

**Antigua and Barbuda: Report on Observance of Standards and Codes—Basel Core Principles for Effective Banking Supervision—Offshore Banking**

This Report on the Observance of Standards and Codes on Basel Core Principles for Effective Banking Supervision—Offshore Banking for **Antigua and Barbuda** was prepared by a staff team of the International Monetary Fund as part of the Eastern Caribbean Currency Union Financial Sector Assessment Program and as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **November 16, 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Antigua and Barbuda or the Executive Board of the IMF.

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ANTIGUA AND BARBUDA

**Report on the Observance of Standards and Codes: Basel Core Principles for  
Effective Banking Supervision—Offshore Banking**

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November 16, 2004

**EXECUTIVE SUMMARY**

This report contains a summary assessment of adherence to the Basel Core Principles for Effective Banking Supervision with respect to the offshore sector of the Antigua and Barbuda.

The assessment has helped to identify the extent to which the regulatory and supervisory frameworks are adequate to address the risks in the financial system. It has also formed the basis for recommendations made for improvement in financial regulation and supervision.

Assessors identified the need to enhance prudential supervision including a risk-based framework for capital adequacy and the need to implement supervisory guidelines for, inter alia, credit, market, and connected lending risk. The absence of adequate information sharing and cooperation arrangements with the Eastern Caribbean Central Bank was also cited as an important deficiency. The absence of meaningful mind and management in the jurisdiction by some offshore banks will continue to be a challenge for the conduct of periodic on-site inspections overseas.

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## I. BASEL CORE PRINCIPLES (OFFSHORE BANKING)

### General

1. This Report on the Observance of Standards and Codes (ROSC) for the Basel Core Principles for Effective Bank Supervision was prepared by a team of two independent bank supervision experts<sup>1</sup>. The mission was conducted from February 23 to March 5, 2004. The report provides a summary of the level of observance of the regulation and supervision of offshore banks licensed by the Financial Services Regulatory Commission (Commission) of Antigua and Barbuda with the Basel Core Principles (CP).

### Institutional and macroprudential setting, market structure—Overview

2. Antigua and Barbuda is part of the Eastern Caribbean Currency Union (ECCU), which is comprised of eight members, the others being: Anguilla, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.<sup>2</sup> There are 16 offshore banks licensed in Antigua and Barbuda, some employing 50 or more staff in Antigua and Barbuda, and some with only a single staff member in the jurisdiction, the remaining management and staff being located in offices in Central and South America.

3. Aggregated assets reported by the offshore banking sector totaled about US\$ 3.0 billion, equivalent in size to about 4 times GDP, as at December 2002. The largest bank represents 61 percent of the sector's aggregated assets, highlighting an important degree of concentration. Investment portfolios represent the bulk of the banks' assets and are predominantly composed of government and corporate bonds and equities. Loan portfolios include a number of large exposures, some exceeding 25 percent of capital, and/or connected party loans. Since 2002, there has been a gradual strengthening of the regulatory and supervisory regime, which has reduced such exposures somewhat, but some banks still require more time to meet the higher standards. A few banks reportedly also carry substantial investments in local real estate projects.

4. Mission staff were informed that loans are frequently collateralized by cash, CDs, and equities (so-called "back-to-back lending") that would reduce their risk of loss. Reported non-performing loans are low. Some banks appear to undertake substantial derivative transactions but no data is available at this moment to substantiate the extent of the exposure.

5. Two of the licensed banks accept deposits only from within their groups, or from related companies. Although, in principle, identical regulatory requirements apply to such captive banks, in practice they are routinely in violation of the large loan and connected lending limits applicable to the other licensed offshore banks. Both such banks (one of which

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<sup>1</sup> Marcel Maes (Belgium) and Tony Maxwell (Canada).

<sup>2</sup> Anguilla and Montserrat are overseas territories of the United Kingdom.

appears to be a special purpose vehicle set up to finance a single investment) have little or no activity reported on their income statements.

6. The number of licensed offshore banks has been substantially reduced in the past few years following the strengthening of the regulatory requirements regarding minimum paid up capital (US\$5 million), minimum equity to assets (5.0 percent), connected lending and the physical presence. A stronger anti-money laundering regime has also contributed to the decline in numbers. This assessment acknowledges that substantial progress has been made, while highlighting a number of areas that need to be further strengthened in order to achieve compliance with the CPs.

