Financial Stability Report January - June 2015

Issue No. 4

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EXEUCTIVE SUMMARY

During the first half of 2015, the Central Bank—whose regulatory purview includes banks and credit unions—in co-ordination with the Securities Commission (securities market regulator) and the Insurance Commission (insurance industry regulator), continued to execute its mandate of promoting financial sector stability and soundness, by ensuring that industry participants remained compliant with domestic and international principles and best practices. This report, which is published on a semi-annual basis, provides an overview of key developments in the international and domestic financial sectors, and culminates with a discussion of the potential risks to the health and resilience of the sector.

The regulators' surveillance included information on licensees' asset growth, capital accumulation and profitability. Assessments were made via both onsite and offsite examinations. Overall, the results showed that banks remained very liquid and highly capitalized. In addition, the application of stress testing models to banks' balance sheets indicated that they were extremely resilient to adverse shocks.

Non-bank financial institutions continued to perform favourably over the period, with the insurance sector registering gains in the assets of both life and non-life products, which bolstered improvements in equity and net income. Further, the industry's financial soundness indicators remained in line with international benchmarks.

The Bank maintained an effective monitoring and supervisory regime, commensurate with international standards. In this context, several key deliverables in Phase 1 of the Basel II and III Implementation Programme's roadmap were implemented over the review period.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

During the first half of 2015, the global economy continued to expand at an uneven pace, reflecting a slowdown in several emerging markets, which offset modest gains in advanced economies. From a financial stability perspective, the central banks of most major economies maintained their highly accommodative monetary policy stances, given the relatively robust levels of capital which existed in their banking systems and the low inflationary environment.

With regard to economic activity, real GDP in the United States grew by an annualized 3.9% in the second quarter of 2015, a rebound from the weather-related 0.2% decline recorded in the prior three-month period (see Table 1). However outcomes in Europe were mixed, as gains in euro area output slowed moderately to an annualized 0.4%, while the expansion in the United Kingdom quickened to 0.7% from 0.3%. In Asia, output growth in China stabilized at an annualized 7.0% in the second quarter, in comparison to the prior period, while declines in both exports and consumer spending resulted in a 1.6% annual fall in Japan's real GDP, a reversal from an earlier 3.9% expansion.

Most of the major economies recorded broad-based reductions in their unemployment rates over the review period. In the United States, the jobless rate fell by 20 basis points in the second quarter to 5.4%, while the euro area posted a similar sized reduction to 11.1%. Conditions were slightly more challenging in the United Kingdom, as the unemployment rate firmed by 10 basis points to 5.6% in the three months to June; although both China and Japan recorded 10 basis-point reductions to 4.0% and 3.4%, respectively.

With inflationary pressures largely under control, major central banks maintained their highly accommodative monetary policy stance. In the United States, the Federal Reserve held its key interest rate at the historic low of between 0.00-0.25%, and kept its existing policy of reinvesting principal payments from its holdings of mortgage-backed securities, agency debt and rolling over maturing Treasury securities at auction. Similarly, the European Central Bank maintained key interest rates at historic lows, while the Bank of England sustained its bank rate at 0.5% and held its asset purchases of secured commercial paper, gilts and corporate bonds at £375 billion. Conditions in Asia were more challenging, as the People's Bank of China (PBOC) intervened in the market by cutting both interest rates and the Bank's reserve requirement ratio in the face of slumps in real estate and in stock market prices. In addition, the PBOC raised the ceiling on deposit rates marginally by 10 basis points to 1.3%. The Bank of

Japan continued its quantitative easing programme in an effort to achieve its inflation target of 2.0%, while setting a goal to increase the monetary base at a pace of ¥80 trillion.

TABLE 1

Selected Indicators for Developed Economies (%)

	2012	2013	Q1 2014	Q2 2014	Q1 2015	Q2 2015
GDP Growth Rates						
United States	2.8	1.9	-2.1	4.6	-0.2	3.9
Euro Area	-0.7	-0.5	0.2	0.0	0.5	0.4
United Kingdom	0.3	1.8	0.8	0.8	0.3	0.7
China	7.7	7.7	7.4	7.4	7.0	7.0
Japan	1.4	1.5	1.6	-1.8	3.9	-1.6
Unemployment Rates						
United States	8.1	7.4	6.7	6.1	5.6	5.4
Euro Area	11.4	12.0	11.7	11.5	11.3	11.1
United Kingdom	8.0	7.2	6.8	6.4	5.5	5.6
China	4.1	4.1	4.1	4.1	4.1	4.0
Japan	4.4	3.4	3.6	3.7	3.5	3.4
Inflation Rates						
United States	2.1	1.5	1.5	2.1	-0.1	0.1
Euro Area	2.5	1.3	0.5	0.5	-0.1	0.2
United Kingdom	2.8	2.6	1.6	1.9	0	0
China	2.6	2.6	2.4	2.3	1.4	1.4
Japan	0.0	0.4	1.5	3.6	2.3	0.4

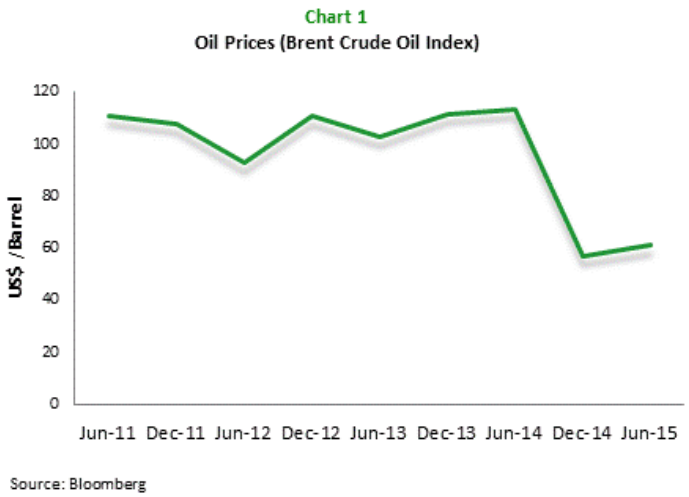
Sources: IMF, International Statistical Bureaus

TABLE 2

Selectd Caribbean Countries GDP Growth Rates (%)

	2008	2009	2010	2011	2012	2013	2014	2015e
Bahamas	-2.3	-4.2	1.5	0.6	2.2	0.0	1.0	1.2
Barbados	0.3	-4.1	0.2	0.8	0.0	-0.7	0.2	1.0
Belize	3.8	0.3	3.1	2.1	4.0	1.6	3.6	2.2
Eastern Caribbean	2.6	-5.2	-3.3	-0.1	0.2	0.7	2.9	2.2
Guyana	2.0	3.3	4.4	5.4	4.8	4.8	3.8	3.2
Jamaica	-0.8	-3.4	-1.4	1.4	-0.5	0.5	0.7	1.1
Suriname	4.1	3.0	4.2	5.3	4.8	4.7	1.8	1.5
Trinidad & Tobago	3.4	-4.4	0.2	-2.0	1.2	1.6	0.8	1.0

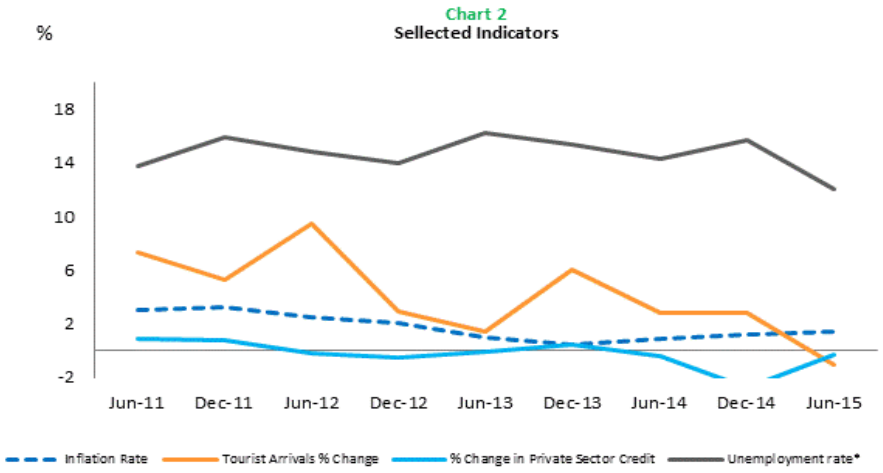
Sources: IMF, International Statistical Bureaus, Regional Central Banks



1.2. The Domestic Environment

Domestic economic conditions improved slightly over the first half of 2015, supported by modest gains in tourism sector output, while a series of varied-scale projects continued to buttress construction activity. According to the Ministry of Tourism's data, overall visitor arrivals decreased by 1.1% to 3.3 million over the first six months of 2015, following a 2.8% improvement over the corresponding period of 2014. This was due to a 2.8% contraction in cruise visitor passengers to 2.6 million, compared to a similar gain in the preceding year. In contrast, the high value-added air segment rose by 5.0% to 0.8 million, extending last year's 2.6% improvement. Construction activity tapered during the first half of the year, as work on the Baha Mar project paused, and mortgage financed housing investments continued to be constrained by banks' conservative lending stance. Specifically, the value of residential mortgages for new construction decreased by 3.1% to $1.0 billion, following a 3.7% falloff a year earlier. Similarly, the number of construction starts declined by 15.5% to 250 over the six-month period, following a similar contraction in the prior year, while the number of completions contracted by 47.9% to 161, a reversal from a 62.6% expansion in 2014.

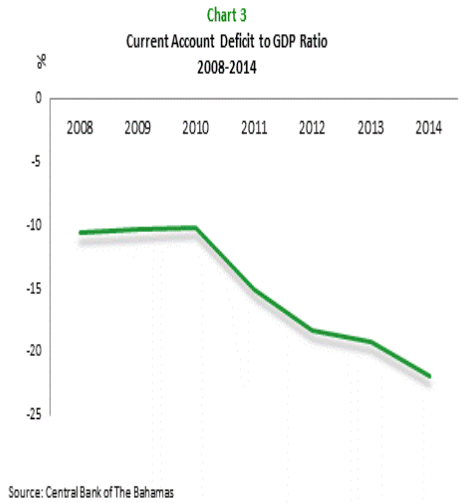
While no sustained improvement in the jobless rate was recorded, domestic inflation firmed over the twelve months to June to 1.41% from 0.89% over the first half of 2014, as the pass-through effects of lower global oil prices cushioned the introductory impact of VAT.

