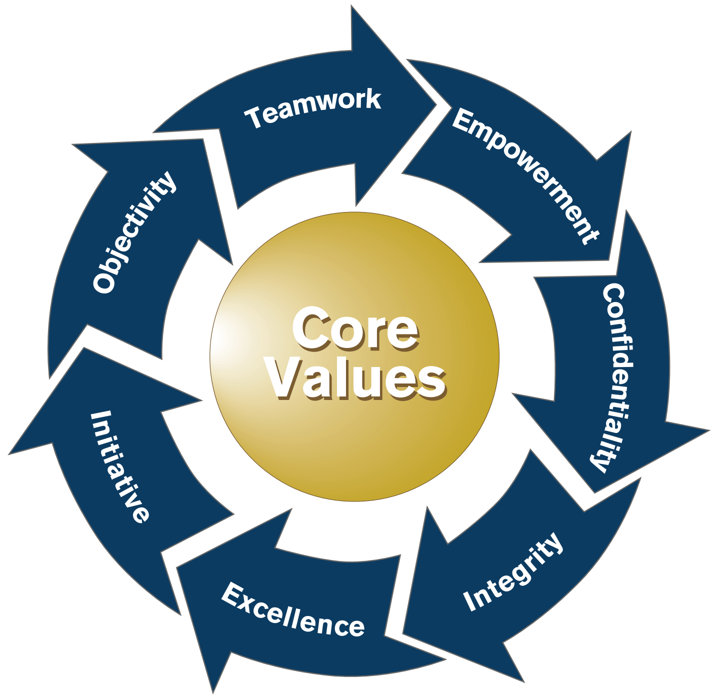
THE CENTRAL BANK · OF THE BAHAMAS ·

2010

ANNUAL REPORT
and Statement of Accounts

For the year ended 31 December, 2010



Mission

To foster an environment of monetary stability conducive to economic development, and to ensure a stable and sound financial system through the highest standards of integrity and leadership.

Vision

To promote a leading financial services industry within the framework of dynamic monetary policy developments, modernized payment systems, sound management strategies and capacity building.

April 12, 2011

Dear Prime Minister:

In accordance with Section 32(1) of the Central Bank of The Bahamas Act, 2000, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2010. Included with this Report is the Annual Statement of Accounts of the Bank for the year.

Respectfully yours,

Wendy M. Craigg
Governor

The Rt. Hon. Hubert A. Ingraham
Prime Minister and Minister of Finance
Office of the Prime Minister
Sir Cecil Wallace-Whitfield Centre
Cable Beach
Nassau, N.P., Bahamas

Directors and Senior Officials

At December 31, 2010

DIRECTORS

Mrs. Wendy M. Craigg – Chairman

Mr. Philip Stubbs

Dr. Ronald Knowles

Mr. Wayne Aranha

Mr. Colin Callender, Q.C.

SENIOR OFFICIALS

Mrs. Wendy M. Craigg	Governor
Mr. Michael F. Lightbourne	Deputy Governor
Mr. Stanislaw J. Bereza	Inspector, Banks & Trust Companies
Mr. Bert A. Sherman	Senior Manager
Ms. Cecile M. Sherman	Manager, Banking
Mrs. Sylvia L. Carey	Manager, Human Resources
Mrs. Cassandra C. Nottage	Manager, Banking Supervision
Ms. Rochelle A. Deleveaux	Legal Counsel & Board Secretary
Mr. Gerard L. Horton	Manager, Exchange Control
Mr. John A. Rolle	Manager, Research
Mr. Keith T. Jones	Manager, Accounts
Mr. Errol L. Bodie	Manager, Information Technology
Mr. Ian B. Fernander	Manager, Administration
Ms. Cleopatra Rolle	Manager, Internal Audit

CONTENTS

FOREWORD

In 2010, the world economy continued to emerge from the recession following the wake of the recent financial crisis. For The Bahamas, recovery in major overseas source markets aided in a revival of tourism activity and provided for a stable economic outcome. However, domestic business activity and employment conditions remained weak, and dampened the level of private sector credit growth. Abated levels of foreign exchange earnings from the real sector were somewhat compensated by several sizeable one-off transactions, sustaining a healthy level of external reserves and robust bank liquidity. Given the lack of broadening in the recovery, the Bank's monetary policy posture was unchanged in 2010, with close attention given to monitoring trends within the financial sector.

Financial sector conditions were relatively stable over the year, despite a deterioration in banks' credit quality indicators, which occurred at a diminished rate in comparison to 2009. The system's aggregate capital ratio was well in excess of the Bank's 17.0% regulatory requirement, and firms continued to increase measures to buffer provisions against loan losses and assist customers in restructuring loans to guard against increased delinquencies.

Nevertheless, consumers remained cautious in their spending patterns and appeared to focus on reducing their outstanding obligations. The resultant softness in consumer demand dampened Government's revenue intake, due to the high proportion of import and other indirect taxes in the revenue mix, although the overall fiscal performance benefitted from gains associated with new revenue measures. As spending levels increased, however, the overall deficit deteriorated further from pre-crisis levels.

In its own affairs, the Bank continued to make progress towards the achievement of its strategic goals, as defined in the 2009 – 2013 Strategic Plan, which already included activities to ensure the resiliency of the Bank in this more challenging environment. Key milestones were achieved in measures undertaken to strengthen the effectiveness of the monetary policy framework, through improvements in the Bank's financial programming model. Safety and soundness objectives were advanced in the strategic rollout of a comprehensive risk assessment framework for the supervision of banks and trust companies, the strengthening of the legal framework for bank supervision and further enhancements to the stress testing model. The Bank's ongoing effort towards the implementation of a credit bureau and the development of a framework for the supervision of financial conglomerates with other domestic regulators are yet other initiatives that will drive this objective in the coming year.

Several significant legislative changes took place during the year. In particular, the Central Bank of The Bahamas (Amendment) Act, 2010 came into force in September 2010 which, *inter alia*, expands the duties of the Bank to include ensuring financial stability and overseeing the development of a sound and efficient national payment and securities settlement system as core functions. Various amendments were also made to the Banks and Trust Companies Act, 2010 to enhance the Bank's oversight function. These are to be supported by the compendium of draft legislative and regulatory initiatives relative to the oversight of domestic payment systems and instruments, which have already completed the public consultation phase and now await final legislative approval.

Undoubtedly, the Bank has been able to confront the challenges of the current economic environment by drawing on the strength of its staff, who I would like to thank for their dedicated efforts.

OUR OPERATIONS

GOVERNANCE & ACCOUNTABILITY

The Bank's corporate governance framework, as outlined in the Central Bank of The Bahamas Act, 2000 (the Act), prescribes, inter alia, the roles and responsibilities of the Board of Directors, the Governor and the Deputy Governor.

Board of Directors

During 2010, the Board of Directors, chaired by the Governor, continued to provide policy and general administrative direction to the Bank. In January, Dr. Duane Sands resigned from the Board and was replaced, in September, by Dr. Ronald Knowles, bringing the number of directors to the full complement of five (5).

On appointment to the Board, each member is required, under the Act, to sign a declaration of secrecy in relation to the affairs of the Board and the Central Bank. Board members are indemnified by the Bank against personal, civil or criminal liability, in respect of any act done in good faith while carrying out, or intending to carry out, their duties under the Act. Board members have adopted a Code of Conduct, which provides guidance on the ethical standards expected of them in connection with the execution of their responsibilities and duties.

The Board, which is required to hold monthly meetings, met on twelve (12) occasions in 2010. Three (3) Directors form a quorum and, in the absence of the Governor, the Deputy Governor is entitled to exercise a vote. During its meetings, the Board considered regular reports on monetary and financial developments; monthly financial statements and reports comparing actual financial performance against the approved budget; and substantial financial contracts for the procurement of goods and services; and was kept informed of the Bank's activities and decisions through detailed quarterly operational briefings.

Audit Committee

Since January 2009, the Audit Committee has been integral to strengthening the corporate governance framework of the Bank. The Committee assists the Board in fulfilling its oversight responsibilities for the financial reporting process, the system of internal controls, risk management issues, and liaising with the external auditors and making recommendations to the Board regarding financial reporting and the effectiveness of the internal audit function. The Committee also played an active role in monitoring the implementation of recommendations made by both the external and internal auditors.

The Audit Committee consists of three (3) non-executive Board Members, Mr. Philip Stubbs (Chairman), Mr. Wayne Aranha and Mr. Colin Callender, Q.C. The Heads of Internal Audit and the Accounts Department normally attend the meetings of the Committee. In 2010, the Committee held fourteen (14) meetings, inclusive of three (3) with the external auditors.

Accountability & Transparency

The Bank seeks to ensure a high degree of transparency in the conduct of its affairs, which facilitates accountability. In accordance with statutory requirements, the Bank prepares a report of its activities during the year, which is submitted to the Minister of Finance within four (4) months after the end of

BOX 1: STRATEGIC FOCUS FOR 2011

STRENGTHEN THE MONETARY POLICY FRAMEWORK

- Improve the existing annual forecasting methodology and create quarterly forecasts.
- Develop the framework for monitoring and forecasting banking system liquidity.
- Implement a market based auction mechanism for Government bonds.
- Introduce a comprehensive online reporting system for licensees.
- Enhance operations of the new Payments Unit.

STRENGTHEN AND IMPROVE THE SUPERVISORY REGIME

- Complete implementation of the risk-based supervisory framework.
- Extend the stress testing framework, to include interest rate and liquidity risks.
- Improve crisis management capabilities.
- Enhance coordination mechanisms with other financial sector regulators.

STRENGTHEN THE BANKING AND TRUST SECTOR

- Continue to build internal capacity in the areas of trust and wealth management.
- Sustain efforts to implement a credit bureau.
- Pursue dialogue with banks towards the implementation of a national ATM switch.
- Progress work towards the eventual assumption of regulatory and supervisory responsibility for credit unions.

DEVELOP LEGAL FRAMEWORK AND ENSURE BUSINESS CONTINUITY

- Ensure continued compliance with core principles for systematically important payment systems.
- Fully implement the Bank's Succession Plan.
- Complete the build-out and maintain readiness of the Disaster Recovery Plan.

each fiscal year. Copies of this report are laid before Parliament. Monthly balance sheet information is also provided to the Minister and published in the Gazette. In addition, the Bank releases publications on domestic economic and financial developments in its Monthly Economic and Financial Development (MEFD) reports, Quarterly Economic Reviews (QER) and Quarterly Statistical Digests (QSD). All of these publications are made available to the public on the Bank's website.

To support the desired level of coordination between monetary and fiscal policy, and to keep the Minister informed on the Bank's performance of its statutory obligations, the Governor meets monthly with him or his designee.

Strategic Planning

The Board-approved Strategic Plan (2009-2013) sets out the goals, objectives and strategies which continued to underlie the activities pursued by the Bank during 2010. In November, Management conducted its annual review of the Strategic Plan, to evaluate progress with the various activities targeted for 2010. The report, which was submitted to the Board in December, showed that the main focus areas of the Plan were largely on target for completion within the agreed timeframes, and the Board approved several adjustments to target dates, as required. The Bank's work programme for 2011 will continue to be guided by the various activities outlined in the Plan.

Bank Management

The Bank's executive management comprises the Governor, the Deputy Governor and Department/Unit Heads, who meet weekly to discuss ongoing work programmes and activities. Internal governance is supported by several committees, either directly chaired by the Governor or under delegated authority to other Bank officers. These committees remain active in providing clear advice on matters pertaining to the Bank's core functions and overall operational practices and procedures, as well as the implementation of the Strategic Plan, as approved by the Board.

