

## CAYMAN ISLANDS



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## **BASEL II – SUPERVISORY REVIEW PROCESS (PILLAR 2)**

# Cayman Islands Monetary Authority

## SUMMARY OF PRIVATE SECTOR CONSULTATION AND FEEDBACK STATEMENT



### BASEL II – SUPERVISORY REVIEW PROCESS (PILLAR 2)

#### Regulatory Measure: *Requirements: Basel II – Supervisory Review Process (Pillar2)*

Section of proposed Regulatory Policy	Industry Comment	Authority's response	Consequent amendments to the draft Requirements
<b>General Comments</b>			
<b><i>Not applicable</i></b>	Overall, we are supportive of the move to formalize and expand guidance around the supervisory review process as this helps guide institutions and their expectations.	Not applicable	Not applicable
<b><i>Scope of Application</i></b>	Can institutions that are part of larger internationally active banking groups rely upon their ultimate parent's ICAAP given the implicit guarantee that exists?	<p>Although banks are allowed to rely on risk assessment methodologies used within the banking group, all licensed banks are expected to prepare an Internal Capital Adequacy Assessment Process (ICAAP) for their operations in the Cayman Islands.</p> <p>The approved ICAAP should be proportional to the nature, scale, complexity and business strategy of a licensee and also consider the operational environment. The Rules and Guidelines document states:</p>	No amendments

		<p><i>"Where the Bank is a subsidiary of a foreign Bank that is subjected to consolidated supervision, it may leverage off consolidated group methodologies for assessing its risk. However, the Bank's ICAAP must reflect its own circumstances and group-wide data. Additionally, the methodologies used must be appropriately modified to give rise to internal capital targets and a capital plan that is relevant to the Bank."</i></p>	
<p><b>Appropriate Management Information Systems</b></p>	<p>Management Information Systems maybe needs to be more tightly defined. Can this include 'tools' such as banking system or other generated reports or does the Authority expect licensees to purchase off the shelf software for all risk categories?</p>	<p>Management Information Systems (MIS) broadly refer to computer-based systems that are designed to provide managers with the tools to organise, evaluate and efficiently manage operations. The Rules and Guidelines do not prescribe the type of software to be used or recommend the purchase of specific software.</p> <p>Licensees are responsible for ensuring that the MIS implemented are able to support the requirements stipulated in the Rules and Guidelines, and to ensure that their MIS provide the Board and senior management with timely and relevant reports on the Bank's risk profile and capital needs. The systems should allow for the aggregation of exposures and risk measures across business lines and support customised identification of concentrations and emerging risks.</p>	<p>No amendments</p>

<b>ICAAP Outcome</b>	Despite the comments at 139 to 143 there is an absence of any transparent internal review (at CIMA) or dialogue process that is independent of the Banking Division. The process may be more transparent and robust if either before issuing a capital adjustment or afterwards as part of a dialogue process with a licensee, that any increase suggested by the Authority be agreed/reviewed by an independent body such as the Management Committee, or any disagreement by a licensee be referred to it as an independent arbiter / arbitrator;	Paragraph 141 of the Rules and Guidelines states: " <i>The Authority has an internal forum which is used to discuss the review of Banks' ICAAP submissions.</i> " The internal forum will be comprised of CIMA employees and will make decisions based on the recommendations of the Banking Supervision Division.	No amendments
<b>ICAAP Outcome</b>	There is no guidance as to what would make an institution domestically systemically important and what, if any, consequences, expectations or extra responsibilities/obligations that such a designation would bring;	The Authority is aware that the Basel Committee on Banking Supervision has issued a framework for dealing with domestic systemically important banks, and includes factors such as size, complexity, interconnectedness, the lack of readily available substitutes for the financial infrastructure provided and global (cross-jurisdictional) activity. While the Authority has not published guidance on the matter of systemic importance, due cognisance is paid to institutions which meet the criteria set out above and work has commenced on developing a framework for the identification of systemically important financial institutions in the Cayman Islands and implementing specific requirements for these institutions.	No amendments
<b>Supervisory Review and Evaluation Process</b>	No timeline appears to have been suggested for the issue of Supervisory Review findings. While licensees are held to 4 months after their year-end with up to a month extension, there is no mention of a similar window for SREP to be completed.	The Authority's review process is part of a broader supervisory regime which involves some combination of: <ul style="list-style-type: none"> <li>a) Off-site review;</li> <li>b) On-site inspections;</li> <li>c) Discussions with senior management;</li> </ul>	No amendments

		<p>d) Review of work done by external auditors;</p> <p>e) Review of work done by internal auditors; and</p> <p>f) Review of periodic reporting.</p> <p>As part of the review process, the Authority is responsible for reviewing the ICAAP submissions and for taking action if shortfalls are identified, as appropriate. The length of the review process will therefore be dependent on the nature, scale and complexity of the operations of individual banks.</p>	
<b>Guidelines for Calculating Interest Rate Risk in the Banking Book</b>	Guidelines (Annex III) – as long as these are truly guidelines and can be substituted by a licensee’s own internal evaluation processes (if any exist) and not necessarily mandatory as some other ‘guidelines’ issued by the Authority have been interpreted. The same comments apply for the Stress Testing Principles and Guidance in general.	Guidance issued by the Authority is intended to assist licensees to comply with relevant laws, regulations, rules and statements of principles or to describe standards for conduct of business. Guidance contains recommendations on how licensees should operate and represent a measure against which the Authority will assess compliance by licensees.	Not applicable
<b>Internal Capital Adequacy Assessment Process</b>	The submission of the ICAAP within three months (which is a reduction from the current 4 months) of a Bank’s financial year-end will be extremely challenging and therefore timeline not consistently met.	The intention was not to change the ICAAP submission timeframe in this revision. The Rules and Guidelines will be amended so that the submission timeframe remains within four months of the financial year end.	Paragraph 7 of the Rules and Guidelines document has been changed to: “ <i>Banks must have in place a Board approved Internal Capital Adequacy Assessment Process (ICAAP) that is proportional to their nature, scale, complexity and business strategy. Banks must submit their ICAAP to the Authority within <b>four</b> months of its financial year-end.</i> ”