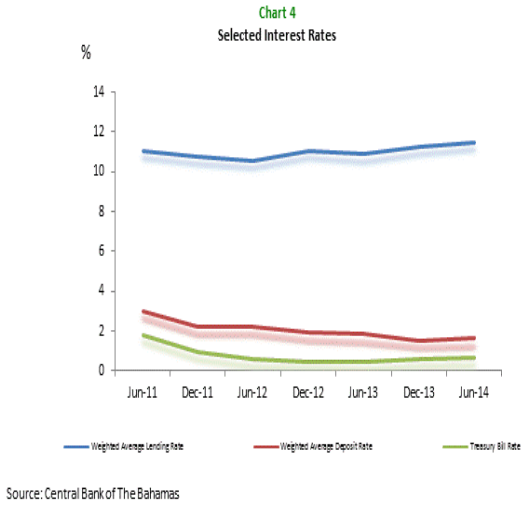


Source: The Central Bank of the Bahamas, The Department of Statistics

Fiscal developments were favorably impacted by the introduction of the Value-Added Tax (VAT), as the FY2014/15 deficit contracted by a third to $382.0 million. VAT proceeds supported total revenue gains of $276.5 million (19.1%) to $1,701.5 million, eclipsing a $132.1 million (6.8%) rise in aggregate expenditure. On a half-year basis, the fiscal reform process resulted in a more than 50% reduction in the January-June deficit to $121.8 million, compared to a shortfall of $270.9 million in the same period of the prior year.

In external sector developments, the estimated current account deficit contracted by $171.8 million (25.3%) to $506.4 million. This was explained by an expansion in the services account surplus, as the near-completion of a major foreign investment project resulted in a sharp reduction in construction service outflows, while stopover visitor growth led to gains in net travel receipts. However, the capital and financial account surplus decreased significantly by $653.9 million to $156.3 million, primarily associated with a sharp decline in other 'miscellaneous" investments inflows—owing to a combination of reduced private loan financing and a tapering in the Government's foreign borrowing activity, while net direct investment inflows also moved lower.





On the monetary side, foreign currency inflows from real sector activities continued to support the expansion in both bank liquidity and external reserves over the first half of the year, although the pace of growth moderated from the previous period, when Government received net proceeds from its $300 million external bond issue. In addition, the average interest rate spread widened, on account of an increase in the weighted average loan rate and a narrowing in the corresponding deposit rate; however, banking sector profitability indicators deteriorated, due mainly to higher provisioning for bad debts.

TABLE 3:

The Bahamas: Macroeconomic Indicators

	2009	2010	2011	2012	2013	2014	Jun-12	Jun-13	Jun-14	Jun-15
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	(5.2)	1.1	0.3	3.6	2.5	0.9	n.a.	n.a.	n.a.	n.a.
Real GDP Growth Rate (%)	(4.2)	1.5	1.1	1.0	0.0	1.0	n.a.	n.a.	n.a.	n.a.
Inflation Rate (Average chg in RPI)	1.9	1.3	3.2	2.0	0.4	1.2	2.5	1.0	0.9	1.4
Unemployment Rate	14.2	N/A	15.9	14.0	15.4	15.7	14.8	16.2	14.3	12.0
Overall Fiscal Balance (B$M)*	(403.1)	(376.7)	(319.8)	(557.3)	(485.3)	(406.8)	(450.6)	(546.1)	(480.1)	(382.0)
as % of GDP	(5.2)	(4.8)	(4.1)	(6.8)	(5.8)	(4.8)	n/a	n/a	n/a	n/a
Private Sector Credit (B$000)	6,595.9	6,572.7	6,647.5	6,629.3	6,551.9	6,367.8	6,656.0	6,516.4	6,471.5	6,291.3
Weighted Average Lending Rate %	10.6	11.0	11.0	10.9	11.1	11.8	10.6	10.9	11.5	12.1
Weighted Average Deposit Rate %	3.8	3.4	2.6	2.0	1.7	1.4	2.2	1.8	1.6	1.4
Treasury Bill Rate %	2.8	2.4	1.0	0.6	0.7	0.7	0.6	0.5	0.7	0.8
Gross Int'l Reserve (B$M)	815.9	860.4	884.8	810.2	741.6	785.8	928.0	797.1	1,016.8	953.1
Import Cover Ratio (Non-Oil (CIF) in weeks)	20.9	21.6	19.7	16.0	15.4	14.9	18.3	17.0	20.4	18.4
Current Balance (B$M)	(808.5)	(796.8)	(1,192.7)	(1,504.6)	(1,493.9)	(1,860.2)	(548.3)	(476.4)	(669.7)	(506.4)
as % of GDP	(10.3)	(10.1)	(15.0)	(18.3)	(19.4)	(21.9)	n/a	n/a	n/a	n/a
Total Public Sector Debt (B$M)	4,266.1	4,799.7	4,953.2	5,770.2	6,346.4	7,121.8	5,138.4	6,069.5	6,532.7	7,194.0
of which: External	767.3	915.9	1,044.5	1,464.3	1,613.7	2,120.5	1,160.9	1,481.3	1,919.4	2,143.3
Internal	3,498.8	3,883.8	3,908.7	4,305.9	4,732.7	5,001.3	3,977.5	4,588.2	4,604.3	5,050.6
Total Arrivals ('000s)	4,645.1	5,254.8	5,587.6	5,940.2	6,150.8	6,320.2	3,180.6	3,224.6	3,315.0	3,278.6
Tourist Expenditure (B$M)	2,014.2	2,163.2	2,141.6	2,311.4	2,284.7	2,308.3	1,328.9	1,237.3	1,255.5	n/a
Construction Number of Permits Issued	2,416.0	1,996.0	1,948.0	1,916.0	1,462.0	n/a	1,004.0	661.0	n/a	n/a
Value of Starts (B$M)	360.9	154.2	147.5	116.6	140.2	n/a	62.9	49.4	n/a	n/a
Value of Completion's (B$M)	297.0	337.6	500.6	317.1	216.6	n/a	102.1	110.8	n/a	n/a
Oil Prices (Brent Crude Oil Index)	63.5	80.3	111.8	111.4	109.1	98.5	112.5	107.5	109.7	58.8

Source: Central Bank of The Bahamas, Department of Statistics, Bloomberg

N/A - Not Available

* June totals reflects the Fiscal Year data.

CHAPTER 2: FINANCIAL SYSTEM

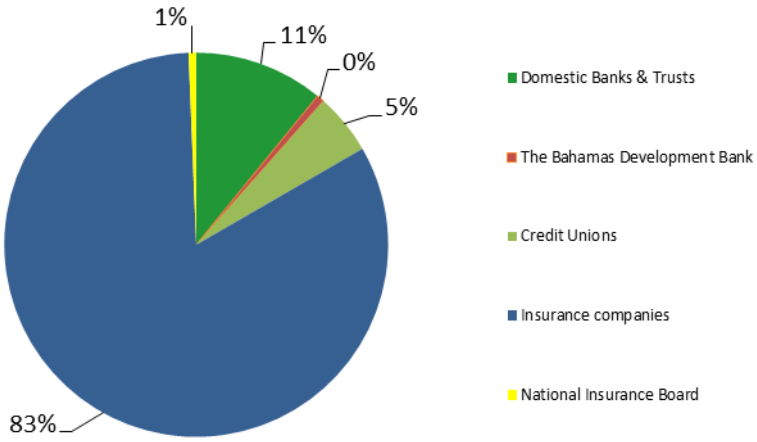
2.1. Overview of the Financial System

The Bahamian financial sector, which represents approximately 15% of the country's GDP, encompasses over 400 banks and non-banks and employs in excess of 6,500 individuals. The institutional profile of the sector is shown in Chart 5 and Table 4. While exclusively domestic operations include: Money Transmission Businesses (MTBs), credit unions, The Bahamas Development Bank, the National Insurance Board and The Bahamas Mortgage Corporation [1] (see Chart 5), international business companies (IBCs) and private trust companies (PTCs) are more confined to the external sector. More pervasive in both sectors; however, are banks and trust companies, insurance and capital market activities. At end-June, the number of public banks and trust companies licensed by the Central Bank totaled one-hundred and one (101), eighty-four (84) of which were offshore banks. The relevant domestic institutions include eight (8) commercial banks and nine (9) other local financial institutions (non-commercial banks and trust entities) or OLFIs, whose aggregate assets totaled $9.8 billion.

Box 1: Regulators and Principle Legislations	
Regulator	**Principle Legislation**
Bahamas Development Bank	Bahamas Development Bank Act, 1974
Central Bank of The Bahamas	Banks and Trust Companies Regulations Act, 2000 Cooperative Societies Act, 2015
Insurance Commission of The Bahamas	Insurance Act, 2005 External Insurance Act, 2010

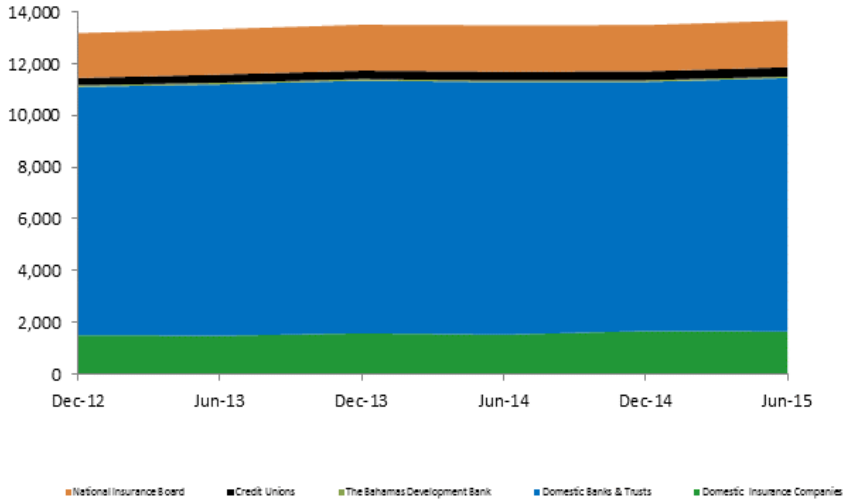
[1] Balance sheet information for the Bahamas Mortgage Corporation is currently not available.

