



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

IMPLEMENTATION OF BASEL III

NOVEMBER 2013

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I. ABBREVIATIONS

For the purposes of this paper the following abbreviations will be used:

“AT1”	Additional Tier 1 Capital
“Basel III Capital Paper”	<i>Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (June 2011)</i> , published by the Basel Committee
“Basel III Liquidity Paper”	<i>Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring (December 2010)</i> , published by the Basel Committee
“Basel 2.5 Main Paper”	<i>Enhancements to the Basel II Framework (July 2009)</i> , published by the Basel Committee
“Basel 2.5 Market Risk Paper”	<i>Revisions to the Basel II Market Risk Framework (July 2009)</i> , published by the Basel Committee
“Basel Committee”	Basel Committee on Banking Supervision
“CCB”	Capital Conservation Buffer
“CET 1”	Core Equity Tier 1
“Handbook”	<i>Banks and Deposit Companies Act 1999: Revised Framework for Regulatory Capital Assessment (December 2008)</i> , published by the Bermuda Monetary Authority
“HQLA”	High Quality Liquid Assets for the purpose of meeting the Liquidity Coverage Ratio.
“IOSCO”	International Organisation of Securities Commissions
“LCR”	Liquidity Coverage Ratio
“NSFR”	Net Stable Funding Ratio
“QIS”	Quantitative Impact Study
“RWA”	Risk-Weighted Assets
“SIB”	Systemically Important Bank

II. INTRODUCTION

1. In December 2011, the Bermuda Monetary Authority (the Authority) released a Discussion Paper (DP) entitled *Implementation of Basel III in Bermuda*¹ that commenced the formal public consultation process on the adoption of the Basel III² measures related to the quality, consistency and transparency of capital, the leverage ratio, capital buffers, and prudential liquidity standards.

2. In the DP, the Authority provided a summary of the Basel 2.5 and Basel III standards (focusing on provisions relevant to this jurisdiction), and sought the views of Bermuda's banks and other stakeholders with respect to future implementation in Bermuda.

3. The Authority highlighted its view that the adoption of these new standards is important to protect the interests of depositors, the Bermuda financial system, and the reputation of Bermuda's banking market and its participants. The Authority was pleased to note that submissions in response to the DP supported the Authority's position.

4. The implementation of these standards in Bermuda must be carefully assessed, ensuring that the revised framework remains appropriate to local conditions while continuing to meet international standards. The Authority has noted respondents' comments with respect to the implementation of specific elements of Basel 2.5 and Basel III in Bermuda and these have been addressed in the proposals presented in this Paper. In addition, we have also incorporated the findings of our latest QIS on capital and liquidity and the credit risk information derived from our enhanced monitoring into our assessment of Basel III implementation.

5. Two key concerns that were common to all respondents with respect to the DP:

- i. ***Level playing field*** – Respondents were concerned that the adoption of a revised framework, if inconsistently applied to individual institutions, may lead to artificial barriers to local competitiveness. It is proposed that the revised framework will be consistently applied to all institutions, however, that is not to say that all institutions will be subject to the same individual regulatory capital assessment as such assessment (via the Capital Assessment and Risk Profile (CARP) process) reflects each individual institution's risk profile. There was also concern that if a regime more onerous than international standards were to be adopted that this may lead to global competitiveness challenges for the Bermuda market as a whole.

¹ Available at <http://www.bma.bm/document-centre/consultation-papers/Banking/Basel%20III%20Discussion%20Paper.pdf>

² See *Basel III: A global regulatory framework for more resilient banks and banking systems (June 2011)*, available at <http://www.bis.org/publ/bcbs189.pdf>, and <http://www.bis.org/publ/bcbs188.pdf>

It is the Authority's intention to implement a revised framework consistent with the proposals of the Basel Committee. It should be noted that Basel III has broad acceptance globally and is being adopted by major jurisdictions, including potential competitor jurisdictions such as the United States (U.S.).

