20reccomendations.pdf?retry=1] who expressed based on feedback specific to the granularity criterion, "this may likely introduce significant burden on banks to implement it and may result in a significant increase in capital requirements for the smallest banks in particular". The European Banking Authority (EBA) by way of the aforementioned reference document advanced recommendations for retention of the existing provisions citing that the granularity criterion is inadequate from a risk perspective "as the composition of the retail portfolio may be more aligned with the overall size of the balance sheet of an individual institution", to which we agree. The EBA advanced recommendations in respect the consideration of a hard granularity criterion, which we would wish to have considered given our concerns.	

Issue	Comment/Question	CBTT Response
Capital Conservation Buffer	Please clarify whether the Capital Conservation Buffer is additive to the overall minimum Tier 1 Capital and Total Capital requirements. In the specific case of a non-DSIB entity whose total Common Equity Tier 1 Capital is at least 7%, would there still be a need for additional Common Equity Tier 1 Capital to constitute a 2.5% Capital Conservation Buffer?	The capital conservation buffer is established above the regulatory minimum capital requirements. For example, an institution with a 10% CET1 ratio and no additional Tier 1 or Tier 2 capital would meet all minimum capital requirements, but would have a zero capital conservation buffer.
Timeline for Implementation and Parallel Reporting	With respect to the additional amendments as result of IMF review we do raise a concern as to the material impact of the amendments on the capital ratios, which would take immediate effect once the regulation is enacted. We recommend that a brief parallel reporting period be with the revisions be enacted, so that the licensees can appreciate the impact of the change on their capital ratio.	The Central Bank will introduce a one year transition period for institutions to meet the new minimum capital adequacy requirements given the proposed changes to the Regulations[2]. Specifically, where the Regulations are promulgated and any of the capital ratios maintained by a financial institution fall within the ranges in Table 1 below, the institution will be given up to one year to meet the minimum capital requirements.

[2] Based on a preliminary assessment of the impact of the measures, one holding company was just on the 10% minimum. Further, for the institutions that were affected the average change in the ratio was about 250 basis points

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<tr><td></td><td>While we appreciate the recommendations of the IMF relating to the three areas outlined, we have some concerns regarding the timeline for implementation of the amendments. Financial institutions may not have sufficient time to properly assess impact and to take the necessary action to rebalance their exposures. In this regard we recommend a grace period of one year for these amendments to be enforced.</td><td>Table 1
<table><tr><th>Minimum Ratio</th><th>Range</th></tr><tr><td>CET 1</td><td>3% - 4.5%</td></tr><tr><td>Tier 1</td><td>4% - 6%</td></tr><tr><td>CAR</td><td>8% - 10%</td></tr></table>
However, when the Regulations come into effect and it is determined that the licensee or FHC does not meet the stipulated minimum ratios in Table 1 above, the licensee or FHC will be requested to submit a board approved capital plan to the Central Bank within three (3) months. The capital plan should detail how the licensee or FHC intends to meet the requirements within a one year period.

The Central Bank may take enforcement action where the ratios fall below the ranges set out in Table 1.</td></tr>
</table>

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		The Central Bank will not extend the period of parallel reporting after the draft Regulations have been enacted.