Chart 5
Domestic Banks & Non-banks (June 2015)



Source: Central Bank of The Bahamas

Chart 6
Estimated Assets of Domestic Financial Institutions



Source: The Central Bank of The Bahamas, Insurance Commision of The Bahamas

2.2. Banks & Trust Companies

Over the first half of 2015, the number of licensees decreased by 2 to 252 (see Table 4), reflecting a similar reduction in the number of international banks to 235 from 237, while domestic banks' operations remained unchanged at 17.

TABLE 4									
Structure of the Financial System									
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**Jun-13**	**Jun-14**	**Jun-15**
Banks &Trusts									
Offshore Banks	252	256	260	249	249	237	249	246	235
Domestic Banks	20	20	18	19	18	17	19	18	17
Total	**272**	**276**	**278**	**268**	**267**	**254**	**268**	**264**	**252**
The Bahamas Development Bank	1	1	1	1	1	1	1	1	1
Non-Bank Financial Institutions									
Mutual Funds	788	753	713	652	735	830	660	768	n.a
International Business Companies	160,383	160,793	163,499	166,342	169,575	172,681	167,873	171,104	174,161
Credit Unions	13	13	13	13	11	7	7	7	7
Insurance companies	174	178	127	139	147	143	141	144	143
Domestic Companies & Agents	*154*	*157*	*114*	124	128	122	123	124	122
External Insurers	*20*	*21*	*13*	15	19	21	18	20	21
National Insurance board	1	1	1	1	1	1	1	1	1

Source: Central Bank of the Bahamas

n.a. not available

2.2.1. The Bahamas Development Bank

The Bahamas Development Bank (BDB) finances investments in a number of sectors including: agriculture, fisheries, tourism, manufacturing and transportation services. The Bank's balance sheet has remained relatively stable in recent periods, and over the six-months to June, total assets fell marginally by 0.3% on a yearly basis, to $61.4 million, with the loan portfolio decreasing by $0.3 million (0.8%).

2.3. Non-Bank Financial Institutions

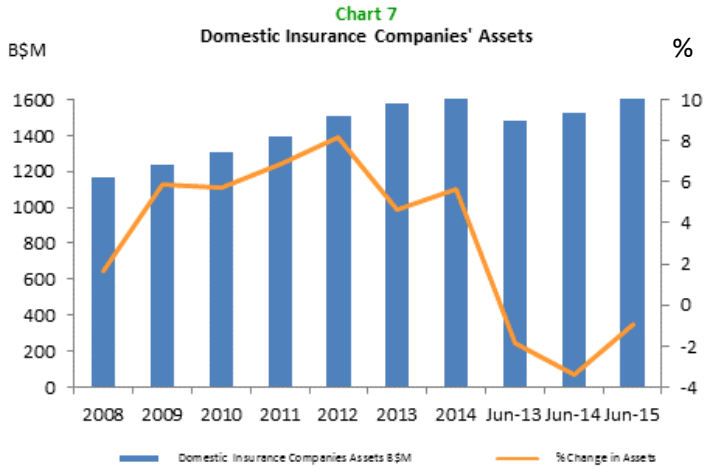
2.3.1. Insurance Companies

The number of insurance companies and intermediaries remained at 143 over the six-month period. Specifically, domestic insurers remained at 29, while the external insurers rose by 1 to 21, agents & brokers increased by 4 to 57; however, sub-agents fell by 2 to 26. Preliminary statistics showed that the value of domestic insurance companies' assets declined further by 0.7% ($11.5 million) over December 2014 to $1.65 billion (see Chart 7). In contrast, underwriting business vis-à-vis gross premiums collected grew by $20.1 million (5.4%) to $391.9 million at end-June 2015, when compared with the same period last year. In terms of the loss ratio (net claims to net premiums), for life insurance companies, this stood at 69.3%, vis-à-vis the non-life ratio of 35.4%.

2.3.2. The National Insurance Board

The National Insurance Board's investment portfolio continued to grow during the first half of 2015, up by 0.8% to $1.8 billion and comparable to the prior year's 1.0% expansion. The bulk of the assets remained in local Government bonds (34.2%), which decreased by 1.5% over the six-month period, while

holdings of equity securities (11.8% of the portfolio) rose by more than a third. In addition, net investments in direct finance leases (9.8% of the portfolio) fell modestly, by 0.8%.



Source: Insurance Commision of The Bahamas

2.3.3. Credit Unions

The number of active credit unions rose by 1 to 8 at end-June 2015, while the value of total assets increased by an estimated 4.1% to $361.8 million, following the previous period's 5.4% expansion. The loans category—which comprised the dominant share of assets—fell by 2.6% to $224.9 million, with the bulk of the lending focused on the consumer segment (71.6%), followed by mortgages (22.7%) and revolving credit lines (5.7%). With regard to liabilities, total deposits also firmed by 5.3% to $307.1 million, relative to the prior year's 6.0% expansion. In addition, the capital & surplus position steadied at $40.9 million.

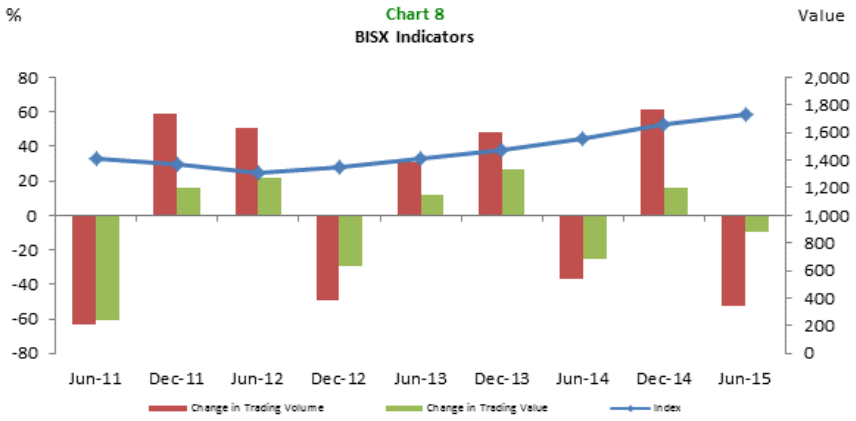
2.3.4 Other Non-Bank Institutions

Domestic capital market activity on the Bahamas International Securities Exchange (BISX) was relatively subdued over the first six months of the year, as the volume of shares traded fell by more than half to 1.2 million, while the corresponding value decreased by 9.7% to $7.3 million.

In contrast, supported by the price appreciation of several securities, the Bahamas International Securities Exchange's (BISX) market capitalization advanced by 11.2% to $3.7 billion, while the BISX All Share Index[2] rose by an estimated 4.3% to 1,730.3 points, following a 6.2% gain a year earlier (Chart 8).

[2] This is a market-capitalization weighted index comprising all primary market listings excluding debt securities.

Further, the number of listings—consisting of common and preference shares and debt tranches of the Government and private listed companies—increased by 5 to 34.



Source: Bahamas International Securities Exchange (BISX)

CHAPTER 3: BANKING SECTOR

This section focuses on the impact of the domestic banking sector on financial stability. While the licensed banks and trust companies total 252, some 84 public licensees operate exclusively in the international sector. Foreign exchange controls prohibit international banks from investing in domestic securities, and they are also generally not allowed to hold Bahamian dollar balances—except for the purpose of facilitating the payment of local expenses. Their impact on domestic financial stability is therefore not material.

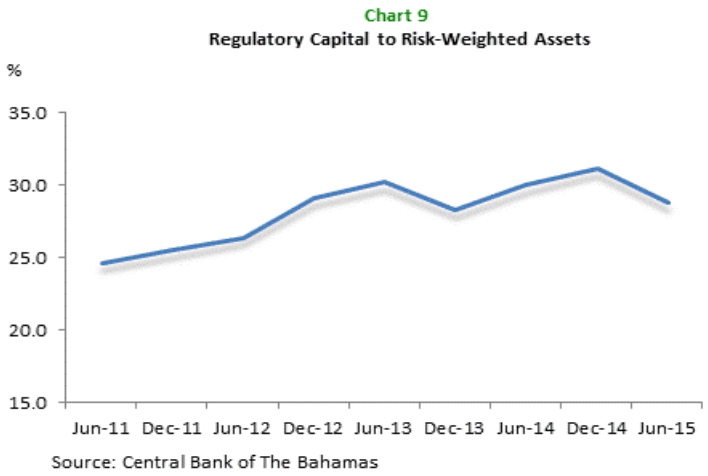
3.1 Domestic Banking Sector

In terms of ownership, 4 of the 8 onshore commercial banks are subsidiaries of Canadian banks, 3 are locally owned, and 1 is a branch of a United States' based institution. The banks are primarily funded by deposits and their assets are comprised mainly of loans, such as residential mortgages and consumer loans—although each institution tends to specialize in different segments of the market. The majority of the sector's assets—in excess of two-thirds—are concentrated in the 3 largest banks. On average, given these institutions' conservative lending practices, banks have maintained high levels of liquidity over the last five years, while the spreads between deposit and lending rates, as well as fee-based income, support the overall profitability of the sector.

3.1.1 Capital Adequacy

Over the first six months of 2015, banks' aggregate capital adequacy ratio, which reflects capital as a percentage of risk weighted assets[3], narrowed by 2.4 percentage points to 28.8% at end-June, 2015, although remaining well above the international benchmark of 8.0% (see Chart 9). In addition, as part of the Central Bank's efforts to ensure that banks maintained sufficient levels of capital to act as a buffer against the systematic risk associated with the significant credit concentrations in the jurisdiction, the Bank imposed higher capital adequacy ratios on the domestic banks in 2009. It therefore expects that all institutions should maintain prudential ratios of greater than 17% (the target). There is also a "trigger" of 14.0%, below which a bank will be required to take active measures to either reduce their risk exposure or augment their capital.