BOX 2: KEY MANAGEMENT COMMITTEES

COMMITTEES	MEETING FREQUENCY	PURPOSE
Executive Management	Weekly	Considers management and day-to-day operations of the Bank.
Monetary Policy	Monthly	Discusses economic and monetary developments and decides on issues relating to the formulation and implementation of monetary policy.
Investment	Weekly	Maintains oversight and management of the country's external assets, and provides input into the investment recommendations for the Staff Pension Fund and Voluntary Savings Plan, and dormant accounts and sinking funds under the Bank's management.
Policy Advisory	Monthly	Considers supervisory and regulatory policy initiatives applicable to the banking and trust industry and money transmission businesses.
Pension Administrative	Quarterly	Considers matters relating to the administration of the Bank's pension plan, including financial statements and actuarial reports.
Selection and Appointment	As necessary	Undertakes final screening and makes recommendations of candidates applying for position vacancies at the Bank.
Tenders	As necessary	Oversees the procurement process for significant items, starting with the request for proposal, and culminating with the recommendations for vendor selection.

Monetary Policy

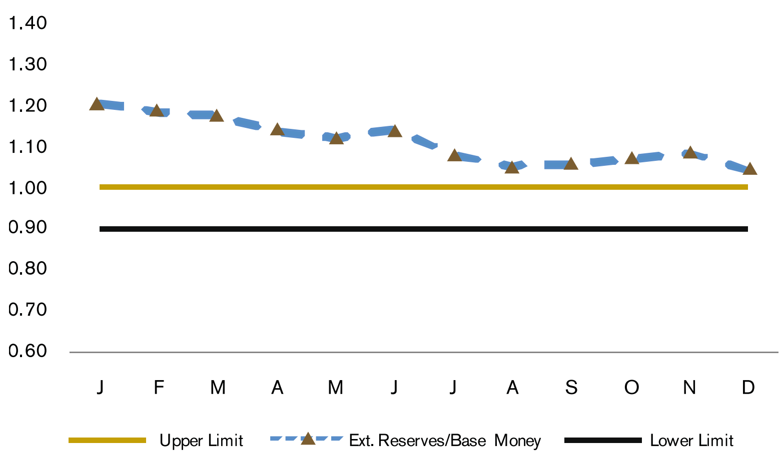
The Bank's Monetary Policy Committee (MPC) is charged with reviewing monetary and financial trends and developments within the banking sector, with a view to determining policies to effect a stable monetary environment. In this regard, the Committee sustained its monitoring of domestic and international developments to assess their impact on the financial sector and, by extension, their effects on external reserves.

The MPC held twelve (12) regular meetings in 2010 and, in its deliberations, took note of a number of persistent themes and outcomes, namely:

- The tentative signs of recovery in the global economy during 2010, particularly in the United States market, contributed to a steady recovery in visitor arrivals in the key tourism sector. However, industry discounts and other incentive programmes tempered the level of foreign currency receipts from the sector.
- Foreign investment inflows were muted, as global credit markets remained constrained.
- Domestic financial sector developments were dominated by the continued growth in loan arrears and sluggish real sector activity which, alongside persistent high unemployment levels, led to banks maintaining a conservative lending posture—contributing to an anaemic level of private sector credit growth.
- External reserves were significantly boosted by a number of extraordinary one-off receipts.

The key external reserves indicator, the ratio of external reserves to base money, remained comfortably above the Bank's policy target range, of 90% to 100%, during 2010. For the first six months of 2010, the ratio varied within the range of 111% - 120% of base money, in line with the typical firming in tourism receipts during the winter tourist season, and was augmented by net inflows from the sale of a business entity in May. Over the balance of the year, the ratio trended downwards, as net foreign currency inflows related to real sector activities slowed, and there were some gains in private sector credit. However, external reserves were supported by Government's short-term foreign currency borrowings from the domestic banking sector in September, and the receipt of proceeds from a bank's capitalisation of its local subsidiary in November.

Ratio of External Reserves to Base Money (2010)



Source: The Central Bank of The Bahamas

The Committee maintained its close monitoring of domestic commercial banks, and observed a significant slowdown in the rate of deterioration of credit quality indicators. To support its deliberations, the Committee, through the Bank Supervision Department, made several requests to the commercial banks for more detailed information on the composition of arrears, loan restructuring as well as banks' practices regarding provisions and loan write-offs, with the objective of ensuring consistency and the adoption of best practices across institutions. Further scrutiny of individual firms was undertaken during the Department's quarterly prudential meetings, the results of which were reported to the Committee during its monthly sessions. Overall, the Committee acknowledged the likelihood of a persistence of the arrears rate at current levels, given the near term outlook for no notable change in employment and general economic conditions which would materially improve borrowers' ability to meet their obligations. Notwithstanding, no financial stability issues were signalled, in light of banks' healthy capital positions.

The Committee also determined that, overall, the Bahamian economy showed signs of stabilization in 2010, with opportunities for an improved performance in 2011, based on several planned real sector projects. Nonetheless, the Committee did not discount uncertainties associated with the pace and broadening of the global recovery.

Given the sluggishness of the real sector and the fact that growth in external reserves—which supports the parity of the Bahamian Dollar with the US Dollar—primarily emanated from extraordinary foreign exchange inflows, the Committee decided to leave the monetary policy posture unchanged in 2010. The Committee undertook to continue its close monitoring of domestic and international developments, to assess their impact on the financial sector and external reserves, and the need for any change in policy perspective.

RISK MANAGEMENT

The Bank's executive management team is responsible for ensuring that risk management principles are integral to daily operations and that all risks are sufficiently addressed. Among the key mechanisms used to deal with operational risks are effective budgetary controls, separation of duties, the creation of policies and standard operating procedures, a sound procurement framework and an internal audit function that continues to play a crucial role in monitoring operational risks.

The Bank continued to give focus to its readiness and response capabilities to business disruptions. As part of its ongoing efforts to put in place a comprehensive Business Continuity Plan (BCP), the Bank engaged a consultancy firm to develop the Plan. The strategy was informed by a disaster simulation exercise organized for the senior management, who also took on board recommendations submitted by the consultants to address issues identified in the BCP risk assessment and business impact analysis segment of the project.

In 2010, the Bank's focus on people risk was underscored with the completion of its Succession Plan, using a framework developed by executive management and approved by the Board. Based on Department Heads and the Succession Planning Team's assessment, employees were identified for the Talent Pool, from which the Bank may draw to fill critical position vacancies. Steps are now underway to finalize development plans for employees assigned to the Talent Pool, with the objective of addressing any competency gaps identified in the assessment process.

To manage the risk of fraud and other irregularities, the Board approved a comprehensive Fraud and Corruption Prevention Policy, which provides a system for prevention, detection and the reporting of any suspected fraudulent or corrupt activity. The Policy seeks to:

- raise and promote the awareness and vigilance among employees, that the prevention of fraud and corruption is a shared responsibility;
- ensure that management is aware of its responsibilities for establishing procedures for preventing fraudulent or corrupt activities and/or detecting fraud or corruption when it occurs; and
- ensure that all suspected fraudulent and corrupt activities may be reported, even anonymously, and are properly addressed.

Other areas and discussions around risk included security and access management, IT controls and vendor management.

INTERNAL AUDIT

Internal Audit (IA) is an essential component of the Bank's internal control framework, through its independent and objective evaluation and reporting on the effectiveness of controls, risk management, and the governance process. In so doing, it assists the Bank in its pursuit of efficiency and excellence. The operations of the Internal Audit Unit are guided by a Board-approved Internal Audit Charter, which formalizes the mission, authority and responsibilities of this function within the Bank.

The Unit's efforts are framed within the context of a risk-driven Annual Audit Plan, which is approved by the Board. To maintain independence, the Head of Internal Audit reports functionally to the Audit Committee, through monthly meetings, and operationally to the Governor.

In 2010, the Unit conducted an Executive Review and reviews of processes in the Accounts, Banking, Bank Supervision, Exchange Control, Research, Administration, and Human Resources Departments. A number of follow-up reviews of management's implementation of audit recommendations were also undertaken during the course of the year. Overall, there was adequate assurance that a sufficient framework of key controls was in place to facilitate attainment of the Bank's objectives.

CURRENCY AND BANKING SERVICES

Currency Operations

The Banking Department is responsible for ensuring an adequate supply of Bahamian currency (banknotes and coins) in circulation, along with maintaining confidence in the banknotes issued to the public. In this context, the Department takes special care in the design, minting and printing of currency, and in pursuing appropriate due diligence in the issuance and redemption of banknotes, and the issuance of coins. Thirteen (13) circulated currency denominations currently exist, comprising eight (8) banknote and five (5) coin denominations. Banknotes are issued in denominations of $0.50, $1, $3, $5, $10, $20, $50, $100, and coins are circulated as 1¢, 5¢, 10¢, 15¢ and 25¢. In terms of value, the $100 banknote maintained the largest share of currency in circulation at end-December 2010, at 37.9% of the total, and the 1¢ coins constituted 74.7% of the aggregate volume of currency. During the year, the Bank issued reprints of the ***CRISP*** $10 and $20 banknotes, which were previously released in 2005 and 2006, respectively. Although there were no design changes, both banknotes contained slight security upgrades.

The Bank remained committed in its efforts to combat counterfeiting, thereby promoting public confidence in the banknotes. To assist retailers and cash handlers in the verification of the authenticity of banknotes, the Bank hosted Counterfeit Detection Seminars, in Nassau and Freeport, during which time participants were provided with updated information and materials.

Procedural upgrades in the distribution and management of currency, introduced in the latter half of 2010 in collaboration with the commercial banks, are expected to significantly improve the issuance, redemption and expenditure aspects of the currency operation.

For 2010, both the value of the Bank's currency liabilities and amounts held in active circulation by the public decreased, by 3.8% each, to $307.8 million and $307.2 million, respectively. Average currency in circulation fell by 1.2% to $276.0 million, which represented an estimated 3.7% of GDP. However, currency measures do not take into account the co-circulation of United States currency.

Daily Exchange Rate Fixing

The Bank's official buying and selling rates for U.S. dollars from/to commercial banks was unchanged at US$1.00 = B$1.00 and US$1.00 = B$1.0025, respectively, and at par for cash transactions. Foreign exchange rates for the quotation of Pound Sterling were obtained each business day from the international market, at 9:00 a.m. and 11:30 a.m., and at other appropriate intervals, depending on the dollar value of transactions and market volatility. For Sterling sales, the Bank maintained the policy of adding a commission of one half of one percent to the mid-rate. The highest bid and offer Pound Sterling/Bahamian dollar rates, of 1.6357 and 1.6439 respectively, were employed on January 19, 2010 and the lowest, of 1.4328 and 1.4400 respectively, on May 25, 2010.

Relations with the Public Sector

As official registrar and transfer agent for Government debt, the Bank continued to oversee and facilitate the issuance, redemption and servicing of Bahamas Government Registered Stock (bonds) and Treasury bills, alongside debt securities issued by the Bahamas Development Bank, Bahamas Mortgage Corporation, the Clifton Heritage Authority and the Bridge Authority.

For Treasury bills, the statutory ceiling on the maximum amount Government is permitted to borrow remained capped at 25 percent of the lesser of ordinary revenues, as provided in the most recent approved budgetary estimates, or the average revenue for the latest three years of audited accounts which have been tabled in Parliament. The issuance of an additional $57.3 million in Treasury bills increased the undiscounted outstanding stock to $301.6 million for 2010, and a total of $37.4 million was rediscounted. With regard to price, the average tender rate (on rollover maturities) rose by 13 basis points to 99.02%, which corresponded to a 37 basis point reduction in the average discount rate, to 2.44% at end-December 2010.

During 2010, the outstanding value of Bahamas Government Registered Stock rose by 10.3% to $2,503.6 million. The Bank, as Registrar, arranged four (4) new bond issues totaling $294.7 million and redeemed a scheduled $60.0 million. New issues featured a maximum maturity limit of 27 years and stable effective coupon rates, at spreads of commercial banks' Prime (5.50%) to Prime + 1.25%.