7. Subsequent to the mission's on-site work, the Commission advised that new guidelines and regulations have been issued that addressed a number of weaknesses identified during the on-site work. The mission commends the authorities for these positive developments, while noting that considerable time and effort by both the Commission and the banks will be required before one can reasonably expect that they have all been fully and effectively implemented.

### **General preconditions for effective banking supervision**

8. The Commission's functions and responsibilities are set out in the IBC Act. The Office of National Drug Control Policy (ONDCP), which is the authority responsible for the implementation of the AML/CFT measures in Antigua and Barbuda, works in close collaboration with the Commission.

### **Main findings**

#### ***Objectives, Autonomy, Powers, and Resources (CP 1)***

9. The framework for prudential regulation is provided by the IBC Act and by regulations in Statutory Instruments, as well as by the supervisory practices that have been built into the operational procedures of the Commission. The mission found no significant evidence of government interference.

10. However, the requirement that the appointment of the Supervisor of International Banks (who reports to the Administrator, who reports to the Board) be approved by the Minister gives the Minister de facto control over three layers of appointments at the Commission. This could leave the way open to inappropriate interference. It is recommended that the security of tenure provided in law be strengthened, similar to that provided to the Director and Deputy Director of the ONDCP.<sup>3</sup> Financial resources appear to be adequate and staff skills and training are intensively addressed issues.

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<sup>3</sup> Notwithstanding that the ONDCP Director was dismissed following the recent change in government.

11. The IBC Act empowers the Supervisor to require banks to immediately take such remedial measures as the Supervisor considers necessary when, as a result of an examination, he is of the opinion that the bank is carrying on its business in an unlawful manner or is in unsound financial condition.

12. Legal protection for the supervisory agency and its staff against lawsuits for actions while discharging their duties in good faith was provided for, subsequent to the mission's on-site work. An effective information sharing agreement is needed with the ECCB, which has supervisory responsibility for domestic banks in the jurisdiction. The urgency of this is reinforced by the existence of two sets of affiliated banks, each with a domestic and an offshore banking operation in Antigua and Barbuda. The Commission also advised that, subsequent to the mission's on-site work, regulations were issued (April 2004) that empower the Commission to require a regulated entity to furnish any relevant information regarding the entity's related companies. To the extent that the regulated entity is able to provide this information, this will improve the Commission's access to regulatory information about the domestic affiliates and the entire group. The Commission also reported that it has the legal authority to share information with foreign regulatory authorities.

### ***Licensing and Structure (CPs 2–5)***

13. It is recommended that the permissible activities of banks licensed and subject to supervision as banks are clearly defined either by the Supervisor, or in laws or regulations, with particular reference to restrictions on the ability of captive banks to accept third-party deposits. The license application requires extensive information, and a minimum capital requirement of US\$5.0 million. The Commission has recently revised its procedures to require more information about the financial strength of the shareholders, and to strengthen its review of proposed strategic and operational plans, particularly with respect to corporate governance.

14. The anomalous situation of captive banks<sup>4</sup> needs to be resolved. Either they must be required to adhere to the full set of prudential requirements applied to offshore banks generally in the jurisdiction, or they should be issued a separate class of license that clearly prohibits taking deposits from outside the group. They should also be required to make their status clearly known to all their external counterparties.

15. Regulations require that no licensed institution shall make a change to its board of directors or to the direct or indirect, legal or beneficial owner of five percent or more of a class of shares in that institution, without prior approval from the Commission.

16. Regulations have very recently been enacted that define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need supervisory approval.

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<sup>4</sup> Currently there are only two captive banks in Antigua.

***Prudential Regulations and Requirements (CPs 6–15)***

17. The Commission is to be commended for its efforts to strengthen the supervisory requirements by substantially increasing the minimum fully paid-up capital. The mission has been informed that the introduction of this requirement and the 5 percent minimum equity to assets requirement have been instrumental in reducing the number of bank licenses and has acted as a barrier for de novo banking in the jurisdiction. Very recently, the regulations have been amended to provide for a capital charge for market risk. However, the Commission is encouraged to follow through on its announced plan to introduce a more complete risk-based minimum capital requirement consistent with the Basel Capital Accord.

18. A comprehensive guideline on Investment and Lending was recently issued that addresses banks' policies, practices and procedures related to the granting of loans and making of investments. The guideline further addresses the issue of connected lending, and requires identification of potential sources of conflict of interest. It also requires that procedures be put in place to ensure that those involved with the implementation of the investment and lending policies understand where these situations could arise and how they should be addressed. A new regulatory limit on large exposures strengthens the recent supervisory action. It now remains for the guidelines to be put into full effect as soon as possible.