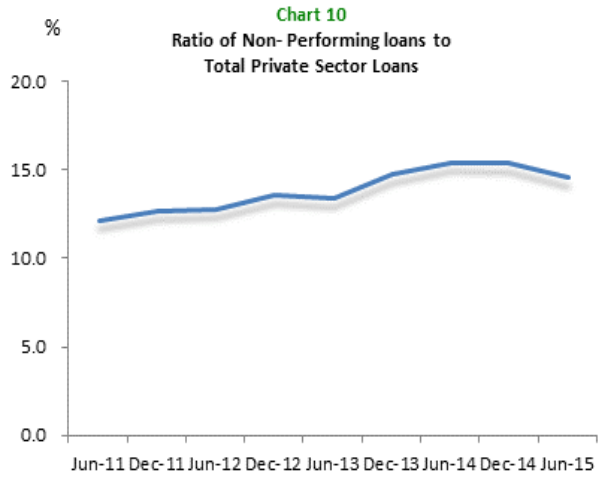
[3] The risk weighting process used for measuring a bank's on-balance sheet credit exposures cover all on-balance sheet assets held by the bank, except those assets or investments which are required to be deducted from total capital. The risk weighted amount of an on balance sheet item is determined by multiplying its current book value by the relevant risk weight (0%; 20%; 50% or 100%).



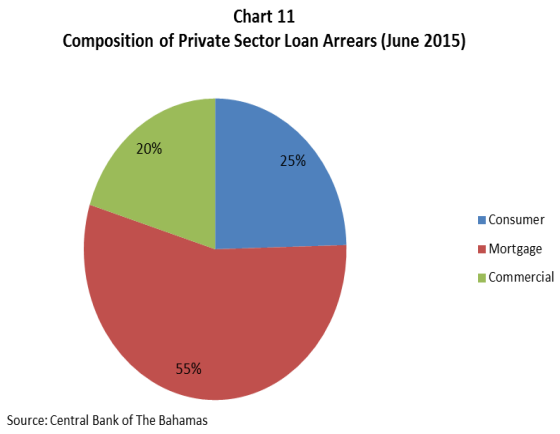
3.1.2 Asset Quality

During the review period, banks' credit quality indicators improved moderately, reflecting in part the modest growth in economic activity and loan write-offs. Total private sector loan arrears decreased by 7.9% to $1,191.4 million, a slowdown from the prior year's 0.5% expansion. Correspondingly, delinquencies as a proportion of total loans declined by 1.5 percentage points to 19.9%, vis-à-vis a 0.3 percentage point increase in 2014. The falloff in arrears reflected mainly a reduction in the non-performing segment by 6.3% to $916.1 million, attributed to sustained loan write offs, a turnaround from a 3.6% rise in the previous year. Similarly, overdue obligations in the 1-3 months category contracted further by 12.7% to $275.3 million, extending 2014's 7.0% falloff.

The half-year contraction in overall arrears was due to broad-based declines in the various components. Specifically, mortgage delinquencies fell by 5.8% to $657.9 million, after a 0.7% reduction in the preceding year, while the consumer segment declined by 12.0% to $292.5 million, following a 2.3% reduction in 2014. Similarly, commercial loan arrears decreased by 8.2% to $241.0 million, relative to the prior year's 5.6% contraction.



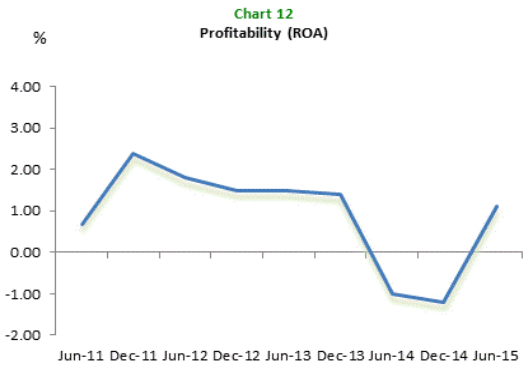
Source: Central Bank of The Bahamas



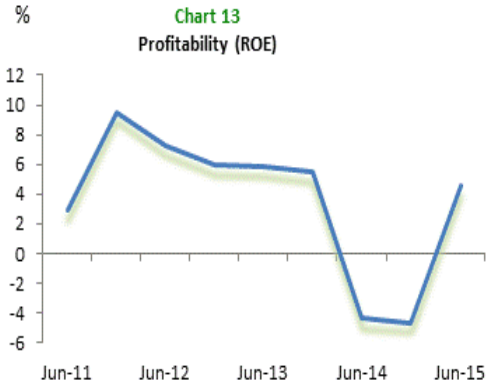
Source: Central Bank of The Bahamas

3.1.3. Profitability

Reflecting mainly a significant decline in bad debt expenses and one-off charges for goodwill impairment, banks' profitability indicators improved over the six-month period. The respective ratios of net income to total assets and equity, reversed to positive 1.1% and 4.5%, from negative outturns of 1.2% and 4.6% in 2014. The improvements in these ratios were explained by increases in commission and foreign exchange income, as the ratio of trading and fee receipts to total income firmed by 2.9 percentage points to 5.9%, extending the prior period's 33 basis points widening. Further, the ratio of net interest income to average assets was relatively stable at 5.3%, while a slight gain in interest revenue and a reduction in interest expense contributed to the net interest income to gross income ratio increasing by 20 basis points to 70.0%. Banks' total non-interest costs also narrowed over the period, resulting in a 16.1 percentage point reduction in the non-interest to gross income ratio to 50.2%.



Source: Central Bank of The Bahamas

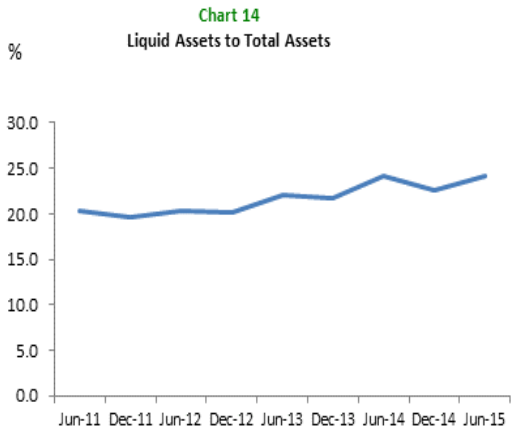


Source: Central Bank of The Bahamas

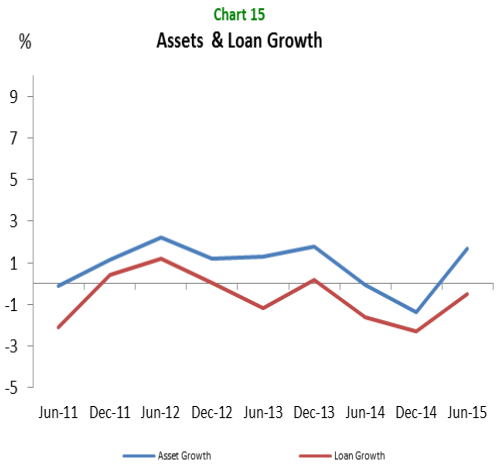
During the first half of 2015, the interest rate spread widened by 45 basis points to 7.28%, vis-à-vis an 11 basis points firming to 6.96% in the prior year.

3.1.4. Liquidity

Banking sector liquidity remained robust over the first half of 2015, supported by net foreign currency inflows from real sector activities and the persistent weakness in private sector credit. As a result, the ratio of liquid assets to total assets firmed by 1.5 percentage points to 24.2%, compared to a 2.5 percentage point rise in the prior period. Further, liquid assets also rose as a proportion of short-term liabilities by 2.2 percentage points to 36.6%, extending the 3.2 percentage points advance a year earlier. The liquidity buildup also corresponded to continued firming in the ratio of total deposits to loans by 2.4 percentage points to 93.6%. In addition, the share of demand deposits to total balances increased by 1.6 percentage points to 33.4%, after remaining stable in the prior year.



Source: Central Bank of The Bahamas



Source: The Central Bank of The Bahamas

3.1.5. Growth in Assets

Following 2014's incremental reduction, domestic banks' total assets rose by $446.4 million (4.6%) over the first half of 2015. This was largely attributed to a broad-based hike in other "miscellaneous" assets by $304.7 million (90.6%), while securities' holdings advanced by 8.4% ($134.8 million), due primarily to a 9.9% increase in investments in Government paper. Further, banks' cash balances at the Central Bank firmed by 12.5% ($75.6 million). In a slight offset, loans and advances decreased by $36.1 million (0.5%), owing primarily to a $59.7 million (0.9%) decline in credit to the private sector, overshadowing a $23.6 million (3.9%) rise in gross claims on the public sector (see Table 5).

TABLE 5										
Summary of Total Domestic Assets of the Banking System (B$M)										
	2008	2009	2010	2011	2012	2013	2014	Jun-13	Jun-14	Jun-15
Total Domestic Assets	**9,147.3**	**8,970.8**	**9,382.6**	**9,489.0**	**9,602.1**	**9,773.3**	**9637.1**	**9,723.5**	**9,765.7**	**10,083.6**
Loans and Advances	**6,997.3**	**6,951.1**	**7,075.5**	**7,103.7**	**7,106.0**	**7,118.8**	**6,954.4**	**7,021.3**	**7,003.0**	**6,918.3**
Government	145.8	76.5	180.3	145.7	152.4	253.6	352.1	164.0	230.9	362.1
Public Corps.	343.5	305.9	339.8	326.8	338.5	329.8	251.3	340.8	300.6	264.9
Private Sector	6,508.0	6,568.7	6,555.3	6,631.1	6,615.2	6,535.4	6351.0	6516.4	6471.5	6291.3
Other Assets	**870.1**	**479.4**	**449.0**	**441.6**	**491.6**	**512.3**	**336.3**	**484.3**	**332.6**	**641.0**
Till Cash	**117.6**	**111.8**	**113.2**	**126.9**	**127.4**	**138.1**	**142.5**	**93.7**	**100.2**	**109.8**
Balance with Central Bank	**322.3**	**375.6**	**518.7**	**560.1**	**563.3**	**513.6**	**606.7**	**659.0**	**757.5**	**682.3**
Securities	**840.0**	**1,052.9**	**1,226.3**	**1,256.7**	**1,313.9**	**1,490.5**	**1,597.3**	**1465.3**	**1572.4**	**1732.1**
Central Government	713.6	918.6	1,093.3	1,123.0	1,180.4	1,354.6	1361.5	1332.9	1436.6	1496.3
Rest of Public Sector	97.5	107.0	115.6	117.4	119.4	119.4	219.0	119.4	119.1	219.0
Private Sector	28.8	27.2	17.4	16.4	14.1	16.6	16.8	12.9	16.7	16.8
Source: Central Bank of The Bahamas										

3.1.6. Stress Testing Analysis

Overview

The Central Bank, through prudential supervision, continues to assess licensees' credit, interest rate and liquidity risks resilience via its stress testing models. For the first half of 2015, the results showed that the overall impact of the banking system's capital levels—based on the application of credit and the interest rate risk stress tests—was minimal, as healthy capital buffers were maintained. In addition, robust levels of liquidity were sustained.