The value of outstanding Bridge Authority bonds remained at $28.0 million, bearing maturities ranging from 2014 – 2029 and variable yields of Prime plus a margin of 1.000% - 1.6250% per annum. Similarly, the value of Clifton Heritage Authority bonds outstanding was unchanged at $24.0 million, with maturities spanning between 2020 and 2035, and carrying variable yields of Prime plus a margin of 0.2500% - 0.7500%, per annum.

Relations with Banks

In accordance with Section 19 of the Act, banks are required to maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since its implementation in 1974, the reserve ratio has remained at 5.0%, with a minimum of 80% to be held in deposit balances at the Bank. In line with growth in the Bahamian dollar deposit base, required reserves increased by 3.7% to $247.7 million. Institutions also maintained balances to facilitate cheque clearing arrangements.

STRATEGIC GOAL:

Secure, Efficient and Modern Payment System

PAYMENTS DEVELOPMENTS

The Bank, in its oversight role for payment systems, is committed to the implementation of safe and efficient payment arrangements, critical to the overall financial stability objective. Since 2004, the Bank has spearheaded efforts, with the collaboration of the clearing banks, to modernize the payment and settlement system in The Bahamas. The Bahamas Interbank Settlement System (BISS) was introduced in May 2004, to facilitate final and irrevocable gross settlement of high value (more than $50,000) and time critical payments between clearing banks and their customers, across accounts held with the Bank. In 2010, BISS recorded a 12.6% hike in volume to 59,944 transactions, extending the 17.1% gain in 2009; and the associated value advanced by a slightly higher 7.3% to $11.6 billion.

Following extensive co-operative efforts between the Bank and the Clearing Banks Association (CBA), the Automated Clearing House (ACH), operated by the Bahamas Automated Clearing

House Limited (BACH), was formally launched on January 22, 2010. The ACH, which is owned by the seven (7) participating clearing banks, allows for more efficient cheque clearing, enhanced efficiency in local money transfers and a reduction in processing times. These improvements provide benefits for banks, merchants and the general public. With the advent of the ACH, cheque clearing time has been reduced from T+5 to T+1. In September 2010, the ACH also implemented a system of direct credits between participants, further extending its range of services. Efforts are also underway to introduce customer initiated transactions.

Payment Services

Automated Teller Machines (ATM)

ATMs are widely used by banks' customers for small value cash withdrawals, deposits, intra-client account transfers and account enquiries. At end 2010, a total of 184 machines were installed throughout The Bahamas. However, the ATMs are operated on a stand-alone basis which is inconsistent with the growing trend of ATM interoperability worldwide. In 2011, the Bank intends to pursue discussions with the clearing banks on the introduction of a national payment switch, to act as a central clearing facility for ATMs, Point-of-Sale (POS), internet and mobile based transactions. The objective is to further facilitate and promote e-commerce throughout the country and provide enhanced convenience for card users.

Credit Cards

Credit cards are issued by domestic commercial banks under popular international brand names, such as Visa, MasterCard and American Express, and some are accepted by the ATMs of selected banks on the common ATM switch operated by Visa International for cash withdrawals. The popularity and convenience of these cards has led to their rapid rise over the years. At end-2010, credit card debt amounted to $262.9 million or 4.0% of total private sector credit, and the fifth largest consumer debt component.

Debit Cards

The use of signature based debit cards, which enable cardholders to make payments or withdraw cash from their deposit accounts at ATMs and electronic funds transfers at point of sale (EFTPOS), is growing. Many of these are in the form of bank issued VISA branded ATM cards, which may be accepted at any credit card POS terminal.

Cheques

Reflecting the ongoing shift away from the use of retail cheques to more efficient payment instruments, including credit and debit cards, the volume of cheques fell for the fourth consecutive year, by 0.3%, although levelling-off from the 6.3% and 3.7% declines in 2009 and 2008, respectively. The corresponding value of these cheques also fell, by 6.6% in 2010, relative to reductions of 15.5% in 2009 and 1.3% in 2008. However, cheques remain the most widely used non-cash payment medium in The Bahamas.

Payments Oversight

In June 2010, the Bank established a Payments Unit within the Research Department, to facilitate monitoring and oversight of payment systems–to include:

- assisting in the identification and evaluation of the potential for systemic risk arising from any changes in the design and operation of systems or conduct of operations and market participants;

- ensuring effective governance and enforcement of system rules;
- ensuring acceptable levels of operational and service efficiency––inclusive of effective access, reliability and consistency in service delivery, innovation in the provision of payment services and evolution of user costs;
- ensuring effective transparency and communication of the governance arrangements; and
- providing advice on broad financial policy issues affecting payments.

The Unit, which reports monthly to the Bank's Monetary Policy Committee, will work closely with payment systems participants and other relevant authorities to ensure the smooth and efficient functioning of these services.

On the legal and regulatory front, the Bank spearheaded several initiatives to support payment systems. In September 2010, the Central Bank of The Bahamas (Amendment) Act, 2010, came into force, giving the Bank more explicit supervisory oversight of payment systems in The Bahamas. Specifically, section 5 of the 2000 Act was amended to expand the duties of the Bank to include that of ensuring the stability of the financial system and the promotion and oversight of a sound and efficient national payment and securities settlement system. A new section 25 was also added, authorizing the Bank to regulate and oversee payment and securities settlement systems and electronic money and other payment instruments.

In early 2011, the Bank anticipates concluding the legislative process with the enactment of the following key pieces of new and amended legislation aimed at strengthening the payment and settlement infrastructure.

- Payment Systems Bill, 2011
- Payment Systems (Oversight) Regulations, 2011
- Payment Systems (National Payments Committee) Byelaws, 2011
- Companies (Amendment) Bill, 2011
- Bills of Exchange (Amendment) Bill, 2011
- Bankruptcy (Amendment) Bill, 2011

In accordance with the Bank's procedures for proposing amended or new legislation and regulations, all of these documents were issued for public consultation, and are available on the Bank's website.

THE BAHAMAS CREDIT BUREAU PROJECT

The Bank acknowledges the beneficial role of credit bureaus in enhancing a country's financial infrastructure and supporting the overall objective of stability and economic growth. Essentially, a credit bureau is a company or organization that collects, stores and maintains information about consumers' credit history. This information is compiled in a credit report, which the bureau shares with providers of credit, such as banks, credit card companies, insurance companies and certain retailers, for a nominal fee. Creditors then utilize these reports to determine whether or not to grant loans or extend credit, and at what interest rate. Customers can also request a copy of their credit report, in order to review the information, and as a means of tracking their performance in meeting borrowing obligations over time.

In 2010, the Bank, under the auspices of the Caribbean Regional Technical Assistance Centre (CARTAC), was included in the International Finance Corporation's (IFC) regional initiative to provide technical assistance for the establishment of credit bureaus. After meeting with officials from the Bank, the Government and other key stakeholders in February 2010, the IFC, which is a member of the World Bank Group, committed to provide advice to the Bank on the framework for the effective operation and supervision of a credit bureau in The Bahamas, which meets international standards. The IFC's team for The Bahamas' Credit Bureau Project comprises members from the World Bank and the IFC.

During the year, the Bank made progress with the initial assessment exercise, necessary to inform the design and regulatory framework for the launch of a credit bureau in The Bahamas. The IFC commenced the first phase of the project by conducting a Market Assessment, which comprised a review of the legal and regulatory framework and the business environment in The Bahamas, in respect of the operation of the credit market. To facilitate the review of business practices, with regard to lending, the IFC team met with and surveyed regulated and non-regulated credit providers, including banks, leasing companies, microfinance institutions, retailers and utility companies, using a Business and Technical Assessment Questionnaire to gather relevant data about their credit operations. The IFC is scheduled to present the Bank with a report of their findings from the Market Assessment in the first half of 2011 and a summary of the team's findings will also be provided to credit market participants.

The implementation of a credit bureau for The Bahamas is expected to occur over the next 18 to 24 months. Legislation will be drafted to provide a robust legal framework to give the Bank regulatory oversight of the credit bureau, and to protect the use and confidentiality of consumers' personal and financial information, which would be submitted to and/or disclosed by the credit bureau. Other agencies that will be integral to the oversight function, particularly with respect to ensuring the rights of the consumer, are the Data Protection Commissioner and the consumer protection arm of the Ministry of Labour and Social Development. The proposed legislation will, *inter alia*, outline the situations in which or the permissible purposes for which a company or organization may request a credit report, and will provide procedures to change or remove incorrect data which may be contained in a credit report. In 2011, the Bank will prepare a National Strategy document that will set out the proposed design of the credit bureau and facilitate the consultative process with stakeholders and the public.

DORMANT ACCOUNTS ADMINISTRATION

Section 20 of the Banks and Trust Companies Regulation Act (BTCRA) directs banks to transfer to the Bank, accounts where "no transaction has taken place, or no statement of account has been requested or no written acknowledgement has been received from the customer, during a period of seven years", thereby releasing banks from liability for such accounts and protecting the rights of clients who return to claim dormant funds.

During 2010, banks continued to report their dormant accounts via the Bank's web based Dormant Account Reporting System (DARS). For the 86 banks which reported, dormant balances were valued at $9,243,863 an increase of 80.4% over 2009. Claims processed aggregated $411,682, bringing the outstanding net dormant account balances under administration, inclusive of interest, to the equivalent of B$64,195,177.

STRATEGIC GOAL:

Prudent Foreign Exchange Management

FOREIGN RESERVES MANAGEMENT

The Bahamas' official foreign exchange reserves comprise foreign government securities, deposits in foreign banks, Special Drawing Rights, and the Reserve Position in the International Monetary Fund (Reserve Tranche).

Foreign reserves are managed by the Bank, through its Investment Committee (IC), according to the provisions of the Central Bank of The Bahamas Act and are further guided by Board-approved investment policy and guidelines. To effectively minimize risk, key tenets of the guidelines include the preservation of capital and liquidity management, and the optimizing of returns within the constraints of the former two principles.

The preservation of capital objective is achieved predominantly through control of the portfolio's risks, with the requirement that assets have an investment grade rating of A1 or higher. The Bank also ensures, using weekly forecasts, that it maintains sufficient liquidity to support the country's commitments in the international market.

During 2010, the IC met weekly, and on several ad hoc occasions, to discuss, *inter alia*, current market trends and developments that could impact foreign exchange reserves, to review counterparties, and to consider investment placements.

EXCHANGE CONTROL ARRANGEMENTS

During 2010, the Bank continued to refine internal and external processes in respect of Exchange Control arrangements. Key process changes were the elimination of manual forms used by the public in applying for foreign currency approvals, on January 18, 2010; the streamlining of documentation requirements at commercial banks and money transmission businesses (MTBs), and the corresponding electronic capture and submission of foreign currency sales information to the Bank. Significant progress was also made toward the implementation of the Exchange Control Web Reporting System (ECWRS) for the on-line reporting of client account foreign currency transactions by attorneys, accountants and licensed financial and corporate service providers.

Another notable policy change was the harmonization of the current account regimes for residents and temporary residents, such that temporary residents are now able to access the same facilities available to residents for all of their foreign currency transactions. The Bank also rationalized delegated limits for both permanent and temporary residents relative to key current account items, particularly gift remittances and business/professional travel facilities, adjusting limits to $1,000 per transaction and $10,000 per trip, respectively. Review of the regime continued throughout the year, with the objective of enhancing the unification efforts.

As a consequence of the adjustments pursued, the Exchange Control Counter operations at both the Nassau and Freeport locations were officially closed on April 16, 2010. To support the developments and to ensure the integrity and timeliness of reports, the Bank collaborated closely with commercial banks and MTBs in staff training and familiarization initiatives, covering all aspects of the new arrangements.

