

Current Priorities in Banking Supervision

Introduction

Section 34A of the Bank of Jamaica Act (BOJA) provides the legislative mandate for Bank of Jamaica to conduct prudential supervision and periodic examination of deposit-taking institutions (DTIs) in Jamaica.¹ These DTIs include commercial banks, merchant banks, building societies and their respective financial holding companies (FHCs).² The principal aims of Bank of Jamaica's prudential supervision are to promote the safety and soundness of DTIs, their financial groups, and the deposit-taking system of which they are part. As such, the regulation and supervision of institutions licensed under the BSA remain critical elements of Bank of Jamaica's mandate of maintaining and promoting financial stability.

Bank of Jamaica's supervisory responsibilities under the BSA are operationally discharged through the Financial Institutions Supervisory Division (FISD). The Bank continued to enhance its regulatory framework through various strategic initiatives in response to emerging financial system developments, 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.

In this regard, during the year, Bank of Jamaica made significant progress towards the implementation of Phase 1 of its Basel II/III framework. The Bank further enhanced the effectiveness of the current risk-based supervision framework; and deepened collaboration with its regulatory counterparts both locally and overseas.

Activities relating to the rollout of conglomerate risk-based supervision, and regulatory approvals were among the prioritized regulatory imperatives as at end-2019.

Notably, Bank of Jamaica benefitted from various technical assistance (TA) programmes geared at further strengthening institutional capacity and regulatory frameworks.

I. Implementation of the Basel II and III Framework

Bank of Jamaica's implementation of the international Basel standards is aimed at improving governance and risk management in the banking sector. In this context, Bank of

¹ Regulatory responsibility for non-deposit taking financial institutions rests with the Financial Services Commission, which has supervisory oversight of the securities, insurance and private pensions industries.

² Cooperative societies that operate as credit unions have been designated by the Minister of Finance and the Public

Service as 'specified financial institutions' under the BOJA, as a preliminary step towards placing these institutions under the supervisory oversight of the Bank of Jamaica. This specification currently enables the Bank to obtain information on their operations.

Jamaica continued the planning and execution of its programme for the implementation of the internationally-agreed Basel framework. The programme consists of three phases, to be executed over a five-year period.

The first Phase involves consultation on, and implementation of, the minimum capital requirements for credit, market, and operational risk components under Pillar 1 of the Basel framework.

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). This phase will also cover the consultation on, and implementation of, the framework for designating Domestic Systemically Important Financial Institutions (D-SIFIs).

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).

Implementation of the Liquidity Coverage Ratio

In streamlining the Basel II/III implementation programme, Bank of Jamaica revised the order and phasing of certain components, including accelerating the implementation timeline of one aspect of the Basel III liquidity framework – the Liquidity Coverage Ratio (LCR).³

In this regard, Bank of Jamaica conducted a preliminary assessment to ascertain the sector's readiness for the LCR and assess general compliance with the minimum LCR requirement of 100%. To further inform the calibration of the LCR, a preliminary quantitative impact study (QIS) was conducted by way of industry survey, disseminated in January 2019. Thereafter, a consultation paper was disseminated to the industry and other stakeholders in July 2019, for which feedback was received in August. Bank of Jamaica then, after careful consideration of the QIS and stakeholder feedback received, developed a Standard of Sound Practice on the Liquidity Coverage Ratio (LCR SSP). The LCR SSP was published in October 2019 on a phased basis. Beginning end-October 2019, the LCR minimum requirement was set at 75 per cent for a period of one year. The minimum requirement will be increased to the full LCR minimum of 100 per cent by October 2020.

³ The LCR measures a deposit-taking institution's ability to withstand a 30 calendar day period of significant liquidity stress by the amount of unencumbered high-quality liquid assets (HQLA) that it holds to meet these short-term

obligations. These HQLA, which include cash, government securities, central bank deposits, and qualifying corporate debt, should be equal to or greater than the net cash outflows over the 30 calendar day stress period.