Credit Risk

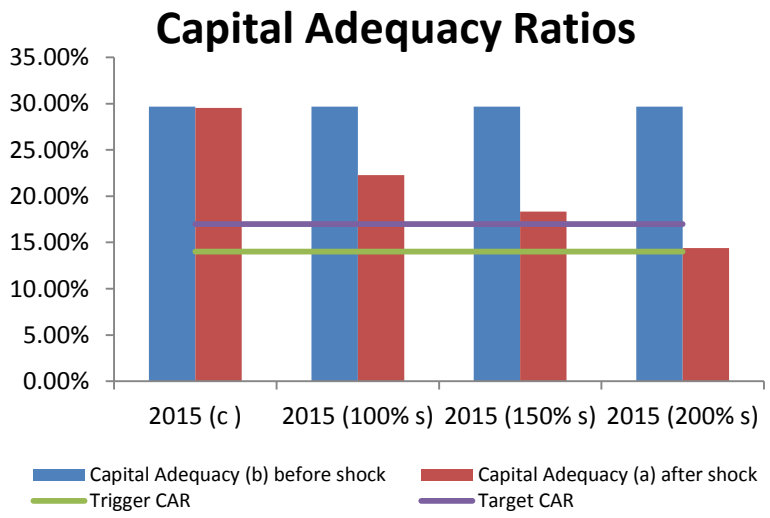
The stress testing for credit risks simulates the impact on earnings and capital adequacy of shocks (improvements or deteriorations) to the level of non-performing loans and provisioning levels, having regard to potential shortfalls against the 14% trigger and 17% target capital adequacy ratios.

Since the last update, the provisioning assumption for mortgages has changed, because the 50% additional haircut taken for mortgage property values, due to the subdued economic environment, is no longer assumed, given that the level of provisions has increased to more than 50% for this sector of loans. In conducting the stressed scenarios and using shocks to the NPL rates of 100, 150 and 200 percent for forecasted years 2015 through 2017, the level of deterioration in the non-performing loan book continued in 2015, but is anticipated to improve slightly in 2016 and 2017.

At forecasted levels over the 3-year period, NPLs remain at the $1.0 billion mark in 2015, but real economic indicators suggest that in the following two years, levels should drop below the $1.0 million mark. At shocked levels, NPLs increase within the $1.7 billion to $2.0 billion range (at 100 percent); $2.2 billion to $2.6 billion range (at 150 percent) and $2.6 billion to $3.1 billion (at 200 percent).

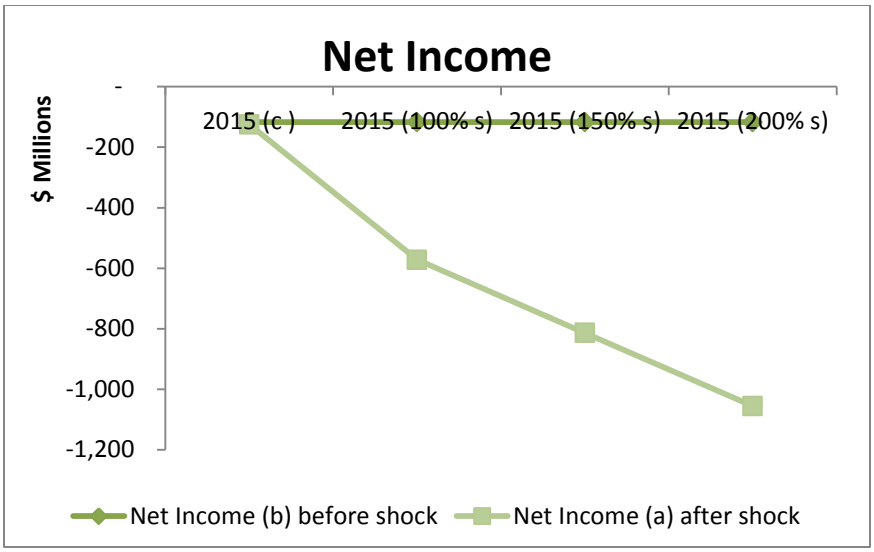
Chart 16 shows that, at the current (c) levels, the capital adequacy ratio (CAR) is slightly below 30%. Due to a stressed loan portfolio, this will negatively impact the banks' bottom line, thus indicating that should NPLs reach the 200% shock level, there will be a need to inject capital into the system, with the lowest ratio reaching a low of 14.4%, just slightly above the 14 percent trigger, but in breach of the 17 percent target ratio–the required level.

Chart 16



These adverse shocks would correspond to reduced earnings of banks, resulting from both higher provision levels and lower levels of interest income (Chart 17). Utilizing actual data for the previous period, the model assumes that prior to any shock there is an aggregate net loss of around $117.1 million, with further steady declines when shocks are applied. While the results are indicative at a system level, the capital levels at individual banks vary.

Chart 17



Interest Rate Risks

The interest rate stress test model continues to utilize the duration method in computing the impact of interest rate changes, in both local and foreign currency, on the banking book. With little to no movement in the Bahamian Prime Rate, there is no impact on banks' capital levels based on the domestic market. The banks' estimated capital levels at June 2015 stood at $2.0 billion. However, after the impact of assumed changes in the yield curve of 100 basis points for Bahamian currency and 200 basis points for foreign currency, the level increases to $2.2 billion. Thus capital buffers remain resilient in the face of such shocks.

Liquidity Risks

The liquidity risk stress tests model looks at projecting the solvency of a bank, should there be a run on deposits using a cash flow baseline, which focuses on liabilities due within a 30-day period or less and long-term assets, which can be quickly converted into cash to meet the obligations of the depositors. Using data reported quarterly to the Bank, various assumptions are made relative to the inflows and outflows, ranging from 0% - 80%, to determine the level of cash flow needed to meet liquidity demands. The results from the test suggest that the gap of the system's maturities within the short-term buckets (that is, up to 12 months), is covered by long-term highly liquid assets (greater than 1 year).

CHAPTER 4: THE INSURANCE SECTOR

4.1 Overview

The Insurance Commission of The Bahamas (ICB) functions as the supervisory body for the insurance sector, which comprises both domestic and international insurance companies. The 29 domestic firms at end-June comprised 12 life and health insurers, providing whole, term and universal life coverage, and 16 non-life insurers, offering automobile, fire, liability and property coverage and 1 association of underwriters. The sector is dominated by 10 major life and non-life entities, which together account for a combined market share of 80% of total gross premiums written and the majority of insurance coverage.

The external insurance sector, which is governed by the External Insurance Act, grew by 35 to 129 companies at end-June, 2015, of which 18 were insurance companies, 99 were captive cells, 9 were insurance managers and 3 were other external insurers. Despite accounting for the largest share in terms of the volume of companies, external entities by virtue of their activities have little impact on the stability of the overall sector. Consequently, the focus of this analysis will be on the domestic insurance sector.

4.2 Life Insurance

During the first half of 2015, life insurance companies continued to dominate the domestic insurance landscape, holding 76.3% of total assets and attracting 55.7% of gross premiums. Preliminary data from the ICB showed that the sector's aggregate assets rose by 1.0% to $1.2 billion during the six-month period, a turnaround from a 0.2% contraction a year earlier.

With regard to growth, the increase in assets was led by a 3.6% rise in the combined investment portfolio to $884.8 million, as holdings of Government securities—the largest asset category—advanced by 13.5% to $432.0 million, while the private sector segment decreased by 4.3% to $452.8 million. In terms of the latter, holdings of corporate securities and preference shares fell by a combined 27.2% to $53.0 million and corporate equity securities' holdings—both listed and unlisted—declined by 23.9% to $33.1 million. In addition, investment property assets were reduced by 1.5% to $86.0 million. In contrast, other "miscellaneous" investments more than doubled to $10.5 million and mutual funds expanded by 7.3% to $16.8 million. Further, mortgage loans firmed by 1.7% to $156.0 million, while policy loans rose by 1.4% to $97.4 million. With regard to other assets, cash & deposits—the most liquid asset category—contracted by 13.4% to $182.5 million, while fixed assets declined by 3.0% to $42.8 million.

Life insurance companies' total liabilities increased by 3.8% to $877.8 million in the first half of 2015, extending the year earlier growth of 2.7%. This outturn was due primarily to a 29.6% rise in other liabilities to $136.9 million, while technical reserves—which were utilized to finance policy holders'

claims and future benefits—edged up by a muted 0.1% to $741.0 million. However, equity levels were lower by 4.3% at $342.2 million, reflecting mainly a 39.8% reduction in other "miscellaneous" reserves to $43.7 million, which overshadowed the 6.7% gain in retained earnings to $200.3 million and the 1.1% rise in shareholders' capital to $98.2 million.