With respect to capital account developments, the Bank continued to administer the liberalized programme implemented in 2006, which comprises:

- broader options for residents' investments abroad, including the non-sponsored Bahamian Depositary Receipt (BDR) programme—in which BISX-listed broker/dealers structure and market BISX-traded domestic instruments backed by foreign securities, for investments by residents. Under this programme, broker/dealers are permitted to acquire foreign exchange, at par, up to a maximum of the lesser of 5% of the country's external reserves from the end of the previous year or $25.0 million per annum, in equal quarterly tranches.

- an annual facility to the National Insurance Board (NIB) to acquire high quality foreign assets in its investment portfolio at the official rate of exchange, up to $25.0 million;
- liberalization of credit facilities for temporary residents; and
- enhanced opportunities for non-Bahamians' investments in domestic debt and equity instruments.

During 2010, only two of five BISX-listed broker/dealers participated in the BDR programme, acquiring a total of US$13.0 million, which was nearly three times the 2009 allotment. In contrast, the NIB's purchase during 2010 was lower by $3.375 million at $9.375 million.

Under the liberalized regime, residents continued to purchase foreign currency directly from commercial banks for certain capital account transactions, such as share purchase schemes of their offshore parents, time-share property purchases of up to $25,000 and offshore equity investments deemed "special criterion". Investors were also able to purchase foreign currency through the Investment Currency Market (ICM) for other types of investments, at a premium of 12.5%, and with sales at a discount of 10.0%. On this basis, sales amounted to $2,736,051 and purchases, $99,445. At end-2010, the balance on the ICM, taking into account the BDR related activity, was $327,472, up from $297,235 in 2009.

The role of Authorized Dealers (domestic commercial banks) and Authorized Agents was heightened during the year by the increased delegation of foreign currency transactions to banks. At end-2010, the number of Authorized Dealers and Authorized Agents operating domestically remained at eight (8) and fourteen (14), respectively.

ECONOMIC ANALYSIS, STATISTICS AND RESEARCH

STRATEGIC GOAL:

Meaningful Contribution to National Economic Policymaking

The Research Department continued to play a vital role in the execution of the Bank's mandate, through its collection, analysis and dissemination of economic and financial data on developments within the domestic and international economies. Integral to this objective was the preparation of key reports, such as the Monthly Economic and Financial Developments (MEFD) report, the Quarterly Economic Review (QER) and the Quarterly Statistical Digest (QSD). Among the surveys conducted was the Annual Banking & Financial Sector survey, which was published in the March edition of the QER and provided an assessment of the trends in the domestic and offshore financial sectors during 2009. The Department also conducted two surveys of business conditions to gauge the state of the business community and its expectations for the next six months; and provided an analysis of economic developments for the Government's mid-year and FY2010/11 Budget Communications.

During the year, staff continued to support the work of the MPC, through the coordination of the monthly meetings and the presentation of a number of policy briefs. As part of its mandate to prepare high quality and relevant research, the staff presented a total of four research papers at the Department's in-house Roundtable Forums, while two papers were presented at external conferences. Specifically, the study of "The Bahamas and CSME" was presented at the Central Bank of Barbados' Annual Review Seminar in July and a presentation on "The Recent Global Financial

Instability: Implications for Debt Sustainability in The Bahamas" was delivered at the Caribbean Centre for Money and Finance (CCMF) conference in Trinidad and Tobago in November.

As a critical aspect of the Department's work agenda, important progress was achieved on several strategic projects, including the drafting of guidelines to facilitate the proposed auctioning process for Government bonds. The Department's staff also benefitted from training in the area of economic forecasting, provided by a consultant from the Caribbean Regional Technical Assistance Centre (CARTAC), which led to significant refinements being made to the Bank's forecasting model.

Going forward, the Department expects to continue to improve its internal operations and the quality of information provided to the public, by making greater use of technology and becoming more efficient with regard to several of its processes.

LEGAL ISSUES

During the year, significant progress was made on several key pieces of legislation drafted by the Legal Unit. In particular, both the Central Bank of The Bahamas (Amendment) Act, 2010 and the Banks and Trust Companies (Amendment) Act, 2010 came into force, on September 1, 2010. The Unit also drafted several pieces of legislation related to the Bank's oversight of payment and securities settlement systems.

In its ongoing effort to ensure the appropriateness of the legislative framework, the Unit proposed several amendments to legislation related to banks, trust companies and other licensees of the Bank. These included: the Banks and Trust Companies Regulation (Amendment) Bill, Banks and Trust Companies (Large Exposures) (Amendment) Regulations and the Banks and Trust Companies (Liquidity Risk Management) Regulations.

The Legal Unit continued to provide advice and administrative services to the Board of Directors of the Bank, and was instrumental in the vetting of Memoranda of Understanding between the Bank and the home country supervisory authorities of financial institutions, which are licensed by the Bank. The Unit also continued to review international anti-money laundering and countering the financing of terrorism standards and, as a consequence, updates were made to the Bank's 2009 Guidelines on the Prevention of Money Laundering and Countering the Financing of Terrorism.

The Unit also acted as the secretariat for the Group of Financial Services Regulators (GFSR), which is currently chaired by the Governor. In this regard, the Unit coordinated the monthly meetings of the GFSR and the work of its various legal and other subcommittees.

STRATEGIC GOAL:

Safety and Soundness of Financial System

PRUDENTIAL SUPERVISION AND REGULATION

Supervisory Developments

The Bank exercises regulatory and supervisory oversight of banks, trust companies, money transmission businesses (MTBs) and private trust companies (PTCs), in order to ensure high standards of conduct and management in their operations and general confidence in the financial sector. To promote the safety and soundness of its licensees, the Bank undertakes on-site examinations and offsite surveillance and monitoring.

During 2010, the Bank made further progress in reorganizing the Bank Supervision Department to support the full implementation of the enhanced Risk-Based Supervision Framework (RBSF), which would deliver greater focus on the most material risk issues affecting firms. Special focus was on the integration of the on-site and off-site supervisory functions, and the staffing of the new Authorizations Unit, which was established in 2009, to complete the transfer of the authorization function from the mainstream supervisory process.

The piloting of the RBSF was largely completed during the third quarter, with the development of full guidance documentation and a desktop assessment of commercial banks, the most systemically important firms in The Bahamas. Thereafter, the Bank commenced the roll-out of the RBSF across all other material firms, beginning with a series of industry presentations on the RBSF in October 2010. The review of material international firms is expected to be completed by mid-2011, which will include the communication of risk assessments and related supervisory programmes to firms. Over the second half of the year, the full roll-out of the risk assessment framework, preparation for carrying out full risk assessments of the commercial banks, and implementation of a more streamlined process for less material firms, will be completed. The process will involve major changes in the supervisory regime, involving closer and more continuous engagement between the firms and supervisors, along with more coordinated and integrated interaction between off-site and on-site supervisory staff.

Policy Unit

During 2010, the Policy Unit made steady progress on a demanding work agenda aimed at addressing gaps identified in a Basel Core Principles (BCP) for Effective Banking Supervision self-assessment, and in playing a leading role in the development, support and implementation of the RBSF. Going forward, the Unit will provide the primary technical support for the risk assessment process, in addition to developing management information, at the portfolio level, for monitoring the risk profile of banks and trusts companies, while the Supervision Unit will retain responsibility for monitoring the risk profiles of the individual licensees. The Unit has also made significant progress in a number of other key areas, including the development of a new market risk and substantially revised liquidity risk and large exposures guidelines, in line with the rapidly evolving international frameworks in these areas. Guidance has also been prepared, in consultation with the major accounting firms, to support independent third party reviews of material outsourcing arrangements between a select group of firms and service providers outside The Bahamas.

TABLE 1: Onsite Examinations Conducted

	2008	2009	2010
Examinations			
Domestic Licensees	7	5	6
Other Licensees	45	15	2
Follow-up /Special focus	4	24	18
Total	**56**	**44**	**26**
Reports			
Finalized Reports	19	30	16
Reports in Progress	8	11	15
Total	**27**	**41**	**31**

Source: The Central Bank of The Bahamas

On-site Examination Programme

The Bank focused considerable resources on rebuilding and developing the Examination Unit, to ensure the alignment of the on-site examination assessments with the enhanced RBSF and integration of a significant number of new staff into the on-site examination process. The on-site examination team's strategic engagement in the risk assessment process, including the validation panel meetings, will ensure a fully integrated and consistent approach and the development of appropriate guidance.

The re-engineered on-site examination process has provided for greater consistency in the identification of supervisory and regulatory issues, a more transparent review process of examination findings and recommendations made by examiners for the remediation of the identified issues through peer reviews, and has ensured consistency among firms' approaches to identifying and mitigating material risk. Additionally, the implementation of a materiality rating system for examination findings has enabled both the Department and the firms to give priority attention to the remediation of issues identified as having higher materiality.

Because of the re-engineered initiatives, and the on-site examiners' involvement with the risk assessment framework, a relatively smaller number of on-site examinations were undertaken in 2010, although normalization is anticipated in 2011. As indicated in Table 1, twenty-six (26) on-site examinations were completed compared to forty-four (44) in 2009 and fifty-six (56) in 2008, the majority of which were follow-up and special focus examinations. Of the 26 examinations undertaken in 2010, safety and soundness examinations of one (1) local private bank and trust company and three (3) major international trust companies were conducted. Special focus examinations, covering reputational risk, credit risk delinquency management and previous examination recommendations for remediation, were also carried out on a number of complex and non-complex firms. In addition, three (3) visits to firms—conducted in response to requests from their home supervisory authorities in Panama, Peru and Switzerland—were initiated. Over the year, sixteen (16) examination reports, including five (5) from 2009, were finalized and fifteen (15) reports are currently at the final drafting stage.

For the first time since the commencement of the on-site examination programme in 2001, the Bank conducted focused on-site examination visits to three (3) commercial bank branches in Grand Bahama. These examinations covered credit risk, reputational risk and the governance oversight provided by the head office or the main branch in New Providence. One important examination conclusion was the need for enhanced oversight of these operations by the head offices and main branches. Given the remote locations of these branches, which could result in higher risk exposures, the Bank will be conducting reviews of other Family Island branches in 2011.

Based on the on-site examinations conducted, the Bank issued recommendations for improvements in business corporate governance, processes of control and risk management processes, including credit, reputation, fiduciary, IT and HR risks. In response to examination findings, a number of firms have been requested to strengthen their client due diligence processes in line with the requirements in The Bahamas, improve management information used to monitor the quality of their asset portfolios, and strengthen corporate governance arrangements through more robust and integrated risk oversight by both senior management and local boards.

Joint Examinations with the Securities Commission of The Bahamas

The Bank undertook three (3) joint examinations with the Securities Commission of The Bahamas (the Commission) in 2010, and conducted a comprehensive review of the Commission's examination templates with a view to identifying areas of duplication. Going forward, the Bank will continue to ensure that the joint examinations achieve the maximum synergies between the Bank's and the Commission's on-site processes.

Supervision Units – Off-site Surveillance Activities

Credit Quality of Domestic Banks

In 2010, the Commercial Banking Unit (CBU) continued to hold quarterly prudential meetings with senior management of the domestic banks, with particular focus on credit quality, corporate governance and credit risk controls, such as delinquency management and collection policies and, most recently, an introduction to the risk-based supervision framework and liquidity risk management. Banks reported on restructured loans, the level of which varied between banks, since each bank worked in different ways with customers experiencing financial difficulties arising from the protracted economic downturn. Despite the decline in credit quality, banks continued to show resilience by maintaining average capital adequacy levels well above the minimum standards.

