



**SUPERVISORY AND REGULATORY GUIDELINES: PU41-0208**  
**Examination Process**  
**Issued: February 14<sup>th</sup>, 2008**

**A GUIDE TO THE CENTRAL BANK'S  
ON-SITE EXAMINATION PROCESS**

**I. INTRODUCTION**

The Central Bank of The Bahamas (*"the Central Bank"*) is responsible for the licensing, regulation and supervision of banks and trust companies operating in and from within The Bahamas pursuant to the Banks and Trust Companies Regulation Act, 2000 and the Central Bank of The Bahamas Act, 2000. Additionally, the Central Bank has the duty, in collaboration with financial institutions, to promote and maintain high standards of conduct and management in the provision of banking and trust services.

All licensees are expected to adhere to the Central Bank's licensing and prudential requirements, ongoing supervisory programmes and regulatory reporting requirements, and are subject to periodic on-site examinations. Additionally, licensees are expected to conduct their affairs in conformity with all other Bahamian legal requirements.

**II. PURPOSE**

The Central Bank's regulatory oversight process emphasizes an ongoing supervisory approach, involving both off-site surveillance and on-site examinations. The identification of excessive risk exposure and requiring implementation of actions to address and reduce those risks is a primary goal of the risk-based supervision framework employed by the Central Bank in the examination process. Risk-based examinations permit Examiner judgment in determining the scope and depth of work to be performed for each activity or function of a specific licensee. The objective of this Guide is to promote awareness and enhance the transparency of the examination process for licensees and other interested parties and should be read in conjunction with the Central Bank's soon to be published *Risk-Based Supervision Framework*.

**III. APPLICABILITY**

This Guide applies to all licensees.

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## IV. ON-SITE EXAMINATION PROCESS

### *(1) Examinations*

Examinations are scheduled as part of the annual plan for examinations. The scope of an examination is determined as a result of the annual planning and ongoing supervisory process, as well as a pre-examination analysis. The scope of an examination can range, with respect to the degree of assessment, from targeted, i.e. special focus, to comprehensive. A specific assessment may also vary in its depth and detail.

A comprehensive examination would include an assessment whether a licensee: 1) has adopted appropriate and effective policies, processes, and procedures to ensure compliance with applicable laws, regulations, supervisory guidelines, and best business practices; 2) the corporate governance process and its risk management and control program provide assurance that the risk in its business activities and operations are appropriately and effectively identified, measured, monitored and controlled; and 3) management and staff have appropriate experience, knowledge training, and technical skill to implement adequate compliance with applicable laws, regulations, supervisory guidelines and best business practices.

### *(2) Examination of Licensees regulated by both the Central Bank and the Securities Commission of The Bahamas (“Jointly Regulated Licensees”)*

In an attempt to better coordinate supervisory efforts and minimize overlaps in regulatory practices, the Central Bank and the Securities Commission of The Bahamas (the Securities Commission) have agreed a Joint On-Site Examination Programme (JEP) for the co-ordination of joint examinations of Jointly Regulated Licensees. The key objectives of the JEP are to streamline the examination activities by coordinating:

- the planning, timing and scope of examinations of these institutions;
- the reporting of examination findings and recommendations; and
- follow-up and enforcement actions, if any.

As the primary regulator/supervisor for banks and trusts companies, the Central Bank will take the lead in co-ordinating the conduct of the joint on-site examinations.

Overall coordination and oversight of the JEP is the responsibility of a Joint Examinations Committee (“JEC”), comprising senior staff responsible for the planning and scheduling of on-site examinations in the Central Bank and the Securities Commission.

The procedures for Jointly Regulated Licensees will broadly follow the outline below. However, where there are differences, these are highlighted.

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### ***On-site examinations versus off-site surveillance***

The collection of information, monitoring and analysis entailed in the supervision of a licensee does not always require an on-site presence, since Examiners can frequently review and evaluate specific reports submitted to the Central Bank. On-site examinations and off-site surveillance complement each other.

On-site examinations enable an Examiner to, inter alia:

- i. test and reach a conclusion about the reliability of systems, controls and reports so that Examiners may reasonably rely upon the information provided for the off-site monitoring and analysis;
- ii. examine changes or anomalies disclosed by off-site surveillance and analysis; and
- iii. evaluate aspects of operations for which off-site surveillance of systems and control is insufficient.

Examiners will make every effort to conduct as many pre-examination procedures as reasonably possible off-site in order to minimize disruptions to a licensee's normal business activities. Additionally, the planning process is mindful of a licensee's space and staff complement when deciding the size of the examination team.

Ongoing supervision of all licensees is ensured through formal and informal communications by their respective Bank Supervision Department ("BSD") Dealing Officers ("DO"). The DO's responsibilities include the off-site monitoring and analysis of conditions of their assigned licensees and advising BSD management, on an ongoing basis, of all matters that have a bearing on the operations of licensees.

