

BANK OF JAMAICA

# CURRENT PRIORITIES IN BANKING SUPERVISION



SUPERVISION OF DEPOSIT-TAKING FINANCIAL INSTITUTIONS

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### Introduction

The Bank of Jamaica (Amendment) Act 2020 was tabled and approved in the House of Representatives and Senate on 17 November and 4 December 2020, respectively; and, when Gazetted, will significantly modernize Bank of Jamaica's (the Bank's) operations by strengthening its governance structures, and providing for increased independence, accountability, and transparency. The amendments made, clarify the Bank's mandates with respect to, inter alia, the maintenance of price stability and financial system stability. Regarding the latter, the obligation for the Bank to conduct prudential supervision, as well as periodic examinations of deposit-taking institutions (DTIs) licensed under the Banking Services Act, 2014 (BSA) in Jamaica, is underpinned by Section 34A of the Bank of Jamaica Act (BOJA).<sup>1</sup> · <sup>2</sup>

The principal objectives of Bank of Jamaica's prudential supervision are to promote the safety and soundness of DTIs, their financial groups, and the deposit-taking system. Accordingly, the regulation and supervision of institutions licensed under the BSA, remained as critical elements of Bank of Jamaica's mandate of maintaining and promoting financial system stability.

In this vein, the Bank, through its Financial Institutions Supervisory Division (FISD), continued to enhance its supervisory and regulatory frameworks, using various strategic initiatives, including updates to existing legislation and guidelines that are aimed at strengthening the resilience of the financial system, and fostering sound governance and risk management practices.

Accordingly, the Bank made further advancements with regard to the implementation of Phase 1 of its Basel III framework. Likewise, the Bank proceeded to enhance the effectiveness of the current risk-based supervision methodology; while it further developed on activities relating to the rollout of conglomerate risk-based supervision.

Regulatory approvals continued to be among the prioritized regulatory imperatives as at end-2020 in response to emerging financial product and financial system developments.

Notably, the Bank continued to benefit from technical assistance (TA) programmes geared at strengthening institutional capacity and regulatory frameworks; and persisted in its fostering of collaboration with its local and overseas regulatory counterparts.

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<sup>1</sup> These DTIs include commercial banks, merchant banks, building societies and their respective financial holding companies (FHCs).

<sup>2</sup> Regulatory responsibility for non-deposit taking financial institutions are the sole responsibility of the Financial Services Commission, which has supervisory oversight of the securities, insurance and private pensions industries.

## **I. Implementation of the Basel III Framework**

The implementation of Bank of Jamaica's Basel III Plan is aimed at strengthening the governance and risk management practices of the banking sector. In this context, Bank of Jamaica continued the planning and execution of its three-phased programme for the implementation of the internationally-agreed Basel framework.

The first phase, which included the consultation on, and implementation of, the minimum capital requirements for the credit, market, and operational risk components under Pillar 1 of the Basel framework, as well as the consultation on and implementation of the revised definition of regulatory capital, is now far advanced. Bank of Jamaica finalized these components and subsequently issued for consultation, the updated requirements to the banking sector and other relevant stakeholders on 28 December 2020. Comments on the proposals will be received up to the close of business on 15 February 2021. Phase 1 completion is expected by end-quarter one, 2021.

The second phase of the programme will include the consultation on, and implementation of, Pillar 2 components of the Basel framework, including the Internal Capital Adequacy Assessment Process (ICAAP), and the Supervisory Review and Evaluation Process (SREP); as well as the consultation on, and implementation of, the framework for designating Domestic Systemically Important Financial Institutions (D-SIFIs). This phase will also cover the execution a quantitative impact study (QIS) on designated DTIs, the aim of which is to enhance the framework while ensuring proportionality based on the structure and complexity of the Jamaican financial landscape.

The final phase will focus on Pillar 3 of the Basel framework vis-à-vis market disclosures, as well as consulting on, and implementing additional capital and liquidity measures, including capital buffers, and the Net Stable Funding Ratio (NSFR).

## **II. Implementation of the Banking Services Act, 2014.**

Activities relating to the operationalization of the BSA, continued to be among prioritized supervisory imperatives over the 2020 period. Similarly to 2019, BSA operationalization activities continued to surround the development, review and revision of Regulations, Supervisory Rules and statutory tools to support the Bank's responsibility regarding the framework for Consolidated Supervision and Regulatory Approvals.

### ***Consolidated Risk-Based Supervision Framework***

Aimed at facilitating the effective implementation of the BSA, the revision of Bank of Jamaica's supervisory methodology continued, allowing for enhancements in the effectiveness of supervision; greater efficiencies in the use of resources; and better alignment of the methodology with widely observed international standards.