19. A recent regulation also establishes that lending to connected parties should take place on an arm's length basis, free of any pressure or conflict of interest. The mission has noted the guidelines issued recently by the Commission on the management of interest rate, liquidity and operational risk, as well as the Commission's intention to issue detailed guidelines on market risk. The mission encouraged their prompt implementation. Other types of risks should also be addressed by separate guidelines or best practices papers.

20. The Commission has acknowledged the importance of the money laundering risk for the licensed banks and has stepped up its regulatory system and its supervisory efforts in order to address this issue.

***Methods of Ongoing Supervision (CPs16–20)***

21. The new quarterly reporting forms have recently been implemented, although it is too early to confirm that the required information is being provided by all the banks, and in a timely manner. The Commission's database also needs to be upgraded to facilitate monitoring trends and developments for the offshore banking sector as a whole, and to make it compatible with the new reporting formats. The Commission has recently decided to implement a program of regular meetings, based on the risk profile of individual banks, with senior and middle management to discuss operational matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems, etc.

22. It is recommended that the required background, experience, and duties of the resident Senior Officer (required as of July 2002) for those banks that have only a basic

physical presence in Antigua and Barbuda be strengthened in order to facilitate meaningful contact with management.

23. The Supervisor has recently been granted the authority to evaluate the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group. This will require developing supervisory processes to ensure awareness of the overall structure of banking organizations or groups, and an understanding of the activities and risks of all material parts of these groups, including those that are supervised directly by other agencies. The Supervisor has also recently been given the authority to establish the principles and norms regarding the accounting techniques to be used, as well as the principles and norms regarding the consolidation of accounts.

***Formal Powers of Supervisors (CP21- 22)***

24. The Supervisor has recently been granted the power to require that banks’ annual audited financial statements be based on accounting principles and rules that command wide international acceptance, and that they are audited in accordance with internationally accepted auditing practices and standards.

Subsequent to the mission’s onsite work, the Commission has advised that, in accordance with the mission’s recommendation, the Superintendent has been granted the authority to apply penalties to management and/or the board of directors under certain circumstances, including monetary penalties, and sanctions to management and/or boards.

***Cross-Border Banking (CPs 23–25)***

25. These core principles only have restricted application, since banks licensed under the IBC Act have no foreign branches or subsidiaries. However, there are management and representative offices located abroad. The Commission has a system of examining the foreign operations of its licensed banks. This process is aided by the MoUs that the Commission has entered into with certain foreign supervisory authorities.

**Recommended action plan and authorities’ response to the assessment**

***Recommended action plan***

Table 1. Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
1.2 Independence	The security of tenure provided in law to the senior management of the Commission should be strengthened.
1.6 Information sharing	Implement an effective system of cooperation and information sharing between the ECCB and the Commission.

Reference Principle	Recommended Action
2. Permissible activities	<p>Consider making the definition of bank clearer and more explicit.</p> <p>Clearly define the permissible activities of banks that are licensed and subject to supervision, with particular reference to restrictions on the ability of captive banks to accept third-party deposits.</p>
3. Licensing	<p>Apply the recently revised licensing procedures in practice at the first opportunity.</p> <p>Address concerns in respect of captive banks noted above in licensing procedures and/or regulations.</p>
5. Investment criteria	<p>Fully implement the new regulation and guideline governing investment criteria.</p>
6. Capital adequacy	<p>Establish a definition of capital, a method of calculation and the ratio required not lower (more lenient) than established in the Basel Capital Accord, and grant the Commission the power to impose a higher capital ratio.</p> <p>Require that the capital adequacy ratio be calculated and applied on a consolidated bank basis, where applicable.</p> <p>Require at least semi-annually capital adequacy reporting by banks to the supervisor.</p>
7. Credit policies	<p>Fully implement the credit policy requirements of the recently finalized Investment and Lending guideline.</p> <p>The supervisor should verify periodically that banks make credit decisions free of conflicting interests.</p>
8. Loan evaluation and loan-provisioning	<p>Fully implement the loan evaluation and loan loss provisioning requirements of the recently finalized Investment and Lending guideline.</p> <p>Consider introducing a requirement for a general provision for loss.</p>
9. Large exposures limits	<p>Fully implement the large exposure limits set out in the recently finalized Investment and Lending guideline, and without undue forbearance.</p>
10. Connected lending	<p>Fully implement the connected lending restrictions set out in the recently finalized Investment and Lending guideline, and without undue forbearance.</p>
11. Country risk	<p>The supervisor verify that banks have information systems, risk management systems and internal control systems to comply with the Commission's policies, and revise the examination manual accordingly.</p>