The sector's overall profitability improved vis-à-vis the same period of 2014, as net income rose by 17.5% to $23.2 million—an estimated 10.3% of total revenue. The growth in net earnings was explained by a 22.9% expansion in investment income to $33.2 million and a 6.4% gain in net premiums written to $192.9 million. Providing some offset, aggregate expenditure expanded by 7.7% to $202.9 million, when compared to the corresponding period last year, reflecting a 20.7% hike in other "miscellaneous" expenses and a 1.9% rise in net claims.

The majority of the financial soundness indicators for life insurance companies, associated with asset quality, capital adequacy and profitability, improved in comparison to their June, 2014 levels. With regard to assets, the ratios of both real estate-to-total assets and equities-to-total assets steadied at 7.1% and 5.6%, respectively. Reflecting an improved capital position, the aggregate ratio of capital-to-total assets trended upwards to 28.2% compared to 26.6% in the prior year, and the capital-to-technical reserves ratio moved higher by 3.0 percentage points to 46.2%, well in excess of the international benchmarks of 7.0% and 10.0%, respectively. Conversely, the ratio of net premiums to capital decreased by 3.1 percentage points to 56.4%. Relative to the same period in 2014, the expense ratio increased by 4.2 percentage points to 35.8%, due to increases in miscellaneous costs, while the respective return-on-equity and return on assets ratios firmed by 30 and 20 basis points to 6.8% and 1.9%, respectively. Improvement was noted in the investment yield ratio, by 40 basis points to 3.7% and in the investment income-to-net premium ratio, by 2.3 percentage points to 17.2% (see Table 6).

Table 6:
Life Insurance: Financial Soundness Indicators (%)

	2013	2014[R]	Jun 2013	Jun 2014[R]	Jun 2015[P]
Capital Adequacy					
Capital/Total Assets	28.2	29.7	26.7	26.6	28.2
Capital/Technical Reserves	44.9	48.3	44.5	43.2	46.2
Net Premium/Capital	108.7	104.7	58.5	59.5	56.4
Asset Quality					
Real Estate + unquoted equities + receivables)/Total Assets	14.7	14.4	14.5	12.9	13.8
Equities/Total Assets	6.0	6.4	5.7	5.5	5.6
Real Estate/Total Assets	7.5	7.3	7.3	7.1	7.1
Earnings & Profitability					
Expense Ratio (expense/net premium)	30.0	29.3	34.4	31.6	35.8
Investment Yield (investment income/investment assets)	6.1	6.3	3.6	3.3	3.7
Investment Income/net premium	14.2	12.2	16.2	14.9	17.2
Return on Equity (ROE)	12.4	3.6	6.0	6.5	6.8

Source: Insurance Commission of The Bahamas & Central Bank of The

[R] = revised

[P] = provisional

4.3. Non-Life Insurance

According to provisional data, the asset portfolio of the non-life insurance sector contracted by 6.0% to $434.8 million, led by a 45.3% reduction in fixed assets to $15.5 million. Also of note, reinsurance recoveries decreased by 38.9% to $26.8 million and cash & deposits by 20.0% to $92.6 million. Conversely, aggregate investments rose by 20.4% to $108.1 million, as debt claims via private instruments rose in aggregate, while holdings of Government debt were unchanged.

Total liabilities declined by 10.0% to $244.7 million, with the 15.2% contraction in technical reserves to $179.3 million, outstripping the 8.0% gain in other "miscellaneous" liabilities to $65.4 million. Similarly, total equity fell marginally by 0.4% to $190.1 million, with reductions in other reserves overshadowing gains in retained earnings share capital.

In comparison to the same period of 2014, the sector's overall profitability improved during the first half of 2015. Net earnings, which represented 15.7% of total income, expanded by 23.5% to $9.5 million, underpinned by gains in premium revenue. In particular, most of the 16.0% growth in total income to $60.5 million, was paced by increases in premium receipts of 16.6% to $55.8 million. In the meantime total expenses trailed, rising by a more modest 14.7% to $51.0 million, owing to growth in net claims and miscellaneous spending.

Other performance indicators for the non-life insurance sector were largely improved over the review period (see Table 7). Benefitting from a rise in earnings, the investment yield and investment income ratios widened by 20 and 30 basis points to 2.3% and 4.4%, respectively. Further, increases were registered for the return on equity, by 70 basis points to 5.0% and return on assets ratio by 40 basis points to 2.2%, vis-à-vis the same period a year earlier. In contrast, the loss ratio—which measurers net claims to net premiums—was higher by 4.5 percentage points at 35.4%, while the expense ratio, a measure of expenses to net premiums, contracted by 5.9 percentage points to 56.0%.

Table 7:
Non-Life Insurance: Financial Soundness Indicators (%)

	2013	2014[R]	Jun 2013	Jun 2014[R]	Jun 2015[P]
Asset Quality					
(Real Estate + unquoted equities + receivables)/Total Assets	50.8	51.3	59.4	51.2	54.5
Reinsurance and Technical Reserves					
Risk Retention Ratio (net premiums /total gross premiums)	34.7	35.8	25.8	28.8	32.1
Technical Reserves/Net Claims	463.8	415	824.6	1230.7	908.4
Technical Reserves/Net Premiums	167.4	169.8	390.7	380.6	321.3
Earnings & Profitability					
Expense Ratio (expense/net premium)	58.2	55.0	68.6	61.9	56.0
Loss Ratio (net claims/net premium)	36.1	40.9	47.4	30.9	35.4
Investment Yield (investment income/investment assets)	9.7	7.8	2.3	2.1	2.3
Investment income/net premium	6.1	5.6	4.8	4.1	4.4
Return on Equity (ROE)	11.3	9.0	3.6	4.3	5.0
Return on Assets (ROA)	4.5	3.7	1.5	1.8	2.2

Source: Insurance Commission of The Bahamas & Central Bank of The

[R] = revised

[P] = provisional

Non-life insurance companies' financial stability indicators remained at prudent levels during the first half of 2015. Although narrowing, technical reserves coverage stood at approximately nine times the value of net claims and more than three times net premiums, when compared to a year earlier.

CHAPTER 5: CREDIT UNIONS

5.1. Overview

Given the growing asset and client base of this sector over the past decade, in June, 2015, the regulatory and supervisory oversight of the sector was officially transferred from the Department of Cooperative Development to the Central Bank of The Bahamas. The transfer of supervision was in line with the World Council of Credit Unions' (WCOCU) recommended standards for enhanced surveillance of these entities. Current supervisory oversight of credit unions is targeted at promoting a buildup of capital buffers and increasing the share of income earning assets on these entities' balance sheets.

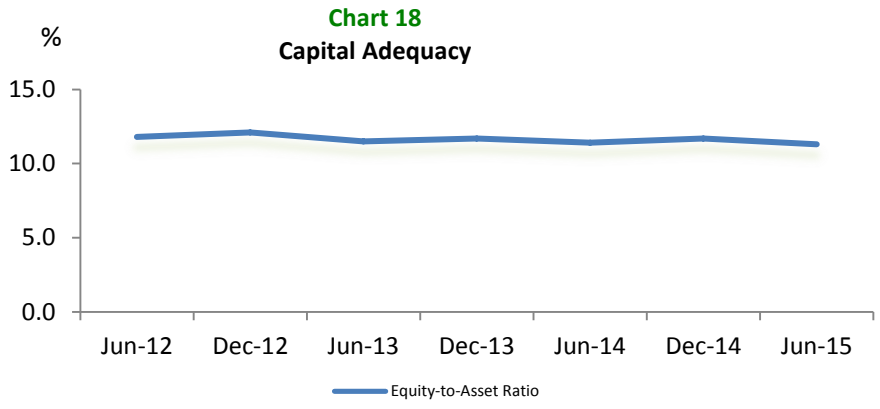
In the six months ended June, 2015, the sector recorded healthy growth in deposits, which fueled a rise in assets and liquidity. However, reflecting the mild domestic economic conditions, leading performance indicators weakened, as declines were recorded in both asset quality and profitability.

5.2. Capital Adequacy

The aggregate level of capital & surplus in the credit union sector remained relatively stable at approximately $41.0 million over the first six months of 2015, following growth of 2.6% in the same period last year. As assets increased, the ratio of total equity[4]-to-total assets (the gearing ratio) declined by 10 basis points to 11.3% at end-June, 2015. Despite the fall in the ratio, the sector's capital ratio remained above the 10% international PEARLS[5] benchmark, as set by the WCOCU.

[4] Total equity is equivalent to capital & surplus resources and includes members' capital and the reserve fund.

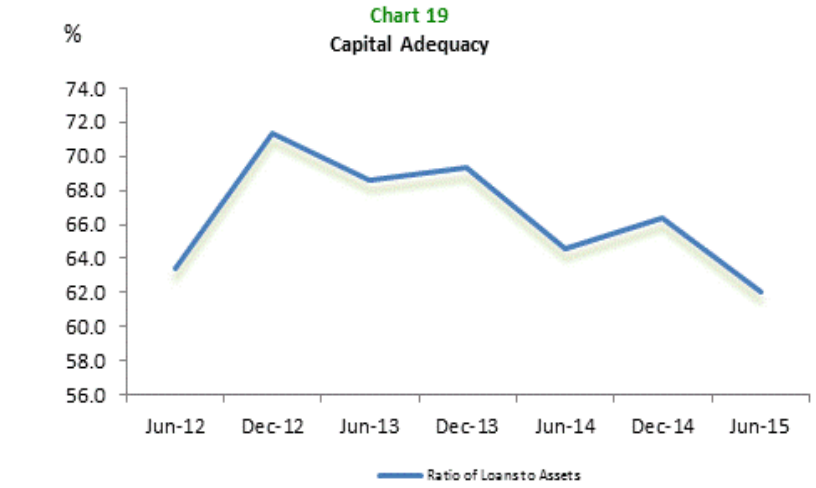
[5] PEARLS" is a financial performance monitoring system based on the International Credit Union Safety and Soundness Principles. It consists, *inter alia*, of a series of financial ratios which provide an assessment of an institution's performance in the areas of, protection, effective financial structure, asset quality, rate of return and costs, liquidity and size of growth.