- ii. ***Timetable for implementation*** – Commenters requested that the implementation timetable provide sufficient time to allow institutions to prepare for adoption of the new rules and, to that end, Bermuda not be among the first wave of jurisdictions adopting Basel III. While there is no desire to unduly delay adoption, the Authority agrees that sufficient time must be given to prepare for implementation and to assess the impact of the proposals, both through ongoing local impact studies and by monitoring international developments. Therefore, it is proposed that the jurisdiction follow a timetable two years later than that adopted by Basel Committee member jurisdictions, with revised formal regulatory reporting to commence in 2015. The Authority also proposes that the timetable provide measured implementation encompassing transitional and monitoring arrangements broadly consistent with those of the Basel Committee timetable. Annex 1, of this paper, sets out the proposed Bermuda implementation timetable.

6. The Authority has conducted several rounds of capital and liquidity (LCR-only) QISs and has used the information gathered when developing this Consultation Paper (CP). We have also worked directly with Bermuda banks to gain their input and perspective on the migration to Basel III and its corresponding impact on their respective operations.

7. The financial industry and other interested parties are invited to submit their views on the proposals set out in this CP. Comments should be sent to the Authority and addressed to policy@bma.bm no later than 31st December 2013.

III. BACKGROUND

8. Bermuda banks and deposit companies are required to meet on an ongoing basis the minimum licensing criteria set out in the Second Schedule to the Banks and Deposit Companies Act 1999 (the Act). This provides, among other requirements, that institutions must conduct their business in a prudent manner, including that they maintain capital and financial resources (liquidity) commensurate with the nature and scope of their operations. The setting and monitoring of requirements for capital adequacy and liquidity, including the effective assessment and management of risk within institutions, represent key elements in the framework of prudential oversight and control applied by the Authority to help protect the interests of depositors. The approach developed and applied by the Authority in that regard under the Act has reflected applicable regulatory standards designed and promulgated by the Basel Committee, the international standard-setting body for banks. Since January 2009, banks licensed in Bermuda have been required to comply with the framework set out in the Authority's Handbook, which conforms to the Basel Committee's *International Convergence of Capital Management and Capital Standards: A Revised Framework*,³ more commonly referred to as Basel II.

9. Since the adoption of a consistent Basel II framework in Bermuda, there has been significant turmoil in the global economy and volatility in the financial markets and banking sectors of certain developed economies in particular. This has led to a broad consensus amongst policymakers that banking regulation needs to be strengthened, with particular emphasis on higher quality capital, improved liquidity, and effective risk management.

10. In response, the Basel Committee published a number of proposals for revising the Basel II framework, thereby broadening the scope of international standards for the prudential supervision of banks. This work can be divided into two elements:

- i. **Basel 2.5** – In 2009, as an immediate response to the financial crisis, the Basel Committee published certain policy enhancements to Basel II seeking to address flaws identified in the existing framework; and
- ii. **Basel III** – At the end of 2010, the Basel Committee agreed to the key elements of a more comprehensive set of standards that not only strengthen the capital adequacy and risk management provisions of the Basel II framework, but also introduced international prudential liquidity standards. The Basel Committee has continued to issue guidance on

³ <http://www.bis.org/publ/bcbs128.pdf>

additional elements of Basel III with a view to adopting the revised regime by Basel Committee member countries in 2013.

11. In this CP, the Authority makes proposals for the adoption of capital and liquidity regulatory requirements consistent with Basel 2.5 and Basel III for this jurisdiction in 2015. These proposals should be viewed in the broader context of the Authority's efforts to promote high standards of risk management and corporate governance within Bermuda's banks. While Pillar 1 of the Basel 2.5 and Basel III standards focuses on quantitative regulatory capital and liquidity requirements, the Authority is of the view that observance of quantitative regulatory prudential minima is only one important element in a comprehensive framework. Of equal importance is the adoption within an institution of a sound framework of governance and risk management under Pillar 2 and appropriate public disclosure under Pillar 3. In addition, the Authority seeks to promote strengthened internal risk management with the publication of a wider policy framework addressing such areas as liquidity risk management and corporate governance.