Reference Principle	Recommended Action
12. Market risk	<p>Determine that banks have set appropriate limits for various market risks, including their foreign exchange business.</p> <p>Determine that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk.</p> <p>Have the expertise needed to monitor the actual level of complexity in the market activities of banks.</p>
13. Other risks	<p>The supervisor should assess compliance with the recently issued guidelines on risk management processes.</p>
14. Internal control and audit	<p>Amend the draft guideline to reflect the changes to Section 65 of the IBC Act, and fully implement the new requirements in practice.</p>
16. On-site and off-site supervision	<p>Create a database that facilitates monitoring trends and developments for the banking sector as a whole.</p> <p>Ensure that the new quarterly reporting system is providing the required information in a timely manner.</p>
17. Bank management contacts	<p>Fully implement a program of regular meetings with senior and middle management to discuss operational matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems, etc.</p> <p>Ensure that the supervisor is being notified by the banks in a timely manner of any substantive changes in their activities or any material adverse developments, including breaches of legal and prudential requirements generally.</p> <p>Strengthen required background, experience and duties of the resident Senior Officer (required as of July 2002) for those banks that have only a basic physical presence in Antigua and Barbuda.</p>
18. Off-site supervision	<p>Ensure that the new quarterly reporting system is providing the required information in a timely manner, including information on on- and off-balance sheet exposures, assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, loan loss provisioning, market risk and deposit sources.</p> <p>Implement an analytical framework that uses the statistical and prudential information for the ongoing monitoring of the condition and performance of individual banks.</p>

Reference Principle	Recommended Action
19. Validation of supervisory information	Fully implement the plan to hold meetings with banks and their auditors to discuss the results of work by the external auditors and to agree on the responsibilities for any corrective work.
20. Consolidate supervision	Fully implement the new powers granted the supervisor to evaluate the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group. This includes developing supervisory routines to ensure awareness of the overall structure of banking organizations (i.e., the bank and its subsidiaries) or groups and an understanding of the activities of all material parts of these groups, including those that are supervised directly by other agencies.
21. Accounting standards	Fully implement the requirements of the recently enacted legislation.
22. Remedial measures	Implement the new powers in practice as/when the situation warrants. Consider amending the law so that supervisory action taken under Section 261 of the IBC Act is not suspended, or at least not wholly suspended, pending the outcome of an appeal.

### **Authorities' response to the assessment**

26. “After the mission in March 2004, the authorities have undertaken a wide range of legislative, regulatory and supervisory steps to improve the offshore banking supervisory regime and expressed commitment to fully implement the Basel Core Principles for Effective Banking Supervision in a time bound manner. While noting that the mission has downgraded the ratings against four principles, after issuing the first report, without any change in the facts and circumstances, the jurisdiction’s response on key issues follows:

- While not agreeing that the existing laws foster “significant interference” from the political directorate with respect to the management of FSRC, the authorities have nonetheless undertaken to revisit this matter.
- While disagreeing with the mission’s assessment of information-sharing, in view of clear legal powers to share information with other supervisors and seek information on banks’ affiliates, FSRC is nonetheless finalizing a MOU with ECCB. FSRC does not view the absence of MOU as an impediment to information sharing since: (1) FSRC has been sharing information and cooperating with other supervisors, including the ECCB, even without a MOU; and (2) FSRC is not dependent on ECCB for information because of its powers (already being exercised) to seek information about their related companies directly from the offshore banks.

- Revised procedures are already being applied to new license applications. FSRC is considering introduction of a separate licensing category for captive banks.
- FSRC will implement a risk-based capital regime incorporating capital charges for credit and market risks, in consultation with regional supervisors.
- Revised bank examination procedures include a review of the recently issued Investment and Lending Guidelines that address credit policies, loan evaluation and loan loss provisioning, large exposure limits, and connected lending. FSRC will implement a requirement for general loss provisions.
- New quarterly bank reports will be effective from fourth quarter ending December 2004, which should facilitate monitoring of trends and developments in the offshore banking sector.”