During 2020, there was continued assessment of the Bank's consolidated supervision framework, which was accomplished through ongoing monitoring exercises of a pilot financial group. These ongoing monitoring exercises included the review of the financial performance, relevant documents from the pilot group's management; as well as the review of stress testing exercises conducted by the pilot group and prudential reports obtained from the Financial Services Commission (FSC) – members of the joint technical working group on consolidated supervision. The outcome of these exercises will inform the finalized implementation plan of the risk-based supervisory methodology.

### **Regulatory Approvals**

**Bank of Jamaica continued to improve upon its regulatory approvals processes, to enable a smoother execution of the internal approvals process, in keeping with the complexity of the varied applications and their attendant service level agreements (SLAs).** Though the impact of the coronavirus (COVID-19) pandemic slowed applications and assessments for regulatory approvals during 2020, over the period, the Bank again assessed several applications for entities licensed under the BSA and their affiliated entities.

Compared to the 68 applications assessed in 2019, in 2020 Bank of Jamaica processed a total of 42 regulatory approval applications, of which 13 were outstanding requests made in the previous year. Of these 42 applications, 25 were marked for assessment under Section 39(5) (Duty to notify for Major Changes); eight (8) were assessed under Section 55 (Permitted Activities); three (3) under Section 7(1) (Functions of the Supervisory Committee); three (3) under Section 108 (Agent Arrangements); two (2) under Section 77 (Substantial Shareholding in Licensee); and one (1) under Section 78 (Regulation of Effective Control of Licensee).

## **III. Other Supervisory Initiatives**

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### **a. Anti-money Laundering, Combatting the Financing of Terrorism (AML/CFT), and Proliferation of Weapons of Mass Destruction (PWMD) Methodology**

**Over the 2020 period, the AML/CFT Unit of FISD continued its off-site monitoring to strengthen the AML/CFT framework of DTIs.** During the year, the Bank required licensees to provide AML/CFT related information on their operations on a semi-annual basis. The information collected was used to develop a risk matrix in which DTIs were ranked according to their risk levels (categorized as either high, above average, moderate, and low risk), which will inform the requisite risk-based assessments going forward.

Further, DTIs submitted quarterly information on know-your-customer/customer due diligence (KYC/CDD) compliance on their respective customer bases, aimed at identifying and closing any existing information gaps.

The Unit also carried out several follow-up activities during the year, to evaluate the effectiveness of remedial measures taken by DTIs to address previously identified weaknesses and other controls implemented to strengthen their respective AML/CFT frameworks.

For 2020, FISD outsourced some of its supervisory functions relating to AML/CFT to an external service provider. This service provider conducted a thematic review of DTIs' sanction screening systems, and the DTIs were subsequently provided with the results of this exercise which required them to assess their respective outcomes

from the exercise; and develop action plans aimed at improving deficiencies identified in the sanctions screening exercise.

Bank of Jamaica continued to bolster its communication efforts with the industry regarding developments in its AML/CFT regulatory framework by disseminating numerous notices relating to AML/CFT matters to FIs (including UN Designations); engaging with members of the Board of Directors and Senior Managers of several DTIs; and conducting meetings with members of the Jamaica Banker's Committee (including the Nominated Officers of the DTIs).

#### **b. The Fit and Proper of Substantial Shareholders, Directors, Officers, and Key Employees of DTIs.**

**The primary mandate of the Fit and Proper function in FISD is to ensure that DTIs are owned, managed and operated by fit and proper persons who maintain high ethical standards, are competent, and qualified for the role they have, and whose dealings generally reflect overall integrity and probity.** In fulfilling the mandate during 2020, 38 non-objection recommendations for DTIs were approved by the Supervisor. There were no assessments with adverse recommendations in 2020. In that regard, this represented a record number of approvals in any given year.

Additionally, the following non-DTI summary reviews were carried:

- Six (6) assessments for the Credit Reporting Oversight function;
- Twenty-four (24) summary assessments for Agent Banking candidates;
- Seventeen (17) reviews for Licensing and Approvals; and

#### **c. Special Resolution Regime for Financial Institutions in Jamaica.**

**The cabinet of the Government of Jamaica (GOJ) approved in 2017 the development of a Special Resolution Regime (SRR), designed to make feasible the resolution of non-viable financial institutions without severe systemic disruption and without exposing taxpayers to undue losses; while protecting vital economic functions.** This would be accomplished through mechanisms which make it possible for shareholders and unsecured and uninsured connected creditors to absorb losses in a manner that gives credence to the hierarchy of claims in liquidation. It is intended that the SRR be implemented in accordance with international standards, and in a manner that is proportionate to the structure and complexity of Jamaica's financial system.<sup>3</sup>

The development of the SRR statute represents a major legislative reform which consists of three substantial work streams, that are to form one standalone piece of legislation, viz: the Administrative Resolution Regime (ARR) for non-viable systemically important financial institutions; the Specialized Insolvency Framework (SIF) for financial institutions (FIs); and Funding Arrangements (Funding) for the SRR.

The development of the legislation made significant strides in 2020, as draft legislation for all the work streams were received from Parliamentary Counsel and reviewed by the SRR technical working group. The proposed revisions were sent to the Ministry of Finance for onward submission to Parliamentary Counsel.