IV. REVISED CAPITAL FRAMEWORK

Definition of Capital

12. The Authority proposes the adoption of the Basel III definition of regulatory capital. Common equity tier 1, or CET 1, will be the predominant form of capital, and together with lower quality equity capital, AT1, will form Total Tier 1 capital. Tier 1 capital is intended to absorb losses on a “going concern” basis with a bank continuing in operation. Tier 2 capital will also form part of regulatory capital, on a “gone concern” basis indicating insolvency and potential liquidation. Tier 3 capital will no longer qualify as regulatory capital. A condition of AT1 and Tier 2 eligibility will be a clear and unequivocal provision requiring the writing off or conversion to common equity of such instruments at the point of non-viability of the bank. This loss absorbency feature is key to any component of capital being considered at any tier. (See paragraphs 54 to 61 of the Basel III Capital Paper and Basel Committee Press Release⁴ for detailed eligibility criteria.)

Minority Interests

13. The Authority proposes the adoption of the Basel III rules with respect to the recognition of minority interests, comprising Tier 1 and Tier 2 qualifying capital issued by consolidated subsidiaries and meeting certain classification criteria, as regulatory capital. (See paragraphs 62 to 65 and Annex 3 of the Basel III Capital Paper for detailed rules.)

Regulatory Adjustments and Deductions

14. The Authority proposes the adoption of the Basel III rules with respect to the regulatory adjustments and deductions in the calculation of regulatory capital.⁵ It should be noted that these adjustments will now be applied in the calculation of CET 1.

15. The Authority proposes retaining national discretion to allow banks to exclude temporarily from the deduction requirement certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

16. The detailed provisions for regulatory adjustments and deductions can be found in paragraphs 66 to 90 of the Basel III Capital Paper.

⁴ Basel Committee Press Release 13 (January 2011) <http://www.bis.org/press/p110113.pdf>

⁵ Including the amendment to the rules relating to the treatment of valuation adjustments to derivative liabilities with respect to to change in own credit risk (July 2012), available at <http://www.bis.org/press/p120725b.htm>

Limits and Minima

17. The Authority proposes the adoption of the Basel III regulatory minimum capital levels as follows:

- i. CET 1 must be at least 4.5% of RWA at all times;
- ii. Tier 1 capital must be at least 6.0% of RWA at all times;
- iii. Total capital (Tier 1 capital plus Tier 2 capital) must be at least 8.0% of RWA at all times.

The regulatory minima above do not include Pillar 2 related add-ons or additional buffers.

Capital Conservation Buffer (CCB)

19. The Authority proposes that the Basel III CCB be adopted, set at 2.5% of RWA, comprising CET 1. The CCB is designed to ensure that banks build up and retain capital buffers outside periods of stress which can be drawn down as losses are incurred. Basel III-consistent capital distribution constraints would be imposed on a bank whose capital level fell within this range. (Detailed provisions can be found in section III of the Basel III Capital Paper.)

Comments received

20. One submission suggested that the CCB might be re-built through constraint of, not only earnings distributions, but also other regulatory costs such as licence fees and deposit insurance premiums. Another respondent raised the concern that maintenance of a uniform CCB may disadvantage certain institutions and advocated a buffer calculation model that takes into account the different business models and risk profiles of each bank.

Authority response

21. The Authority believes that an approach consistent with Basel III is appropriate, focusing on the reduction of discretionary distributions of earnings when the CCB is breached. The cost of recapitalisation of the institutions should be borne by the shareholders (or other capital providers) thereby promoting market discipline. Moreover, the Authority believes that it is unacceptable to introduce an approach which strengthens the capital position of an institution by weakening the other elements of the broader financial safety net, while allowing discretionary distributions of earnings in the form of dividends or bonuses.

22. The Authority takes the view that the CCB already takes account of the relative size, business model, and risk profile of individual banks because it is based on RWA. The buffer is, therefore,

uniformly applied but proportional to the minimum capital requirement to which it relates. The assessment of additional capital add-ons under Pillar 2 also takes into account the different business models and risk profiles of each bank.

Countercyclical Buffer

23. The Authority proposes that the Basel III countercyclical buffer be adopted. The countercyclical buffer is designed to build up capital defences when the risks of system-wide stress are growing and release it during the stress period. Given the need for this buffer to be placed into the context of the Bermuda economy, more analysis and industry input will be needed before a framework can be proposed for consultation. In the interim, the Authority will monitor any risk accumulations that have the potential to create a system-wide stress and will address such risks through existing Pillar 2 and other authority.