Credit Risk/Reviews

As part of its mandate, the CBU continued to undertake critical monthly credit risk assessments, using prudential returns, giving focus to large exposures, loan arrears, sectoral exposures and provisioning levels. With total arrears surpassing the $1.0 billion mark, and accounting for almost 20% of total loans in the system, institutions continued to increase provisioning levels (specific provisions) to offset any expected losses while, at the same time, maintaining a minimum regulatory requirement for general provisions of 1% of their credit portfolio. Given that collateralized mortgages represented nearly 50% of total credit, there is some mitigation of the potential risk of financial loss, which may result from failure of the debtors to honour their contractual obligations to firms.

International Firms

In 2010, the International Supervision Units (ISUs) continued to monitor the financial soundness of firms, through rigorous analyses of quarterly and annually audited financial statements and returns, while ensuring compliance with operational limits imposed by legislation and regulations.

Following the introduction of the enhanced RBSF during the last quarter of 2010, the ISUs commenced a first round of intensive prudential risk assessment meetings with senior management of the international firms. Discussions focused on inherent business risks and mitigating controls—inclusive of reputational, fiduciary, environmental, strategic, legal, regulatory, political, and operational risk, along with governance and credit, liquidity and market risk controls. Twelve (12) risk assessments of material international firms were completed by year-end and a second round of risk assessments is scheduled for March 2011. The review of material international firms is expected to be completed by end-June 2011, and will include the communication of risk assessments and related supervisory mitigation programmes to firms, as appropriate.

New Reporting Format for Domestic Banks

During the fourth quarter, the Bank released a revised Excel Reporting System (ERS) for the reporting of domestic banks' monthly and quarterly assets and liabilities and related information. The revisions are intended to better arrange and streamline data compilation processes and enhance regulatory surveillance of important areas not previously covered in the commercial banks' data sets. The modifications included the consolidation of the financial reporting requirements of both the Research and Bank Supervision Departments, which will allow banks to submit one set of financial reports to meet the needs of both departments. The ERS facilitates the production of standard reports, including balance sheets and income statements, and comprehensive ratio sets, based on CAMELS[1]. In addition, comparative firm and peer group data are now produced, enabling essential macro financial analysis. The broader ratio set will include a comprehensive set of financial soundness indicators, which will be used in the RBSF.

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1 Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity, Sensitivity Analysis and Market Risk.

Stress Testing

The Bank's stress testing model is evolving to be an important additional macro-prudential monitoring tool, used to assess credit, liquidity, interest rate and foreign exchange risks for commercial banks as a whole, as well as for testing the resilience of individual banks.

In 2010, progress was made in extending the stress-testing model to interest rate and liquidity stress events, as well as economic and financial scenarios, to capture a more complete range of potential threats to the financial soundness of commercial banks. Development of these new stress tests was supported by the introduction of additional new reporting from commercial banks, incorporating the analysis of assets and liabilities, in accordance with both bands of liquidity maturity and interest rate repricing dates.

The Bank also distributed its enhanced stress testing model to the commercial banks, to facilitate the application of a common stress testing process across firms. Focus is now being placed on finalizing and updating the model, based on the forecasted macro-economic indicators obtained from the Research Department's Financial Programming Model.

To reinforce the importance of enhanced oversight of the commercial banks to the broader objective of financial stability, the Bank developed and agreed terms of reference towards the establishment of the Systemic Risk Surveillance Committee (SRSC). The SRSC will focus on detecting, assessing and monitoring emerging risks to the financial stability of the domestic commercial banking sector arising from macro-economic developments.

Capital Adequacy

During 2010, the Bank continued to closely monitor the levels and adequacy of capital in the local banking sector. In light of the slow recovery in the domestic and international economy, the Bank has maintained the higher minimum risk-weighted target and trigger ratios, of 17% and 14%, respectively, which were imposed in 2009. This has facilitated the accrual of a strong capital base in most banks, providing the necessary buffer during the year, amid the overall deterioration in asset quality. On average, banks' capital levels were nearly 26% of risk weighted assets as at end-December 2010, significantly exceeding the 8% minimum capital requirement set through international standards.

As the Bank moves towards the implementation of Basel II/III and, in particular Pillar 2, it has become imperative that the fundamental policies and procedures are in place to confirm that all material risks are classified, measured and reported. Ensuring that the level of capital held is directly linked to these risks, and that the banks' strategic and business plans clearly define the capital adequacy goal, will also be important. The aim is to establish an individual capital ratio for banks through the RBSF, which will represent the regulatory minimum 8% plus a capital add-on to capture those risks not fully covered by the regulatory capital. Overall, the minimum capital ratio of a bank and trust company reflects the Bank's perception of the firm's overall risk profile, taking into account all of the relevant assessment factors that have been set out.

Domestic Banks Risk Assessment

A desktop risk assessment has been completed for commercial banks and preparatory work to carry out the full risk assessments has begun for these firms, including their trust companies and subsidiaries. These risk assessments, which are expected to be completed by end-2012, will focus on the full risk profile of the firms, including credit risk and reputational risk. The results will be communicated to the commercial banks, along with the related supervisory programme.

TABLE 2: Regulated Entities

	2008	2009	2010
Bank and Trusts	271	272	276
Banks & Trusts	82	72	73
Banks	45	47	40
Trusts	144	153	163
Private Trust Companies (Registered)	38	50	58
Non-Bank Money Transmission Business	2	2	3

Source: The Central Bank of The Bahamas

Regulated Entities

During 2010, the number of bank and trust licences increased by four (4) to 276 (see Table 2). The net growth in the number of restricted nominee trust entities, by twelve (12), mainly reflected the Bank's efforts to enhance compliance with the policy on firms' nominee activities, and effect enhancements to consolidated supervision of banks and trust companies in The Bahamas.

Of the 276 licensed entities, the number operating through physical presence remained at 249. A stable 27, being branch operations of firms from predominantly G-10 countries, continued to maintain approved restrictive management arrangements. During 2010, the Bank approved the registration of ten (10) Private Trust Companies (PTCs), while removing two (2) PTCs from its register, bringing the total to 58 at end-December. The number of Financial and Corporate Service Providers that act as Registered Representatives remained at three (3), while one additional licensee advised the Bank of its intention to act as a Registered Representatives of PTCs, increasing the number to twelve (12). The number of licensed non-bank MTBs grew by one (1) to three (3) at end-2010.

Domestic and International Regulatory Cooperation

In 2010, the Department continued to engage its domestic and international regulatory counterparts. On the local level, the senior staff of the Department and the Legal Unit represented the Bank at the Group of Financial Sector Regulators' (GFSR) monthly forums. The GFSR comprises the six domestic regulatory agencies with oversight responsibilities for bank and trust companies, securities firms, the domestic securities exchange, insurance companies, credit unions and financial & corporate service providers. The GFSR continued its preparatory work required for a future International Monetary Fund Financial Sector Assessment Programme (FSAP) mission. Each agency has been vigorously following up on items outlined in its Action Plan to ensure that identified gaps in The Bahamas' financial services regulatory regime are being addressed. Several legislative amendments were enacted by Parliament, and various guidelines were either finalized or issued for public consultation.

On the regional level, The Bahamas, along with its regional partners, continued to work on developing a National Financial Crisis Preparedness Plan (NFCPP). In 2010, the Bank established a project team to draft the NFCPP, and its development will form one of the important work streams for 2011.

Regional supervisory colleges were held in May 2010 in Curacao, Netherland Antilles, prior to the Caribbean Group of Banking Supervisors' Plenary meetings for three firms with regional operations. Regional/home supervisors hosted the meetings and areas of concern were discussed.

On the international level, the Bank continued to be engaged with its bank regulatory network to ensure that The Bahamas is not used by undesirable parties to avoid proper oversight and, equally, to ensure that institutions established and based in The Bahamas comply fully with internationally accepted standards and norms of bank management. To this end, the Bank Supervision Department's senior staff represented the Bank at four international regulatory colleges hosted by the Office of the Superintendent of Financial Institutions (Canada) in February 2010 and the Bermuda Monetary Authority in October 2010, to discuss issues relative to the operations of several banks which have regional operations.

The Offshore Group of Banking Supervisors (OGBS) held two meetings (Technical and the Plenary) in 2010 in London and Singapore respectively. Senior management of the Department attended the March 2010 meeting and contributed to discussions on topical issues such as the G-20 offshore initiatives, recent Basel Committee initiatives following the 2008 global financial collapse, and common issues arising out of the FATF working groups.

The Association of Supervisors of the Americas held its Plenary meeting in Antigua, Guatemala, in November 2010, which was attended by a senior staff member.

Regarding information requests, the Bank received and responded to twenty-three (23) requests from seventeen (17) foreign regulatory authorities in 2010. (See Table 3).

TABLE 3: Requests for Cooperation from Foreign Regulatory Authorities in 2010

Country	Number of Requests	Completed	Outstanding[1]
Argentina	2	2	
Aruba	1	1	
Belize	3	3	
Bermuda	1	1	
British Virgin Islands	3	3	
Cayman Islands	1	1	
France	1	1	
Guatemala	1	1	
Hong Kong	2	2	
Jersey	1	1	
Malta	1	1	
Panama	1	1	
Peru	1	1	
Poland	1	1	
St. Kitts	2	2	
Switzerland	1	0	1
Trinidad & Tobago	1	1	
Total Requests	**24**	**23**	**1**

Source: The Central Bank of The Bahamas

"Note 1 in these cases, data has been provided but additional ""follow-up " is required and requests were still being processed at year end.

Membership in International and Regional Bodies

Senior bank supervisory and Legal Unit staff represented the Bank on and contributed to the work agendas of the following international and regional regulatory and supervisory bodies:

- Association of Supervisors of Banks of the Americas (ASBA)
- Offshore Group of Banking Supervisors (OGBS)
- Caribbean Group of Banking Supervisors (CGBS)
- Caribbean Financial Action Task Force (CFATF)

Several Bank staff also served on various technical working groups and committees within these organizations.

Current Issues in Bank Supervision

Over 2010, the expected recovery from the global financial and economic crisis proceeded unevenly, with continuing buoyant economic growth in emerging economies—particularly the BRICS (Brazil, Russia, India, China and South Africa), contrasting with the sluggishness of the recovery in Western Europe and the United States and some Asian economies. The 2010 global trends that were particularly relevant to banks and trust companies and supervision of the sector in The Bahamas included the following:

- The financial position of high net worth client groups in Western Europe and the United States, which had previously made material contributions to the growth in assets under administration and management, and booked in firms domiciled in The Bahamas, continues to be adversely affected by the economic downturn. This loss of confidence has translated into a generally lower risk appetite and a desire to invest in safer, more liquid but lower yielding assets, with a consequent impact on the profitability of the financial institutions managing the funds. From a global perspective, this decline has been offset by the dynamic growth in Asia.
- United States and European governments are continuing to face budgetary pressures, with firms active in international centres urged to repatriate funds to their home jurisdictions to boost tax revenues and, in some cases, to alter the scope of their operations.
- Several South American economies have fared relatively better than Europe and the United States in the crisis, and have now achieved greater economic and legal certainty. These jurisdictions are being viewed, by their own citizens, as more attractive and safe domiciles for their funds relative to offshore locations. This has adversely affected funds under administration and management in a number of offshore jurisdictions, although there are indications that the outflows have now begun to level off.
- The global crisis has accelerated the major structural realignment in the global economy in favour of Asia, including the emerging economies, such as China and India. These countries have been largely unscathed by the economic crisis and have engendered material and growing new classes of high net worth and ultra high net worth individuals. The potential of these new markets now dominates the strategic thinking and expansion plans of the international wealth management firms, including those licensed in The Bahamas. Growth in the scale of operations, including staff complements, of these firms in the international financial centres close to Asia has been comparatively more rapid.
- After the onset of the global crisis, national and international supervisory rule makers recognised the urgency of strengthening the global supervisory framework for financial institutions, in general, and on what are termed "Systemically Important Financial Institution's (SIFI's)", in particular. The areas that were identified for special regulatory focus included minimum prudential standards for capital and liquidity, corporate governance and risk oversight and the arrangements for managing crises affecting large cross-border financial institutions. While over the first two years of the crisis it appeared that considerable consensus had been achieved regarding the tone and direction of the necessary changes, in 2010, the picture seemed more complex and varied. With the Basel Committee's agreed new rules for capital and liquidity in 2010, the stated approaches of major participants in global markets have diverged, leaving considerable room for national variations in the implementation of key new elements of the rules, such as the countercyclical capital buffer to undermine the creation of a "level playing field".