Additionally, in the second quarter of 2020, Bank of Jamaica embarked on a concurrent stream of work to set the foundation for implementation of the regime to make the framework operational, so as to dovetail with the passing of the legislation.

The complete Bill is expected to be tabled in Parliament in the second quarter of 2021.

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<sup>3</sup> The legislative framework for Jamaica's proposed SRR for non-viable financial institutions will be applicable to FHCs, DTIs, Securities Dealers, Insurance Companies (Life and General) and Credit Unions (once cooperative societies that operate as credit unions are brought fully within Bank of Jamaica's regulatory ambit).

## COVID-19

The Bank established a COVID-19 Threat Response Task Force, challenged with the enhanced monitoring of the banking sector (DTIs, DTI Groups, and the credit union sector) for which FISD is responsible. The Task Force's response to the pandemic has included various letters to the industry advising of policy decisions on payment moratoria, AML/CFT measures, fee waivers, and other measures to safeguard the financial system and broader economy.

The impact of the COVID-19 pandemic, which included a scaling down of operations and the imposition of immobilization measures on the Bank and in the wider industry, slowed progress in multiple areas across the Division for the Examinations Departments and Policy Departments alike.

In light of the impact of the pandemic, key actions taken by the Examinations Portfolios included: heightened off-site monitoring of vulnerable institutions; increased communication with DTIs regarding output of stress tests; frequent liaison with financial holding companies re the attendant impact on DTI groups; and increased communication with DTIs on various ameliorative actions taken by the Bank via industry letters and advisories.

The impact of the pandemic also slowed the work in the following area the work stream for Phase 1 of the Bank's Basel III Implementation Plan, originally scheduled for end-2020 completion, as resources were diverted to deal with policy related matters arising from the impact of the pandemic on the deposit-taking sector. This has pushed finalization of the work stream into 2021.

Additionally, several measures were initiated to assist in maintaining financial market stability, including the provision of guidance on the prudential treatment of payment accommodations (and similar schemes for example moratoria and skipped payments); IFRS 9 accounting considerations, and more specifically the factors that should be taken into account when estimating ECLs/provisions); as well as the prudential definition and identification of forborne exposures.

### **d. Temporary Payment Accommodations and Provisioning Guidelines**

Amidst the onset of COVID-19, in 2020, Bank of Jamaica took supervisory action to provide for the attendant uncertainty in economic consequences. Accordingly, FISD implemented multiple ad hoc supervisory initiatives aimed at strengthening DTIs' and FHC designates' ability to operate in the context of the COVID-19 environment. The key objectives of the Bank's implemented measures were to ensure DTIs and FHC designates remained in a position to absorb losses and could continue to provide credit and other financial services to the public, limit the potential negative economic repercussions on the lives of ordinary Jamaicans and preserve confidence in the Jamaican financial system.

These measures provided DTIs and FHC designates with temporary relief in the preparation of their prudential returns, particularly in relation to the treatment of payment accommodations, audited financial statements, and the provisioning for expected credit losses.

### **e. Money Laundering Thematic Assessment**

In 2020, Bank of Jamaica conducted a thematic assessment of wire transfers, a potential source of money laundering (ML) risk exposures in the Jamaican financial system. The study used network analyses of recent trends and patterns to develop possible strategies to mitigate ML risks. The outcome of the assessment informed

stakeholders on the prospective areas of vulnerability to ML within the system, as well as informed recommendations for mitigating policy actions.

FISD's thematic exercise focused on DTIs' wire transfers network over the fiscal year period April 2018 – March 2019 (FY2018/19), the results of which will bolster the Bank's AML/CFT regulatory framework. The findings of this thematic study was subsequently shared with the wider industry in December 2020.

#### ABBREVIATIONS

AML	Anti-money Laundering
ARR	Administrative Resolution Regime
BOJA	Bank of Jamaica Act
BSA	Banking Services Act
CDD	Customer Due Diligence
CFT	Combatting the Financing of Terrorism
D-SIFI	Domestic Systemically Important Financial Institutions
DTI	Deposit-taking institution (commercial banks, merchant banks and building societies)
FHC	Financial Holding Company
FI	Financial Institution (including DTIs, securities dealers, and insurance companies)
FISD	Financial Institution Supervision Division
FPRC	Fit and Proper Review Committee
FSC	Financial Services Commission
GOJ	Government of Jamaica
ICAAP	Internal Capital Adequacy Assessment Process
KYC	Know-Your-Customer
ML	Money Laundering
NSFR	Net Stable Funding Ratio
PWMD	Proliferation of Weapons of Mass Destruction
QIS	Quantitative Impact Study
SIF	Specialized Insolvency Framework
SLA	Service Level Agreement
SREP	Supervisory Review and Evaluation Process
SRR	Special Resolution Regime
TA	Technical Assistance