Systemically Important Banks

24. In the DP, the Authority argued that there is a strong case for requiring those institutions which pose material systemic risk to Bermuda to hold additional capital and undertook to develop specific proposals. In October 2012, the Basel Committee published a policy paper setting out a set of principles to be observed in the assessment of higher loss absorbency (HLA) requirements for domestic SIBs.⁶ The Authority proposes introducing a framework consistent with these principles and will consult with industry in due course.

Comments received

25. One submission recommended that, in the case of a Bermuda subsidiary bank, relief should be provided for the capital buffer held by a Global SIB parent to avoid compounding capital requirements.

Authority response

26. The Basel Committee's principles for Domestic SIBs are designed to complement the proposed Global SIB regime. Under current rules and the Global SIB regime, host authorities may apply a loss absorbency requirement at the individual institution level or consolidated level within their jurisdiction. This is consistent with paragraph 23 of the Basel III rules which states "*as one of the principal objectives of supervision is the protection of depositors, it is essential to ensure that capital recognised in capital adequacy measures is readily available for those depositors. Accordingly, supervisors should test that individual banks are adequately capitalised on a stand-alone basis.*"

⁶ See *A framework for dealing with domestic systemically important banks* (October 2012), available at www.bis.org/publ/bcbs233.pdf

27. Capital held at the subsidiary level would contribute to any regulatory capital requirement at the group parent consolidated level, but would not, of course, contribute to any requirement set at parent stand-alone level. Principle 11, therefore, calls on the home and host supervisor to coordinate and cooperate when formulating a HLA requirement to avoid a situation where the home supervisor may be surprised by the actions of the host supervisor. The Authority does not take the view, however, that such coordination and cooperation would extend to relief from the additional HLA requirement at domestic SIB level.

Counterparty Credit Risk

28. The Authority proposes the adoption of the counterparty credit risk (CCR) amendments of Basel III, which include the addition of a credit valuation adjustment (CVA) to the capital charge to address potential mark-to-market losses associated with the deteriorating credit-worthiness of a counterparty. (The detailed provisions can be found in paragraphs 97 to 117 of the Basel III Capital Paper.)

Comments received

29. Respondents noted that implementation of the CCR amendments would require considerable time and resources to collect data and implement. It was suggested that full implementation of the amendments should be delayed and that a temporary proxy measure be agreed to in the interim period.

Authority response

30. The Authority notes that under current rules, Bermuda banks may calculate the CCR capital requirement only using the Current Exposure Method. Also under a Basel III consistent model Bermuda banks would only be permitted to use the Standardised CVA risk capital charge. This calculation would not require the data collection requirements associated with the Advanced CVA risk capital charge. The Authority will give consideration to any future application from institutions for use of the Advanced CVA Method.

Central Counterparties

31. The Basel Committee published rules relating to exposures to central counterparties (CCPs) in July 2012.⁷ A bank's collateral and mark-to-market exposures to CCPs meeting these enhanced principles will be subject to a low risk-weight, proposed at 2%, and default fund exposures to CCPs will

⁷ See *Capital requirements for bank exposures to central counterparties (July 2012)*, available at <http://www.bis.org/publ/bcbs227.pdf>

also be subject to capital requirements. The Authority proposes the adoption of these rules to ensure consistency with Basel III. It is understood that the rule may have limited impact on Bermuda banks.

External Credit Assessment Institution Eligibility Criteria

32. The Authority proposes amending the external credit assessment institution eligibility criteria in line with Basel III, which includes the incorporation of key elements of the IOSCO's *Code of Conduct Fundamentals for Credit Rating Agencies*⁸ into the criteria. It is anticipated that existing approved external credit assessment institutions would continue to be eligible. (The detailed provisions can be found in Part II B of the Basel III Capital Paper.)

Securitisation Framework

33. The Authority proposes the adoption of the enhancements to the securitisation framework under Basel 2.5. (The detailed provisions can be found on pages 1 to 8 of the Basel 2.5 Main Paper.)

Market Risk Framework

34. The Authority proposes retaining the exemption from reporting under the market risk framework where market risk remains at de minimis levels.