II. Implementation of the Banking Services Act, 2014

During 2019, activities relating to the implementation of the BSA, the primary legislative tool supporting enhancements to Jamaica's regulatory and supervisory framework, continued to be among prioritized supervisory imperatives. The activities included the review and revision of Regulations, Supervisory Rules and statutory tools to support Bank of Jamaica's responsibility regarding the framework for **Consolidated Supervision and Regulatory Approvals**.

Consolidated Supervision

Bank of Jamaica's supervisory methodology continues to be revised to a risk-based approach to facilitate the effective implementation of the BSA; allow for enhancements in the effectiveness of supervision; more efficient use of resources; and alignment of the methodology with international standards. The Financial Services Commission (FSC) and Bank of Jamaica have been collaborating in the execution of consolidated supervision utilizing the risk-based supervisory methodology via a technical working group consisting of members from both agencies. Under the MEFP, both agencies committed to the commencement of a risk based consolidated supervision pilot for at least one domestic systemically important group by May 2019.

Regulatory Approvals

In 2019, Bank of Jamaica continued to modernize its approval processes to better align the level of internal approvals with the complexity of the various applications. Bank of

Jamaica assessed several applications for entities licensed under the Banking Services Act and their affiliated entities. The Bank processed a total of 68 applications in 2019, which were submitted to Bank of Jamaica for regulatory approval. Of these 68 applications, 38 were marked for assessment under Section 108 of the BSA (Agent Arrangements), 17 were assessed under Section 55 (Permitted Activities), five (5) under Section 39 (Duty to notify for major changes), four (4) under Section 7(1) (Functions of the Supervisory Committee), and four (4) under Section 77 (Substantial shareholding in licensee).

Other Supervisory Initiatives

I. Banking Fraud

Supervised institutions and credit unions continued to submit information pursuant to Section 132(1)(b) of the BSA on fraudulent activities affecting their institutions during 2019. The Caribbean Financial Action Task Force's (CFTAF) Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Mutual Evaluation Report of January 2017 and the recent Financial Sector Assessment Programme (FSAP) review of Jamaica's financial system further confirmed the need for a thematic study on the threat and vulnerability of money laundering (ML) risks in the financial system. Bank of Jamaica therefore conducted a thematic assessment of banking fraud, an aspect of money laundering risk exposures in the financial system.

Using quantitative data submitted to the Bank, a matrix was developed to capture the sources of

ML vulnerabilities and threats to the system. The assessment was also informed by a supplementary survey instrument which was disseminated to DTIs licensed under the BSA. The survey instrument was geared at obtaining information, inter alia, on licensees' control, education, and prevention mechanisms, corporate governance structure of banking fraud risk, budgeting for banking fraud, and the prosecution of banking fraud. The thematic assessment evidenced card fraud to account for the preponderance of banking fraud and money laundering risk in the system.

II. Anti-money Laundering, Combatting the Financing of Terrorism (AML/CFT) and Proliferation of Weapons of Mass Destruction (PWMD) Rules

The AML/CFT Unit of FIRD continued on-site examinations using a risk-based methodology. During the year, the Unit carried out several follow-up activities to evaluate the effectiveness of remedial measures taken by licensees to address previously identified weaknesses and other controls implemented to

strengthen their respective AML/CFT frameworks.

In November 2019, drafting instructions were issued for the development of AML/CFT Rules under the BSA and BOJA, to bring into effect the enforceable measures provided for in the Guidance Notes and to support the Bank's oversight regime concerning AML/CFT. The finalized Guidance Notes were approved by the Ministers of Foreign Affairs and Foreign Trade and of National Security and published in the Gazette.

Bank of Jamaica continued to bolster its communication efforts with the industry by:-

- disseminating numerous notices relating to AML/CFT matters to FIs (including UN Designations) since the start of 2019; and
- conducting meetings with members of the Jamaica Banker's Committee (including the Nominated Officers of the DTIs).