Source: Centrla Bank of The Bahamas

5.3. Asset Quality

An analysis of the leading credit quality indicators revealed that credit unions maintained their conservative lending practices over the six-month period. Specifically, the loan-to-asset ratio for the sector declined slightly to 62.1% at end-June from 64.6% a year earlier (see Chart 19), while the ratio of loan loss allowances to total loans increased by 40 basis points to 5.9%. In addition, the ratio of provisions-to-loans steadied at 1.0%, when compared to the same period last year.



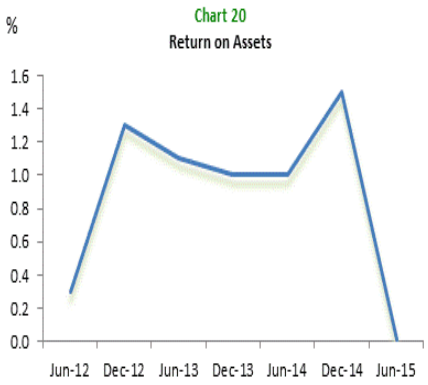
Source: Central Bank of The Bahamas

The value of assets not used directly to generate revenues (non-earning assets), which comprised land, buildings, vehicles, furniture and cash, also expanded further by 36.2% ($9.1 million) to $34.3 million, a slowdown from a gain of 61.7% ($10.6 million) recorded in the first six months of 2014. Reflecting the

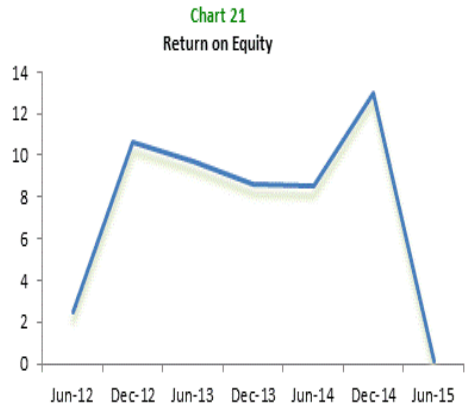
growth in non-earning assets, the ratio to total assets firmed by 1.4 percentage points to 9.5% at end-June, exceeding the prudential maximum of 5.0% of total assets.

5.4. Profitability

Occasioned primarily by declines in both interest and non-interest income, the sector's overall net income deteriorated to a mere $0.1 million over the six-month period, vis-à-vis a level of $3.4 million recorded in the comparative 2014 period. As a result, both the return on assets (ROA) and return on equity (ROE) ratios fell to 0.02% and 0.2% from 1.0% and 8.5%, respectively.



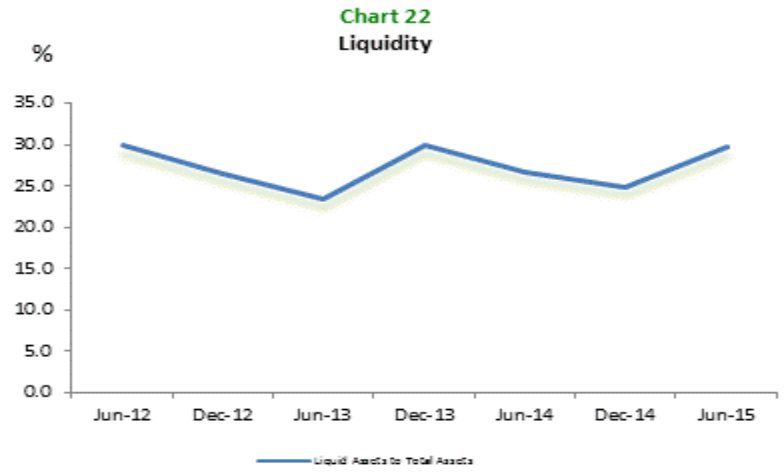
Source: The Central Bank of The Bahamas



Source: Central Bank of The Bahamas

5.5. Liquidity

Buttressed by a build-up in cash balances, credit unions' liquidity levels continued to increase, with the ratio of liquid assets-to-total assets firming to 29.8% from 26.8% at end-June over the prior year. Another measure of liquidity, the ratio of liquid assets (net of short-term payables) to total deposits, expanded by 3.4 percentage points to 34.8%, year-on-year. Further, both ratios remained above the minimum prudential standard of 15%, signaling that the sector in general continued to maintain adequate liquidity levels to meet their short-term obligations (see Chart 23).

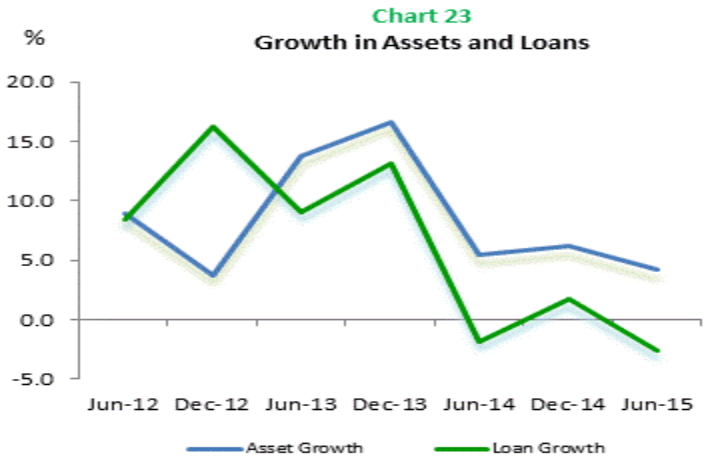


Source: Central Bank of The Bahamas

5.6. Assets

The total value of assets rose by 4.1% ($14.2 million) to $361.8 million over the six-month period, below the 5.4% ($17.7 million) expansion in 2014 (see Table 8). This was mainly concentrated in a 24.3% ($21.1 million) gain in liquid assets to $107.8 million (approximately 30% of total assets), following last year's 6.3% ($6.2 million) reduction. However, the total loan book, which accounted for 62.1% of overall assets, contracted further by 2.6% ($6.0 million), vis-à-vis a 1.8% ($4.1 million) decline in the prior year, owing to decreases in all major categories—with the exception of mortgages.

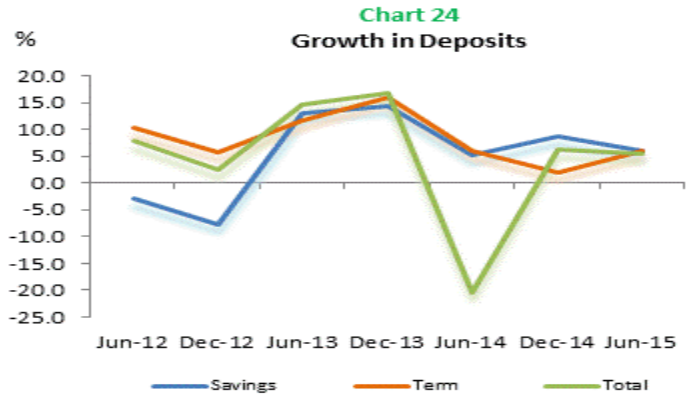
In terms of the components, consumer credit comprised the largest fraction of loans (71.5%), followed by mortgages/land (22.7%), revolving lines of credit (5.7%) and education (0.1%).



Source: The Central Bank of The Bahamas

5.7. Deposit Liabilities

Reflecting in part the continued growth in membership, deposits placed at credit unions expanded by 5.3% to $307.1 million at end-June 2015, following a 6.0% gain over the same period last year. Approximately half of deposits were held in savings accounts (50.5%), with nearly steady gains of 5.9% to $155.0 million. Term deposits—at 42.4% of the total—also firmed by 6.0% to $130.2 million, in line with the prior year's expansion.



Source: Central Bank of The Bahamas

TABLE 8

Selected Financial Indicators for Credit Unions (B$M)

	Dec-12	Jun-13	Dec-13	Jun-12	Jun-14	Dec-14	Jun-15
Assets	280.9	319.2	327.6	294.5	345.3	347.7	361.8
Loans	200.6	218.9	227.0	186.8	222.9	230.9	224.9
Deposits	235.3	269.4	274.7	247.3	291.1	291.6	307.1
Liquid Assets	74.7	75.0	98.6	88.4	92.4	86.8	107.8
Savings	117.8	133.1	134.8	123.8	141.6	146.4	155.0
Term Deposits	103.8	115.9	120.4	108.1	127.6	122.8	130.2
Non-Earning Assets	11.6	23.6	17.2	17.5	27.8	25.2	34.3
Allowance	8.5	9.8	11.2	7.8	12.2	11.8	13.2
Short-Term (ST) Payables	0.7	0.8	1.2	0.8	1.0	1.4	0.9
Capital & Surplus	34.1	36.8	38.4	34.7	39.4	40.7	40.9
Provisions	0.5	1.1	-0.01	0.1	1.0	1.1	1.3
Net Income	3.6	3.6	3.3	0.9	3.4	5.3	0.1
# of Credit Unions	13	7	7	13	7	7	8
Financial Ratios (%)							
Equity-to-Asset Ratio	12.1	11.5	11.7	11.8	11.4	11.7	11.3
Return on Assets	1.3	1.1	1.0	0.3	1.0	1.5	0.02
Return on Equity	10.6	9.7	8.6	2.5	8.5	13.0	0.2
Provisions to Loans	0.5	1.1	(0.01)	0.1	1.0	0.5	1.0
Loans to Total Assets	71.4	68.6	69.3	63.4	64.6	66.4	62.1
Liquid Assets to Total Assets	26.6	23.5	30.1	30.0	26.8	25.0	29.8
Non-Earning Assets/Total Assets	4.1	7.4	5.3	6.0	8.1	7.2	9.5
Allow. for Loan Losses-to-Gross Loans	4.2	4.5	4.9	4.2	5.5	5.1	5.9
(Liquid Assets-ST Payables)/Total Dep.	31.4	27.5	35.5	35.4	31.4	29.3	34.8

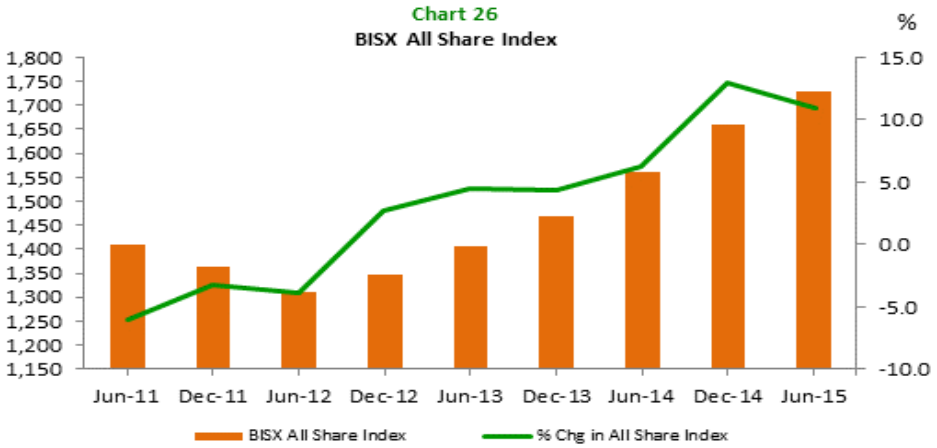
Source: Department of Cooperative Development

CHAPTER 6: CAPITAL MARKETS

Reflecting the mild domestic growth trajectory and investors' conservative stance, developments in the local equity markets remained subdued over the first six months of 2015. Specifically, the total volume of securities traded on BISX contracted by a further 22.9% to an estimated 1.2 million, following the prior year's 7.2% reduction (see Chart 26). Although the average daily trading volume decreased by 15.5% to 11,274 shares, pricing gains pushed the aggregate value of shares traded higher by 4.4% to $7.3 million.