35. The Authority notes that the Basel Committee is continuing its fundamental review of the trading book rules⁹ and therefore proposes deferring any amendment of the Market Risk Framework until this review has concluded. At present, all Bermuda banks are exempt from reporting under the Market Risk Framework and therefore any deferral of the Basel 2.5 amendments would have no immediate impact on the local banking sector.

Prudent Valuation Guidance

36. The Authority proposes amending and extending the scope to the banking book for the prudent valuation guidance in Annex 2.1 of the Handbook, in line with Basel 2.5. (Detailed rules are in Section VIII of the Basel 2.5 Market Risk Paper.)

⁸ See <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>

⁹ See *Fundamental review of the trading book (May 2012)*, available at <http://www.bis.org/publ/bcbs219.pdf>

Leverage Ratio

37. The Authority proposes the introduction of a reportable leverage ratio calculated as the ratio of Total Tier 1 Capital to Total Exposure in line with the Basel III proposal. Total Exposure will include both on-balance sheet exposures (generally measured following the accounting measure of exposure) and off-balance sheet exposures (generally as defined under existing Basel II rules and subject to a credit conversion factor of 100%). (Detailed calculation rules are set out in paragraphs 157 to 164 of the Basel III Capital Paper.¹⁰)

Comments received

38. While respondents were largely supportive of the concept of a leverage ratio, the need to monitor the impact of a regulatory standard based on this measure and appropriately calibrate such a standard was identified.

Authority response

39. In line with the comments received from the banking sector, assessment of the leverage ratio has formed part of the Authority's ongoing QIS. The QIS process has revealed that early imposition of a leverage ratio in line with Basel standards will not present a burden to any of the banks currently operating. It is proposed that the leverage ratio be adopted as a regulatory minimum standard in 2015. Initially the leverage ratio will be set at 6% in 2015, rising to 7% in 2016. The Authority recognises that this proposal imposes a more robust standard than the one currently being proposed by the Basel Committee, and reflects a need to mitigate the risks posed by an absence of the other features of an effective financial safety net, which may be present in the Basel Committee member jurisdictions (such as fully effective deposit insurance and a lender of last resort).

V. PILLAR 2

40. The Authority proposes amending the Pillar 2 rules as set out in section 2 of the DP to incorporate the Basel 2.5 and Basel III amendments. In addition, the Authority will continue to utilise Pillar 2 to address emerging risks that are not being properly captured in existing provisions.

¹⁰ It should be noted that the Basel Committee has issued a Consultation Paper, *Revised Basel III leverage ratio framework and disclosure requirements (June 2013)*, that proposes certain enhancements to the leverage calculation methodology.

VI. LIQUIDITY

Liquidity Coverage Ratio

41. In January 2013, the Basel Committee released a revision¹¹ (January 2013 LCR Revision) to the LCR proposal presented in the original Basel III Liquidity Paper. This revision incorporates various refinements to the LCR to address issues identified by national authorities and the international banking community since the LCR was originally published. The major areas of change were: an expansion of the range of assets eligible for inclusion as HQLA for LCR purposes, through the addition of a new category of Level 2B assets, which national supervisors may elect to recognise as HQLA in their local LCR regulations; a recalibration of the stress assumptions for some cash-flow items; an affirmation of the usability of the stock of HQLA by banks in times of stress; and the adoption of a phase-in timetable for implementing the LCR.

42. The Authority has updated and further refined its policy proposals for the local implementation of the LCR (and other proposed corresponding changes to the local liquidity regime), in response to the January 2013 LCR Revision and after taking into account the comments raised by the industry in the previous consultations as appropriate. This CP invites the industry's comments on the Authority's refined policy proposals as well as its views and suggestions on policy options that it may consider.

43. It is the Authority's objective to implement a robust liquidity regime that aligns with international standards and reinforces banking stability, having regard to local circumstances and the liquidity risks faced by the Bermuda banking sector. Consistent with this objective, the Authority considers it important to maintain a close dialogue with the industry as it develops and shapes its proposals to enhance the local regulatory framework. To this end, prior to issuing this CP the Authority has held various meetings with different groups, both to explain its current thinking on some specific areas and to understand any potential issues and concerns.

44. The Authority will continue to engage the industry in such dialogue in the course of finalising its liquidity proposals, with a view to achieving an optimal approach promoting the stability and the effective working of the Bermuda banking sector.