### ***(3) Pre-examination planning***

An Examiner-in-Charge ("EiC") is appointed to lead the examination team for each on-site examination, who is responsible for the smooth operation of the assigned on-site examination. This responsibility encompasses the preparation of the Scope Letter and Scope Document (both of these documents are explained below), the timely fulfilment of requirements and objectives, and ensuring the Report of Examination ("RoE") properly reflect the examination findings and recommendations.

Depending upon the size and complexity of the examination, the EiC may arrange to meet with the licensee's senior management at a pre-examination meeting to assist the EiC for fact-finding and examination planning purposes.

Prior to the commencement of an examination, the following documents must be completed:

#### ***a) Notification/Scope Letter***

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Addressed to the Senior Official of a licensee, the Notification/Scope Letter includes a detailed list of information needed by the Central Bank to conduct: i) the off-site pre-examination analysis - this information is usually required approximately two weeks prior to the commencement of the on-site examination; and ii) the on-site examination information which is required on-site at the commencement of the examination. The Notification/Scope Letter also identifies the EiC and the commencement date of the planned examination and is generally sent to licensees at least six (6) weeks prior to the start of the examination.

The Central Bank will send the Notification/Scope Letter for a Jointly Regulated Licensee and will include, as an attachment, a formal letter from the Securities Commission.

***b) Pre-examination analysis***

The EiC is responsible for the preparation of pre-examination analyses and the proposed scope of the examination. The EiC reviews and evaluates several sources of information to accomplish this task, including, but not limited to, the following:

- i. prior RoEs and work papers;
- ii. information resident in BSD files including audited financial statements, licensee quarterly reports, Corporate Governance Certificates and other pertinent information; and
- iii. the pre-examination information required of the licensee as detailed in the Notification/Scope letter.

Further factors evaluated by an EiC when determining the scope of an examination include:

- i. a licensee's risk profile;
- ii. the responses received from the licensee to the recommendations of prior RoE(s);
- iii. significant changes in a licensee's organisational structure, systems, products and regulatory requirements; and
- iv. reliance on independent testing performed by a licensee's external and internal auditors.

The pre-examination analysis provides an EiC with the information necessary to define further the scope of an examination and for BSD management to decide on appropriate staffing of the examination team as well as to fine-tune the timeframe necessary to complete the examination objectives.

The practice of defining the scope of examination provides a control on the examination process and documents the areas to be reviewed. To enhance the efficiency of the examination, once the scope has been determined, additional requests may be sent to a licensee, as appropriate, for detailed information such as departmental policies and

procedures, system access reports, and reconciliations that are applicable to the specific functions to be reviewed.

### ***c) Internal Scope Document***

The EiC also prepares an Internal Scope Document, which includes detailed information on team member work assignments of an examination.

## ***(4) On-Site Examination Procedures***

### ***a) Entry Meeting***

On the first day of the on-site examination or as soon thereafter as can be practicably arranged, the examination team will hold an “entry meeting” with the licensee’s senior management. This is an opportunity for the members of the examination team to introduce themselves to the senior managers and discuss assignments, examination scope and timeframes. The meeting also provides a licensee’s senior management with an opportunity to ask questions or raise any concerns or issues associated with the examination. Cooperation and timely response by a licensee to Examiners’ requests will expedite the examination process.

### ***b) Amendment of Examination Scope***

An EiC may consider, during the course of an examination, that certain aspects and activities of a licensee require examination that is more detailed. This may affect the scope previously identified.

The following are examples that may warrant a modification in the scope of an examination:

- i. the Examiners’ assessment of corporate governance, risk management, internal controls and independent testing has revealed significant weaknesses in the function or activity under review;
- ii. the licensee has instituted significant changes in policies, procedures or controls that have not been independently tested or are not addressed in the examination programs;
- iii. the licensee has discontinued specific activities and processes and the examination objectives are therefore no longer applicable; and
- iv. the Examiner has identified concerns in the conduct of testing procedures that warrant further expansion of scope and testing.

### ***c) Testing***

In selecting attributes to be reviewed or tested for each licensee function or activity examined, each Examiner possesses the discretion to select those attributes the Examiner considers necessary to appropriately and adequately assess the corporate governance, risk

management, internal controls and audit coverage, or other relevant assessments, and, where appropriate, assign ratings for corporate governance, market, credit and operational risk and condition and performance.

Examiners may rely upon the work performed by a licensee's external and internal auditors when it is reasonable to do so. The degree of reliance that an Examiner may place on this work is based upon the Examiner's judgment, which may include an assessment of the competence and independence of the auditors involved, the scope of the audits, the amount of testing performed, the timeframe during which the audits were performed, and the overall adequacy of a licensee's system of internal controls. Examiners will consider these factors in determining the level of testing to be conducted.