In discharging its responsibilities of supervision for the sector, as a whole, the Bank is aware of the wide range of inherent risks arising from this very challenging operating environment, which have a differential effect on the various types of firms active in the jurisdiction.

Offshore Sector

As a result of these developments, offshore firms in The Bahamas are grappling, *inter alia*, with lower rates of return, declines in portfolio values and net worth, and the repatriation of assets to home jurisdictions in response to tax incentives. Amid the reduction in their revenue base, firms have curtailed expansion plans and rationalized business line activities.

In particular, there has been a trend towards consolidating representation within firms' locations across the region, including the building of regional "hubs" or "centres of excellence" to provide central services and control functions from one jurisdiction across the region. From a supervisory perspective, the Bank's focus has been to ensure that local governance and risk oversight arrangements are not compromised, as control staff and processes may be located outside the jurisdiction and local representation reduced.

Domestic Sector

Firms operating in the domestic sector have been strongly affected by the downturn in the economy, stemming from the impact of the global crisis on the tourism industry and foreign investment activity. The impact of the crisis continued to be manifested in the notable increase in banks' non-performing loans (NPLs) and the fall-off in profitability. Although the rate of deterioration has now levelled off and the strong capital position of commercial banks, coupled with the strength of the Canadian parents of the main commercial banking groups, continue to ensure resilience and support systemic stability, the long term nature of the economic crisis means that firms are finding few new viable transactions that can offset the deterioration in their lending portfolios. Notwithstanding, the stability of the interest rate structure and the large margins built in, have supported commercial banks' continued profitability, although with some reduction, over the crisis.

Domestic commercial banks, like their international counterparts, are responding to trends of reduced profitability and more limited business opportunities through cost rationalizing measures. Increased attempts to achieve economies of scale are observed in a higher incidence of outsourcing services to regional hubs, with appropriate supervisory scrutiny undertaken to ensure that minimum corporate governance and risk oversight in the jurisdiction are not compromised. From a supervisory perspective, some domestic commercial banks could face increased vulnerability, as the crisis persists, in view of their concentrated exposure in the real estate sector. Margins of excess collateral have been traditionally high, although levels could be eroded in this environment.

In addition to enhancements aimed at building resiliency, the following areas will be given greater prominence in the work agenda.

a. Implementation of Basel II/III

Work on Basel II was placed on hold, given the focus on the implementation of the risk assessment framework as well as uncertainty in the wake of the global financial crisis regarding the agreed parameters of the Basel capital adequacy regime. As this issue has now been resolved and agreement reached on a revised framework, now labelled Basel III, work has started on an important component of this project, i.e., developing a Pillar II (supervisory review) approach, based on the risk assessment framework. Following the survey undertaken earlier in 2010, consideration has also been given to how market risk can be appropriately captured in the risk assessment framework, as well as the Pillar II framework. Over 2011, a credible action plan will be developed, to include a review of regulatory developments, domestic requirements in response to recent changes in international capital standards (e.g., the gearing ratio and definition of capital), approaches (advanced versus standardized treatments), resources required to complete the task, and a timetable for implementation.

b. Integration of Financial Services Regulators in The Bahamas

The Bank has been charged with playing a more material role, in 2011, in achieving the

BOX 3: STRATEGIC SUPERVISORY FOCUS IN 2011

In fulfilling its supervisory and regulatory tasks, the Bank intends to focus and accelerate the various regulatory initiatives, aimed at increasing resiliency of banks and trust companies, namely:

- Progress work towards a comprehensive roll-out of the risk assessment framework across all firms to:
    - focus regulatory resources on the most material risks;
    - achieve closer ongoing monitoring of the evolving risk profile of all firms and develop greater understanding of the business models of the full range of firms by regulatory staff;
    - develop and implement consistent and effective risk mitigation programmes to address material risk issues that have been identified, through the efficient application of all the regulatory tools that are available; and
    - achieve within the risk assessment and risk mitigation process full integration of the work of staff engaged in both on-site and off-site supervision.
- Establish a comprehensive operational framework for management of the risk-based framework, to include:
    - designation of a central risk team to act as a secretariat for the risk assessment validation panels—being custodians of the risk assessment guidance and undertaking analysis at the portfolio level;
    - development of an appropriate management information system (MIS); and
    - alignment of staff training programmes to complement existing initiatives.
- Achieve full implementation of proposed changes to strengthen the legal framework for banking supervision so as to secure greater flexibility and range of regulatory interventions—to include:
    - implementation of the proposed amendments to support a comprehensive range of fines to allow proportionate early regulatory interventions.
- Extension of stress testing for commercial banks to cover liquidity and interest rate risk, as well as credit risk—and to be used in regular financial stability meetings involving both Bank Supervision and the Research Departments.
- Achieve a common, fully integrated and comprehensive on-line reporting framework for all regulated entities, covering the full range of financial risks. Coverage will also be extended to encompass the securities businesses within the banks.
- Complete the development of an enhanced bank crisis management capability within the Bank, key elements to include:
    - testing of crisis scenarios facing banks with domestic capital to identify gaps in supervisory and crisis governance processes as well as gaps in the legal framework for speedy resolution;
    - benchmarking the current legal framework in The Bahamas for problem bank resolution against evolving best practices (e.g. UK/US);
    - development and agreement with all relevant authorities of a crisis management plan for banks in The Bahamas; and
    - working with regional regulatory agencies to develop a cross-border crisis management plan.
- Develop a framework for regulatory colleges of conglomerates in The Bahamas through the implementation of the Memorandum of Understanding (MOU) between securities, insurance and banking regulators in 2011.

long-term goal of a unified financial services regime. The main initiatives that are being progressed are:

i. Integration of the supervision of credit unions into the Bank—The Bank has established a project team, led by the Manager of the Bank Supervision Department to work, along with a prospective Commonwealth Secretariat funded technical advisor, towards achievement of this objective.

ii. Closer integration between the Bank and the Securities Commission with respect to the supervision of banking and securities businesses conducted by joint licensees—The Bank and the Securities Commission have established a project team to undertake, in the first instance, the following tasks:

- An end-to-end comparative review of the Commission's and the Bank's supervisory processes to identify the best practices to be adopted;
- A review of the scope of the Commission's conduct of business/prudential review, to identify areas of overlap with the Bank's prudential examinations. The intention will be to develop a more narrowly scoped conduct of business examination to complement the Bank's on-site examination process of joint licensees;
- Extend and formalize the legal underpinning of the Facilitated Agreement that currently mandates the Bank to determine the Capital Adequacy Requirement for securities business within banks. The Bank is currently considering the appropriate arrangements for determining the minimum capital requirements to support market risk positions, and will extend this consideration to include market risk arising from securities positions;
- Broaden the risk assessment framework developed for banks and trust companies to cover securities businesses and include representatives of the Commission on internal risk assessment validation panels for joint licensees.
- Establish the necessary organizational arrangements to support "one-stop" relationship management by the Bank for all joint licensees.

c. **Development of a Centre of Trust and Wealth Management Expertise**

Over the last two years, the work of the CBU has been critical to ensuring the availability of adequate focus and expertise for the supervision of the domestic commercial banks, which are the most systemically important firms in The Bahamas. Going forward, the Bank will appropriate more focused attention on the development of expertise in the area of trusts and wealth management, the primary business focus of the offshore sector in The Bahamas. This will include recruitment of an additional specialist, with an extensive industry fiduciary risk management skill-set, including trust administration and wealth management experience, to support on-site review of businesses and provide expert advice to the relationship teams and senior supervision management in the ongoing supervision of firms; and the identification of a senior fiduciary risk adviser in the Bank Supervision Department to enhance on-site supervision of the fiduciary risk and wealth management sectors.

New Guidelines and Regulatory/Legislative Initiatives

Guidelines

The Bank is responsible for ensuring that the legal framework and its guidance for the prudential regulation and supervision of its licensed banks and trust companies remain relevant and current. The Bank's work in this respect continued, with the issuance of the following four (4) revised guidelines:

1. *Revised Guidelines for the Corporate Governance of Banks and Trust Companies Licensed to do Business Within and From Within The Bahamas [Issue Date: February 5, 2010]:*
    - Amended to clarify the Bank's position regarding the number of directorships that an individual may hold. Additionally, the Board of Directors' Annual Certification to the Bank was amended to include the annual certification requirements with respect to business continuity and outsourcing arrangements.
2. *Revised Guidelines for Firms on the Prevention of Money Laundering and Countering the Financing of Terrorism [Issue Date: July 29, 2010]:*
    - Provided additional guidance to firms with respect to the Bank's record keeping requirements. The amendment requires firms to maintain the files and business correspondence and records connected to a facility.
3. *Guidelines for Assessing the Fitness and Propriety of Money Laundering Reporting Officers (MLROs) in The Bahamas [November 1, 2010]:*
    - Set out a common set of criteria against which all financial sector regulators will assess the fitness and propriety of individuals nominated to serve as MLROs in financial institutions operating within and from within The Bahamas.
    - Only MLROs appointed after November 1, 2010 are required to be approved by the relevant regulator. However, firms are required to self-assess their existing MLROs against the guidelines and ensure that any deficiencies are corrected within one year of the effective date of the guidance.
4. *Revised General Information and Guidelines for Licence Applications [November 9, 2010]*
    - Updated the annual licence fees payable by the domestic commercial banks under the Banks and Trust Companies Regulation Act, as amended by the Banks and Trust Companies (Amendment to the Third Schedule) Regulations, 2010.

Regulatory/Legislative Initiatives

The domestic regulatory framework for banks and trust companies was further enhanced with the amendment of the Banks and Trust Companies Regulation (Amendment) Act, 2010 (BTCRA), which came into force on September 1, 2010. The amendments to the BTCRA make provision for the following:

- Removal of the requirement for firms to obtain the prior approval of the Bank for the appointment of external auditors, and the replacement of this requirement with the subsequent notice of the appointment of an external auditor. However, the Bank retains the right to require the removal of an auditor of the licensee. This provision also expands the rights and duties of auditors and former auditors of firms, and requires them to provide the Inspector with written notice of specified matters including any fact or matter of which the auditor or former auditor has/had become aware in the ordinary course of an audit, and which is of material significance to the discharge of the Inspector's functions under the Act; and the auditor's intention to resign before expiration of his term as auditor or not to seek reappointment as auditor.
- Removal of the requirement for firms to publish their financial statements in the Gazette, while giving the Bank the discretion to specify the form and manner of the publication.
- Expansion of the Bank's sanctioning and enforcement powers to empower the Bank to appoint a receiver-manager of a licensee where it is desirable for the licensee to be operated

by the receiver-manager as a going concern and also authorize the Bank to appoint a temporary manager of any licensee which, in the Bank's opinion is, *inter alia*, carrying on business in a manner detrimental to the public interest.