45. The Authority proposes the adoption of the Basel III LCR.

¹¹ See *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools (January 2013)*, available at www.bis.org/publ/bcbs238.pdf

46. The Authority proposes adoption of an LCR implementation timetable consistent with that of the Basel Committee beginning in 2015 with a minimum requirement of 60%, rising in equal annual steps of 10 percentage points to reach 100% on 1st January, 2019.

47. It is proposed that the haircuts for Level 2 assets be set consistently with the January 2013 LCR revision, with a reservation of the Authority to employ national discretion in applying a higher haircut percentage.

48. The Authority proposes making use of the national discretion to widen Level 1 asset eligibility by allowing U.S. dollar assets to be fully eligible as Level 1 assets.

49. It is proposed that the national discretion to apply higher run-off rates than the minima prescribed under Basel III will not be applied but that a Pillar II LCR, an institution-specific additional liquidity requirement above the regulatory minimum, could be imposed to address temporary liquidity events and questionable inclusion of HQLAs.

50. The Authority will use national discretion to apply appropriate run-off rates to contingent funding obligations on a case-by-case basis.

51. Institutions will be expected to begin formal reporting of the LCR from the first quarter of 2015. A monitoring period of two years will be observed prior to the formal adoption of the LCR as a minimum regulatory standard. It should be noted that the Authority may refine the assumptions in the LCR calculation based on the results of monitoring local impact and international developments.

Comments received

52. One submission requested that agency investments be allowed as Level 1 assets in the calculation of the LCR.

53. Another request was made that internal data be used for the calibration of liquidity run-off factors.

54. One respondent requested that corporate and trust deposits be treated in a “more retail fashion” for the purposes of the LCR calculation.

55. In the DP, it was suggested that the definition of “small business,” for the identification of unsecured wholesale funding provided by small business customers, be aligned with the definition used in

the deposit insurance framework.¹² One respondent requested that a definition consistent with that of Basel III be used.

Authority response

56. U.S. agencies are treated as Public Sector Entities and as such receive a risk-weighting of one less favourable than the sovereign. In the case of U.S. agencies this would result in a 20% risk-weighting. Under Basel III, one of the criteria for Level 1 eligibility is a 0% risk-weighting. The Authority does not propose deviating from the Basel rules and therefore U.S. agency investments will continue to be eligible as Level 2 assets subject to satisfaction of all eligibility criteria and subject to a 15% haircut.

57. The LCR is intended to be a uniform minimum regulatory requirement. If the Authority were to allow each individual institution to use internal data for the calibration of liquidity run-off factors, then each local bank would be held to a different liquidity standard to the detriment of the level playing field objective. As the run-off rates are a minimum standard, the Authority would be willing to work with the sector as a whole, through the Bermuda Bankers' Association, to use bank data to calibrate more reflective run-off rates where this may be appropriate and in the best interest of all stakeholders. The Authority also contemplates using its Pillar II process to ensure that the LCR remains at a prudent level as business conditions change. The use of internal data is of course an element of the institutions' own internal liquidity stress testing as recommended in Principle 10 of the *Principles for Sound Liquidity Risk Management and Supervision*.¹³

58. Under the Basel III rules, corporate deposits eligible as unsecured wholesale funding provided by small business customers may be subject to the same run-off rates as retail deposits subject to meeting all necessary eligibility criteria. Where there is a corporate trust servicing relationship a proportion of deposits may be eligible for a 25% haircut provided the criteria for qualification in paragraphs 93 to 104 of the January 2013 LCR Revision are met. No deviation from Basel III is proposed with respect to the treatment of corporate and trust deposits.

59. The Authority proposes that "unsecured funding provided by small business customers" consist of deposits and other extensions of funds made by non-financial small business customers that are managed as retail exposures and are generally considered as having similar liquidity risk characteristics to retail accounts, provided that the total aggregated funding raised from one small business customer is less

¹² A company that is registered in the Register of Small Businesses maintained by the Bermuda Small Business Development Corporation under the Bermuda Small Business Corporation Act 1980.