Source: Central Bank of The Bahamas & BISX

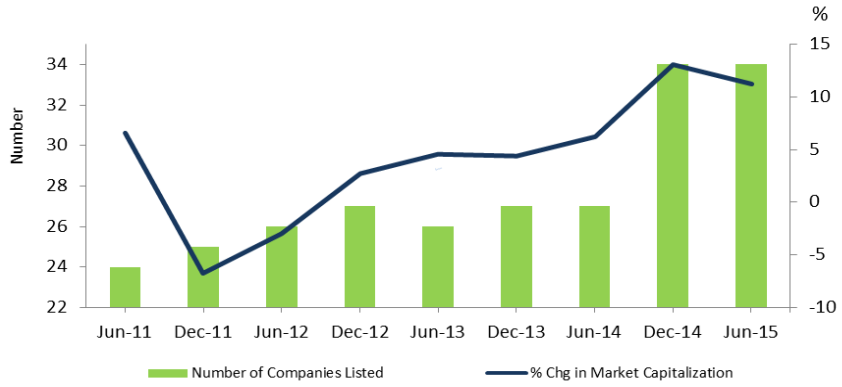
With regard to other market indicators, the BISX All Share Index rose by 10.9% to 1,730.3 points at end-June 2015, following a similar increase in the previous year (see Chart 26).



Source: Central Bank of The Bahamas & BISX

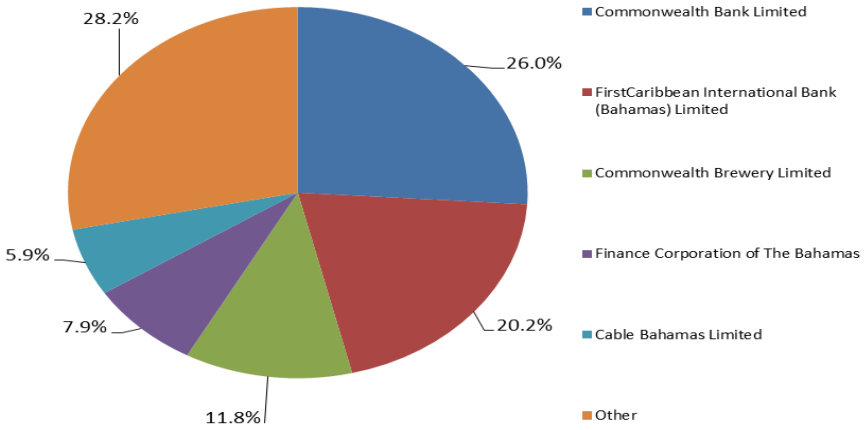
Amid price gains for a number of securities, market capitalization increased by an estimated 11.2% to $3,697.4 million, slightly above the year-earlier rise of 10.9%. The number of securities listed on the exchange advanced by 5 to 34 (see Chart 27), due to new preference share placements by a domestic bank, while tranches of debt securities decreased to 3 from 4 and common shares remained unchanged at 20. At end-June, the 5 largest companies listed on the exchange represented a dominant 71.9% of the total market capitalization, albeit lower than the 74.8% recorded in the prior year (see Chart 28).

Chart 27
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Chart 28
Share of Total Market Capitalization at End-June 2015



Source: Central Bank of The Bahamas & BISX

CHAPTER 7: PAYMENTS SYSTEMS

During the first six months of 2015, the Bank maintained its ongoing programme to ensure that the national payments system—which forms a critical part of the financial services architecture—continued to introduce and develop new and innovative payment instruments and methods. In this regard, the Bank began the process of developing the regulatory guidelines for licensing and supervising retail payments services in general and mobile/electronic money businesses. Draft regulations were also prepared to enable the Bank to provide offsite and onsite supervision of credit bureaus—after the enabling legislation has been enacted and the provider chosen. Similarly, the Bank sustained its offsite and onsite review of systemically important payments systems, including enhancing its compilation and analysis of statistics.

7.1. Real Time Gross Settlement (RTGS)

The RTGS system is owned and operated by the Central Bank and processes large value transactions (greater than B$150,000). During the review period, the volume of transactions processed through the RTGS increased by 30.5% to 36,271 items, a reversal from the incremental 0.1% fall to 27,803 transactions recorded a year earlier, while the corresponding value firmed robustly by 62.3% to $10.6 billion, extending the 6.1% gain noted in 2014.

7.2. Payment Instruments

7.2.1. Cash

An analysis of the use of cash during the initial half of 2015, confirmed that despite the increase in access and use of electronic mechanisms, cash remains the dominant mode of payment. Data for the period ending June, 2015, indicated that the value of currency in active circulation rose by 5.5% to $232.3 million, outpacing the 2.1% gain noted in the same period of 2014, while its share relative to the more encompassing broad money (M2) increased marginally by 10 basis points to 3.7%.

7.2.2 Automated Teller Machines (ATMs)

As commercial banks continued to expand customers' access to banking services beyond the traditional branch network, ATM installations expanded during the first half of the year by 7.4% to 349. Of this number, approximately 90% were configured to dispense only Bahamian currency, while the remaining installations provide both local currency and US Dollars. During the year, the volume and value of transactions processed through ABMs declined by an estimated 12.2% to 2.8 million and by 4.5% to $1.4 billion, respectively.

7.2.3. Cheques and Electronic Payments

The rise of electronic settlements continues to erode the relative importance of cheques for routine and small value transactions. The number of cheques presented for clearing through the ACH during the first six months of 2015, declined by 13.8% to 1.39 million, extending the 27.9% fall-off recorded in the same period of 2014. In contrast, the value of instruments presented for settlement grew by 5.4% to $3.6 billion, a reversal from a reduction of 9.2% to $3.4 billion noted in the prior year.

With regard to electronic payments using the National Automated Clearing House Association (NACHA) format, instructions processed by BACH—consisting primarily of direct deposits of salaries and transfers—firmed by approximately 10.1% in volume to 0.98 million, with the associated value rising by 13.5% to $730.5 million.

7.2.4. Debit Cards

The popularity and use of internationally branded debit cards has risen substantially since their introduction in the 1970s. Currently only one commercial bank has yet to re-brand its cash/ATM cards with true debit functionality, although this is expected to change in the near-term. In this regard, the volume of transactions recorded using these instruments rose by an estimated 13.6% when compared to the same period of 2014, while the corresponding value firmed modestly by 1.2% to $2.3 billion.

7.2.5. Credit Cards

Credit card usage during the first half of the year reflected the ongoing cautionary environment, as cardholders reduced their outstanding balances and banks generally issued fewer cards with reduced limits. As a consequence, data for the first six months of 2015 showed that the volume and value of transactions contracted by 10.8% and 27.9% to 0.6 million and $143.4 million, respectively.

CHAPTER 8: ASSESSMENT OF RISKS

The analysis provided in the previous chapters illustrated that the risks to the domestic financial sector remain relatively low, given the conservative nature of the banking system with its deposit-based funding model, robust capital levels and prevalence of collateral-backed loans. In addition, the other smaller sectors are generally compliant with international standards and have regulatory regimes in place to ensure that changes in global requirements are implemented locally.

From a central bank perspective, chief among the measures to further strengthen the regulatory regime is the rollout of the Basel II and III programmes for the banking sector, which are scheduled for implementation on January 1, 2016. Among credit unions, further balance sheet strengthening is envisioned under the enhanced Central Bank oversight. In this regard, the Bank has issued guidelines regarding the management of credit, liquidity, operational and interest rate risks, while plans are underway to eventually implement a deposit insurance scheme for these firms.

Further, significant progress has also been made towards the establishment of a credit bureau, which, *inter alia*, will enhance the ability of lending agencies to evaluate potential borrowers' credit worthiness. In addition, the Bank is also involved in formulating a National Crisis Management Plan, which will allow for greater cooperation between regulators, in order to allow them to quickly detect emerging risks and resolve adverse developments.

In terms of the insurance sector, in order to adequately address risks the ICB has issued Corporate Governance Assessment Criteria, which are used by companies as a guide for good practices. In addition, the ICB utilizes a risk-based supervisory framework, which facilitates the early identification of emerging risks and closer oversight of institutions deemed "high risk". This framework therefore serves to improve the overall safety and soundness of the sector.

Going forward, it is expected that all of the regulatory agencies will continue to focus attention on strengthening their respective regulatory and supervisory frameworks, to ensure that they remain in line with international standards, while also protecting the stability of the financial sector.

The macro-economic outlook also weighs incrementally more favourably on the financial system, as it is expected to provide further scope for stabilization and a gradual reduction in outstanding credit arrears, and give lending institutions more capacity to resolve distressed loan exposures.