- The distinction between the surrender of a licence and the revocation of a licence. This amendment allows firms to surrender their licences, provided that the specified pre-conditions are met.
- The expansion of the time for commencing prosecutions for summary offences committed under the Act was extended from the current maximum of six months from the commission of the offence (as provided under the Criminal Procedure Code) to the later of either twelve months from the date of the commission of the offence or within three months of the date on which the Attorney General forms the view that there is sufficient evidence to justify the prosecution of the offence under the Act.

Consultation Papers

During the year, the Bank issued three (3) consultation papers:

- Proposed amendments to the Guidelines for Firms on the Prevention of Money Laundering and Countering the Financing of Terrorism—which responded to various issues identified during the last Caribbean Financial Action Task Force (CFATF) mutual evaluation of The Bahamas.
- Proposed amendments to the Guidelines for the Management of Large Exposures—to ensure that the Bank's large exposures requirements are current with international best practices and standards for monitoring and control of large credit exposures.
- Proposed amendments to the Guidelines for the Management of Liquidity Risk—aimed at achieving conformance with the Basel Committee on Banking Supervision's paper on Principles for Sound Liquidity Risk Management and Supervision issued in September 2008. The Guidelines provided for expanded and detailed guidance in areas such as board and senior management accountability, the importance of ensuring that robust controls are in place in liquidity risk management, the design and use of stress test scenarios and the need for robust and comprehensive contingency plans. Importantly, the scope of the Guidelines was extended to cover all public banks and/or trust companies, including the domestic commercial banks.

Deposit Insurance Corporation (DIC)

The Bank has statutory responsibility to oversee the Deposit Insurance Fund (the Fund) for Bahamian dollar deposits in the banking system. The DIC insures Bahamian dollar deposits up to a maximum of $50,000 to any single depositor in each of its 13 member institutions, which do not hold any equity position in the Corporation. The DIC assesses the depository institutions at an annual premium equal to one-twentieth of one percentage (0.05%) of deposits, averaged over March 31 and September 30 of the preceding year.

Based on average total insurable Bahamian dollar deposits in banks of $5.2 billion during 2009, relative to $5.1 billion in 2008, premiums levied and collected in 2010 amounted to $2.6 million compared to $2.5 million in 2009. The accumulated assets of the Fund increased by $3.6 million to $20.0 million at end-2010. Of this amount, holdings of Bahamas Government Registered Stock totalled $17.9 million compared to $14.5 million in 2009.

STRATEGIC GOAL: Operational Efficiency

INFORMATION TECHNOLOGY

The Bank remained focused on the employment of information technology solutions and infrastructure to enable greater efficiency in its business functions and achievement of its strategic objectives.

Following its launch in prior years, the Bank's Document Imaging System was deployed across additional business units–with the aim of moving towards a more paperless environment and the implementation of an integrated electronic document management system. Among the process improvements achieved, were the further integration between the Bank's Treasury Management system and Society for Worldwide Interbank Financial Telecommunications (SWIFT) to advance straight through processing initiatives, thereby eliminating the need for duplicative effort and improving accuracy. In-house application systems also included the delivery of an upgraded Electronic Reporting System (ERS) to facilitate the combined regulatory reporting requirements of the Research and Bank Supervision Departments, and an on-line exchange control submission system for commercial banks to report daily foreign exchange sales data to the Bank.

In the area of network infrastructure, efforts continued towards improving service availability and reliability. A comprehensive network audit was performed by an external consultant, outlining specific recommendations to enhance service delivery and to provide the necessary foundation for future strategic initiatives. Projects initiated to upgrade the Bank's perimeter network security, data centre, and internal network are all expected to be concluded in 2011.

During 2011, the Bank expects to make significant progress with the proposed Online Reporting and Information Management System (ORIMS) project, which will allow for more effective capture, storage and analysis of and reporting on data from its licensees. The Bank's IT governance framework is also to be enhanced through the proposed implementation of Control Objectives for Information and related Technologies (COBIT), and additional internal reviews to complement the annual System and Process Audit of the Bank's financial systems currently performed by the external auditors.

STAFF TRAINING AND DEVELOPMENT

Capacity building is a critical part of the Bank's development strategy. In this regard, throughout the year, the Bank continued to provide opportunities for staff to upgrade their professional and technical skills, partly through in-house initiatives, aimed at strengthening management, supervisory and project management skills and general awareness sessions, inclusive of those related to IT Security, Health and Safety, Employment Law and revisions to the Central Bank of The Bahamas Act 2000.

Focused training for the Bank Supervision Department included overseas courses and workshops on liquidity risk management and credit risk management analysis, internal controls and bank administration. The various training programmes were primarily facilitated by the following organizations: the Financial Stability Institute; the Caribbean Group of Banking Supervisors (CGBS); the Federal Reserve System; the Association of Supervisors of Banks of the Americas (ASBA); and The Bahamas Institute of Financial Services (BIFS). In-house training sessions continued with local industry experts and Bank staff presenting topics of interest and relevance to the work of the Bank Supervision Department. The training programme for 2011 will concentrate primarily on building capacity in the areas of financial stability, crisis preparedness and Basel III.

In an effort to provide further exposure and training opportunities for newly recruited on-site examination team staff, a senior examiner was seconded to the Financial Services Commission, Isle of Man, during the fourth quarter, for a period of five (5) weeks, to observe the on-site examination process in that jurisdiction. During the assignment, the senior examiner was attached to senior management in banking and fiduciary services, and participated in a number of on-site examinations and related business meetings. Additional training for members of the on-site examination team, across the spectrum of risk management, are planned for 2011.

The Research Department continued its efforts to enhance skills in the area of forecasting techniques, economic analysis and statistical compilation, to meet the growing demands of the Department. To this end, staff participated in training sessions hosted by the Caribbean Regional Technical Assistance Centre (CARTAC), inclusive of workshops on Balance of Payments Statistics, Regional Financial Stability & Price Formation and Inflation Dynamics in the Caribbean. Additionally, the Department was represented at a Commonwealth Secretariat workshop, aimed at developing a public debt statistical bulletin.

During the year, officers of the Legal Unit shared their expertise with other employees of the Bank by hosting several in-house training sessions. The Unit made presentations to the Bank's staff on the Banks and Trust Companies Regulation (Amendment) Act, 2010 and the Central Bank of The Bahamas (Amendment) Act, 2010, prior to their enactment. There were also presentations on the Banks and Trust Companies Regulation Act, 2000, the Central Bank of The Bahamas Act, 2000 and on regulations pertaining to private trust companies and MTBs. Other presentations to staff focused on the Financial Transactions Reporting (Amendment) Act, 2009, the Central Bank's Anti Money Laundering and Countering the Financing of Terrorism 2009 Guidelines, the Financial Transactions Reporting (Amendment) Regulations, 2009, the Financial Intelligence Unit (Amendment) Act, 2009, the Securities Industry (Amendment) Act, 2009, the Financial and Corporate Service Providers (Amendment) Act, 2009 and the International Business Companies (Amendment) Act, 2009. The Unit also hosted seminars for Bank staff on the Employment Act and on general principles of administrative law. Staff of the Unit attended a workshop on bank insolvency in the Caribbean and an IMF Pre-Assessment Workshop.

With a view to building capacity within the Internal Audit Unit, the Bank sponsored the participation of staff of the Unit at several auditing courses overseas, which covered operational risk management and an introduction to IT auditing.

Technical training for the Information Technology Department included workshops on business continuity and the critical back-up and recovery software deployed by the Bank. The IT Department was also represented at a Centre for Latin-American Monetary Studies (CEMLA) workshop on Information Technology for Central Banks and the XXI Annual Conference of Central Banks' IT Specialists.

In 2010, the Bank implemented a formal cross-training programme, which was piloted with administrative staff, who were given an opportunity for skill development, knowledge sharing and exposure to the work of other departments. Based on the feedback provided by participants, modifications are expected to be made to the programme to enhance its overall effectiveness in 2011.

Consistent with its strategic objective of ensuring a dynamic, highly skilled workforce to undertake a full range of functions, the Bank embarked upon the development of a Succession Plan, which was approved by the Board of Directors in August 2010. The Plan seeks to identify and support the development of employees who have the potential, capacity and competence to fill key risk positions in the Bank.

Table 4: Total Employees

	2008	2009	2010
Accounts	9	10	10
Administration	30	29	28
Banking	26	26	25
Bank Supervision	51	54	61
Internal Audit	2	3	4
Information Technology	12	13	13
Exchange Control	34	33	31
Governor's Office	8	8	8
Human Resources	9	9	9
Legal Unit	5	5	5
Research	23	23	24
Security	22	22	22
Total	**231**	**235**	**240**

SOURCE: The Central Bank of The Bahamas

STAFF COMPLEMENT AND RELATIONS

At end-2010, the Bank's staff complement stood at 240, a slight increase over the previous year (see Table 4). There were nine (9) new recruits, three (3) voluntary separations and three (3) retirements. In January, the Bank recognized nineteen (19) long-serving employees with ten, twenty and thirty-year awards during its Annual Awards Presentation Ceremony.

The Bank celebrated the 27th anniversary of its Annual Art Competition and Exhibition–Senior and Junior categories–in 2010. The event continued to attract significant participation from both established and developing artists. The Bank's gallery was the venue for nine (9) exhibitions by local artists, including a novel collaboration with the National Art Gallery of The Bahamas (NAGB), whereby staff of the Bank selected pieces from the NAGB for display in the Bank's gallery.

COMMUNITY RELATIONS AND OUTREACH

The Bank continued its educational outreach and community relations programme by hosting students from nine Government and Private Independent Schools to site visits, and offered work experience opportunities to several students. The Bank also continued to participate in the Ministry of Education's National Careers Week and assisted a local service club in Grand Bahama with a presentation to the students of Eckerd College. The Bank's staff also participated in a number of charitable events.

HEALTH AND SAFETY IN THE WORKPLACE

In its continuing efforts to promote an awareness of workplace safety, the Bank delivered training for all staff on health and safety practices and commenced preparation of a Health and Safety Manual.

Complementary structural works initiated in 2010 included substantial repairs to the roof and ceiling of the Bank's main building, as well as the start of an extensive upgrade to the electrical infrastructure. The Bank also sustained its ongoing maintenance work and repairs to its historical properties–the Great House, Verandah House and Balcony House.

FINANCIAL HIGHLIGHTS

The Central Bank's financial statements for the year ended December 31, 2010, along with comparative figures for 2009, are presented on pages 47 to 88 of this report.

The Bank's total assets grew by $118.3 million (11.1%) to $1,184.7 million. External reserves, which are derived mainly from residual tourism and foreign investments inflows, along with public sector borrowings, accounted for 72.6% of assets at $860.4 million. Of this amount, the bulk was invested in marketable securities of foreign governments (58.1%), followed by Special Drawing Rights (20.4%) and deposits with maturities in excess of three months (12.8%).

Domestic assets totalled $312.2 million, for a gain of $74.6 million or 31.4% over 2009. Advances to Government were higher by 15.8% at $113.3 million and holdings of Government bonds, by 55.4% at $164.4 million. The balance included a combined claim on other public sector entities of $11.1 million, currency inventory of $9.7 million, and receivables and other assets of $9.5 million.

The third category of assets, property, plant and equipment, declined by 6.0% to $12.1 million.

Demand liabilities increased by $119.1 million (16.0%) to $862.1 million. Reflecting the high levels of bank liquidity and weak credit conditions, non-remunerated deposits held for banks rose strongly by $143.2 million (38.2%) to account for 60.0% of the total. Among the remaining items, currency liabilities declined by $12.0 million (3.7%) and deposits held for Government and its agencies were also lower by $6.6 million (18.2%).

The Bank's main source of income is returns on its investments. In the context of the pervasive low global interest rate environment, total comprehensive income declined by $0.6 million (17.0%) to $2.6 million. Total income registered a gain of $0.2 million to $24.6 million, of which 52.2% was derived from foreign investments.