¹³ See *Principles for Sound Liquidity Risk Management and Supervision (December 2010)*, available at <http://www.bma.bm/document-centre/policy-and-guidance/BANKING%20II/Principles%20for%20Sound%20Liquidity%20Risk%20Management%20and%20Supervision.pdf>)

than \$1 million (on a consolidated basis where applicable). This definition is broadly consistent with Basel III. It should be noted that such deposits would only be eligible as stable deposits, subject to a 5% run-off, where, among other criteria, these are fully covered by deposit insurance. Therefore, in order to qualify as stable, deposits must meet both the definitions of small business under Basel III and under the deposit insurance framework. Small business deposits that do not meet the necessary eligibility criteria will be classified as less stable and subject to a 10% run-off assumption.

Net Stable Funding Ratio

60. The Authority proposes delaying adoption of the Basel III NSFR until a consensus is developed and articulated by the Basel Committee with respect to its final provisions, many of which are currently subject to ongoing debate across many jurisdictions.

Comments received

61. One respondent noted that the introduction of the NSFR had the potential to be disruptive to the financial sector, and requested that the Authority continue to monitor international developments prior to implementation.

Authority response

62. As was highlighted in the 2011 DP, the Authority regards it as important to begin work in the jurisdiction to understand the impact of the NSFR, while at the same time monitoring closely any new policy developments from the Basel Committee. For these reasons, it is proposed that formal reporting of the NSFR be delayed until the aforementioned consensus is arrived at and a QIS process can be undertaken within Bermuda.

Monitoring Tools

63. The Authority proposes that liquidity information be reported to the Authority in addition to that related to the regulatory minimum standards. The Authority continues to conduct QIS and analysis in this area.

Scope

64. It is proposed that the LCR is applied at both the consolidated and unconsolidated level.

65. It should also be noted that until such time as the LCR migrates in status to the regulatory minimum standard, institutions will continue to be subject to minimum regulatory liquidity requirements under the current framework.

VII. PILLAR 3 AND PUBLIC DISCLOSURE

66. The Authority proposes adopting the amendments to Pillar 3 under Basel 2.5 and Basel III.

67. Additionally, the Authority proposes adoption in the Bermuda framework of the June 2012 issued rules relating to the disclosure of the composition of capital.¹⁴ These rules provide detailed disclosure requirements complementing the high level requirements set out in Basel III.

Comments received

68. One respondent commented that the introduction of additional disclosure requirements is excessive for small banks and may compromise their competitiveness.

Authority response

69. The Authority notes that the proposed changes will provide greater transparency with respect to information that is already being disclosed by Bermuda's banks under Pillar 3. The changes provide a more detailed breakdown and description of the components of regulatory capital and the regulatory capital ratios. Reconciliation to the published financial statements is also to be provided. It is the Authority's view that such enhanced disclosure helps to ensure consistency in the calculation and presentation of the Pillar 3 disclosures, and, therefore, increases the ability of external stakeholders to draw a more accurate and fair comparison of institutions.

70. Where an institution may be concerned about any particular aspect of Pillar 3 disclosure and its effect on competitiveness or the protection of proprietary information, the Authority should be consulted.

VIII. QIS

71. The Authority will continue to conduct studies as needed to assess both the impact of the Basel requirements and any subsequent jurisdictional adjustments.

¹⁴ See *Composition of capital disclosure requirements (June 2012)*, available at <http://www.bis.org/publ/bcbs221.pdf>

ANNEX 1. PROPOSED BASEL III IMPLEMENTATION TIMETABLE FOR BERMUDA

(All dates are as of 1 January)		2014	2015	2016	2017	2018	2019
Minimum CET1 CAR	Parallel Run and Observation	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer	Parallel Run and Observation	0.00%	0.63%	1.25%	1.88%	2.50%	
Minimum CET1 CAR plus Capital Conservation Buffer	Parallel Run and Observation	4.50%	5.13%	5.75%	6.25%	7.00%	
Minimum Total CAR	Parallel Run and Observation	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Minimum Total CAR plus Capital Conservation Buffer	Parallel Run and Observation	8.00%	8.63%	9.25%	9.88%	10.50%	
Leverage ratio	Parallel Run and Observation	6.00%	7.00%	7.00%	7.00%	7.00%	7.00%
LCR	Parallel Run and Observation	60.00%	70.00%	80.00%	90.00%	100.00%	