#### ***d) Examination Findings***

Examination findings are issues that, in an EiC's opinion, should be addressed and/or improved to ensure a licensee's business is performed within the following parameters:

- i. those required of by Bahamas law and regulation;
- ii. those required by the pertinent Central Bank Guidelines;
- iii. those that may impact adversely on the safety and soundness of the licensee; and
- iv. those that fall below "best practice" standards.

Should an EiC consider that all or some of the issues require immediate reporting to Central Bank senior management, this would be done immediately. Dialogue with the licensee in respect to addressing the issues may commence almost immediately and could include the request for an urgent meeting with members of the board of directors and senior management of a licensee.

#### ***e) Exit Meeting***

Throughout the examination process, Examiners communicate with a licensee's management and staff in order to facilitate the flow of information and ensure an accurate understanding of the key risks, processes and controls and the factual basis for examination findings.

Examiners will normally hold an exit meeting with senior management of a licensee to communicate summary results of the examination and to discuss any potential findings, in keeping with the Central Bank's policy of "no-surprises" and that, the examination should be a "supportive and constructive exercise".

### ***(5) Preparation and Issuance of the Report of Examination***

The RoE will usually contain the following broad elements:

***Objectives of the Examination:*** - an outline of the broad objectives of the examination

***Update on a licensee's business activities:***

***Findings:*** - a concise description of the issues revealed during the course of the examination. Reporting is risk-based and in line with the risk-based approach to examinations, with major issues taking priority and minor ones being discussed and agreed verbally or included as an Appendix to the RoE. Minor issues are noted on examiners' working paper files and followed-up during successive examinations to ensure that appropriate actions have been taken, which would eliminate the need for further reporting.

***Recommendations:*** -*each issue will be supported by a recommendation as to the form of remedial action that is required.* The remedial action may take the form of a general statement or be a specific requirement with imposed deadlines.

The RoE will normally contain only the information needed to explain the issue.

***a) Preparation of a Draft RoE.***

The EiC is responsible for the preparation of a Draft RoE. Once prepared, the Draft RoE is submitted to an internal committee of Central Bank's senior management for review and amendment where required, following which the Draft RoE is transmitted to the licensee's senior official.

In the case of the Jointly Regulated Licensees, the Central Bank and Securities Commission will prepare their respective sections of a Draft RoE (marked for discussion purposes only), which will then be forwarded under cover letter from the Central Bank to the licensee's senior official for review and comments.

***b) Closing Meeting***

The EiC is responsible for organising and coordinating a "closing meeting" with the licensee's senior management. The objective is to attempt to ensure that the Draft RoE is both factually correct and that the licensee's stakeholders will fully and correctly understand the recommendations and/or findings.

The closing meeting should result in agreement by all parties that:

- i) the factual basis of the examination findings are correct; and
- ii) the licensee fully understands the intent and direction of the recommendations reported.

The EiC will then make any necessary amendments to the Draft RoE and present a Final RoE for final review by the Central Bank's internal committee prior to transmittal to the licensee.

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In the case of Jointly Regulated Licensees, subsequent to the “closing meeting” the Central Bank and the Securities Commission will make any necessary amendments, to their respective Draft RoEs after which, they are submitted to their respective internal RoE approval committee prior to transmittal to the licensee. .

***(6) Transmittal of and follow-up to the Report of Examination***

The final RoE will be issued under a letter signed by the Central Bank and directed to a licensee’s Senior Official 1, with copies of the final RoE for all members of that licensee’s board of directors. The transmittal letter will advise that a written response is required to be submitted by the licensee to the Central Bank by a specified date, detailing the actions taken by the licensee in addressing the RoE recommendations. This correspondence will be continued until all the recommendations have been addressed to the satisfaction of the Central Bank.

In the case of Jointly Regulated Licensees, each licensee will be required to reply to each agency’s RoE separately and each will see the process to completion. The JEC will consider significant issues that may arise from the follow-up exchange of correspondence in this process.

[It is expected that one of the examination objectives at the next examination of the licensee will be to ensure the actions agreed as being taken by the licensee in addressing the recommendations of the previous examination have in fact been satisfactorily addressed.]

***(7) Special Focus Examinations of Jointly Regulated Licensees***

Where either the Central Bank or the Securities Commission has supervisory concerns about a jointly regulated licensee and considers that a “Special Focus Examination” should be conducted, such an examination may be conducted jointly or individually by each agency without observing the usual notification period.

***(8) Enforcement Action***

Should a licensee fail to address significant issues raised in the RoE, the Central Bank will have recourse to supervisory intervention in accordance with the policy guideline titled “*A Guide to the Central Bank’s Ladder of Supervisory Intervention*”, issued on 12<sup>th</sup> April 2006. Such supervisory intervention will be communicated to a licensee in writing.

In the case of Jointly Regulated Licensees, enforcement action will be taken by the respective agency that has primary responsibility for the issue that caused the concern.

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