Of the $22.1 million in expenses, 63.6% was for staff costs; 28.9% for general and administrative expenses, and the remaining 7.5% represented depreciation outlays. Staff costs increased by 8.0% and reflected, in large measure, the shift in the bank examination team from consultancy to permanent employment status.

ACKNOWLEDGEMENT

The Board of Directors wishes to extend its appreciation to the Bank's staff, for their continued hard work and dedication over the year, which exemplifies their commitment to the Bank.

The Board would also like to thank the international organizations, which have continued to support the Bank by providing technical assistance programmes and in this regard, the Caribbean Technical Assistance Centre (CARTAC) deserves special mention.

OUR ENVIRONMENT

OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

Indications are that the domestic economy stabilized in 2010, in comparison to 2009, when the adverse effects of the global recession led to a 4.3% contraction in output (see Table 5). Favourable developments in the key tourism sector were mainly responsible for the improved economic momentum, as a number of private/public sector initiatives, combined with sustained growth in the key source markets, buoyed broad-based gains in both stopover and cruise arrivals. However, weakness persisted in other sectors, including construction, as both private sector and foreign investment projects stayed below pre-recession levels. Against this background, unemployment rates remained elevated while domestic inflation was subdued—although fuel costs increased significantly, due to higher international crude oil prices.

Amid the softness in domestic demand, Government's tax revenue performance for FY2009/10 remained well below projections, with weakness concentrated in the heavily weighted international trade category. However, modest contractions in spending supported an improvement in the estimated overall deficit to 4.6% of GDP from 4.9% in the previous period—although exceeding the 3.9% budget estimate. Although tax revenues firmed in the first six months of FY2010/11, the overall deficit expanded by 0.5 percentage points to 2.9% of GDP, owing to a sharp contraction in non-tax receipts, following a significant one-time transaction in the previous fiscal period. These developments, inclusive of Government Guaranteed liabilities, resulted in the National Debt advancing to 56.4% of GDP at end-December 2010 from 52.9% a year earlier.

TABLE 5: Selected Economic Indicators (% Change)

	2007	2008	2009	2010
Real GDP	1.9	(1.7)	(4.3)	0.5[1]
Unemployment Rate (actual mid-year)	7.9	8.7	14.2	n/a
Occupied Hotel Room Nights	(4.4)	(3.3)	(13.3)	3.0
Hotel Occupancy (%)	65.5	56.8	49.5	51.5
Total Arrivals	(2.7)	(4.5)	5.7	13.0
Mortgage Disbursements	(10.5)	11.2	(26.9)	(25.9)
Electricity Generation (mwh)	6.1	1.4	(5.2)	n/a
Consumer Price Index	2.5	4.7	1.9	1.3[2]
Debt/GDP Ratio	41.6%	44.0%	52.9%	56.4%

SOURCE: The Central Bank of The Bahamas

[1] Bahamas Government's estimate

[2] Based on Department of Statistics' New Index for The Bahamas (Feb 2010 = 100)

In monetary developments, both liquidity and external reserves registered notable gains, in the context of weak consumer demand and several extraordinary foreign currency receipts. External reserves grew to an estimated 21.7 weeks of non-oil merchandise imports, compared to 20.8 weeks in 2009. Credit expansion was primarily fuelled by Government's increased budgetary requirement, while private sector credit growth remained anaemic. Banks' profitability contracted marginally over the twelve-month period to September, reflecting lower interest income, an increase in provisions against loan losses and higher operating costs. However, a reversal in non-core transactions to a net earnings gain slowed the fall off in net income to a fraction of the previous year's contraction. With no broad-based improvement in borrowers' capacity to service their debt, the deterioration in banks' credit quality continued, although the rate of growth in delinquent and non-performing loans slowed considerably over the previous year.

Buoyed by a tourism-led expansion in the services account surplus, the current account deficit narrowed in 2010 by 0.6 of a percentage point to 11.5% of GDP. By contrast, a decline in Government's foreign currency borrowings offset a capital-led increase in direct investment, to result in a slight narrowing of the capital account surplus.

REAL SECTOR

Tourism

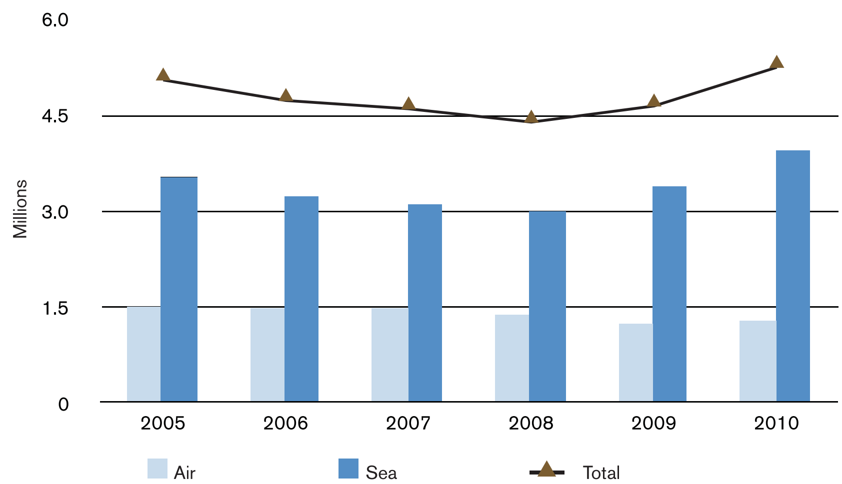
Indications are that tourism output rose moderately in 2010, buoyed by the recovery in the main source markets—particularly the United States—and a combination of local initiatives, such as joint public and private sector promotional campaigns, alongside other incentive programmes.

Total visitor arrivals increased by 13.0% to 5.2 million, extending the 5.7% gain achieved in 2009. Supported by a 10.1% hike in port calls from a number of major cruise lines and higher capacity ships, sea traffic firmed further by 16.5% to 4.0 million (75.3% of the total), after increasing by 13.1% in 2009. The growth was evenly distributed throughout the year, with most monthly gains in excess of 10.0%. Reflecting improvements in the first half of the year, the high value-added air arrival segment recovered by 3.4% to 1.3 million, in contrast to a 10.1% contraction in 2009.

By first port of entry, visitors to New Providence rose by 9.2% to 2.9 million, led by a 12.5% hike in sea visitors and a more modest 3.3% gain in the air segment. Visitor traffic to Grand Bahama strengthened by 34.5% to 0.8 million, as the rerouting of a cruise liner and the return of several others boosted sea arrivals by 46.6%, to overshadow the 9.2% decline in the air component. Benefitting from increased direct services between overseas markets and several local ports, visitors to the Family Islands grew by 11.3% to 1.5 million.

A preliminary analysis of stopovers by major source markets generally mirrored the uneven recovery in the global economy over the course of 2010. As weak consumer fundamentals constrained US output growth, visitors from this market grew by a comparatively lower 2.5% to 1.1 million, although an improvement from the average 0.6% contraction recorded in the five years prior to the economic recession, to account for a commanding 80.1% of the total. Stopovers from the Canadian and Latin American markets, which were relatively less affected by the worldwide economic recession, grew more strongly by 11.4% and 10.8%, but maintained smaller shares, of 8.7% and

Tourist Arrivals



1.5%, respectively. Visitors from countries in the fast growing Asian region, which individually accounted for less than 1.0% of the overall market, rose by 4.1%, for a combined share of 2.7%. In contrast, stopover arrivals from Europe and the Caribbean regions, which continued to be negatively impacted by the crisis, fell by 1.0% and 1.8%, reducing their respective market shares to 5.7% and 1.4%.

Preliminary hotel performance data from the Ministry of Tourism showed that total room revenues firmed by 3.7% to $423.4 million, owing to the 2.0 percentage expansion in average occupancy rate to 51.5% and a more modest 0.7% gain in average daily room rates to $199.0. The increase was attributed solely to the New Providence market, where hotel receipts grew by 5.6% to $373.5 million, buoyed by accretions to both average occupancy and daily room rates. In contrast, provisional earnings for both Grand Bahama and the Family Islands posted declines of 12.8% and 3.4% to $23.7 million and $26.1 million, respectively, as average daily room rates moderated.

Prices

Based on the Department of Statistics' new Consumer Price Index (CPI) for The Bahamas[2], domestic inflation, as measured by changes in the Index, slowed to 1.3% in 2010 from 1.9% in 2009. Underlying this reduction was a decline of 1.2% in average prices for food & non-alcoholic beverages, compared to a 5.1% increase in 2009. Average price gains moderated for furnishing, household equipment & routine maintenance items, by 3.1 percentage points to 0.3%, recreation & culture, by 1.4 percentage points to 0.1%, and miscellaneous goods & services, by 1.6 percentage points to 1.8%. The other categories recorded more modest slowdowns in average cost increases, of under 1.5 percentage points, with the exception of a firming for health and transport prices, to 3.0% and 2.4% from 2.8% and 2.0% a year earlier. The rate of decline in average prices for communication slackened to 0.4% from 1.8% in 2009, while higher international oil prices contributed to the 2.8% boost in average costs of housing and other utility related items, a turnaround from a 0.3% decline in 2009.

The increase in international oil prices had a direct impact on domestic fuel costs. Average prices at the pump for both gasoline and diesel, firmed by 13.4% to $4.34 per gallon and by 22.2% to $3.70 per gallon, respectively. The average fuel surcharge, which also adjusts to changes in fuel costs, surged by 42.4% to 14.3¢ per kilowatt-hour (KWh).

Construction

During 2010, output in the construction sector remained weak, underpinned by the softness in foreign-investment led projects and domestic private sector activity, although several large-scale public sector projects provided support to the sector.

As an indicator of domestic activity, total mortgage loan disbursements for new construction and repairs, as reported by banks, insurance companies and the Bahamas Mortgage Corporation, fell by 37.4% to $170.4 million. Residential financing, which accounted for the majority of the disbursements, at 88.1% of the total, fell by 38.3% to $150.0 million and the commercial component (11.9% of the total) was reduced by 29.3% to $20.4 million. Mortgage commitments, a forward looking indicator, decreased in number by 10.5% to 1,085 and in value, by 29.1% to $130.5 million, from levels in 2009. Lending conditions were relatively unchanged as average interest rates for residential mortgages steadied at 8.4%, while commercial rates rose marginally to 8.9%.

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2 The new CPI has been rebased to February 2010 and features a number of new categories, covering previously unreported items. The weights of the categories in the Index have also been adjusted to reflect changes in consumption patterns. See the Department of Statistics website (www. statistics.bahamas.gov.bs) for further details.

FISCAL OPERATIONS

FY2009/10 Performance

Amid subdued consumer demand conditions, Government's revenue declined during FY2009/10, by 1.6% to $1,302.5 million, approximately 7.5% less than budget estimates—although the pace of contraction slowed in comparison to the previous period (see Table 6). In a modest offset, the implementation of measures aimed at constraining expenses contributed to the overall reduction in expenditure by 2.6% to $1,642.1 million (2.8% lower than estimates). As a result, the overall deficit contracted by $21.8 million to $339.5 million, over FY2008/09, but was 17.6% ($50.9 million) higher than the $288.6 million budget estimate.

Revenue

Tax revenue, which accounted for 85.1% of total receipts, fell by 1.8% ($20.9 million) compared to FY2008/09, and was 10.3% below budget projections at $1,109.0 million. Reflecting the weakness in domestic demand, international trade and transactions taxes fell by 4.8% to $566.0 million (14.4% below estimates). Specifically, import taxes contracted by 8.2% to $348.5 million, while stamp taxes from imports and excise taxes stabilized at $15.1 million and $188.4 million, respectively. In addition, non-import related stamp taxes declined by 16.5% to $162.2 million, due to lower revenues from property sales and financial transactions. Smaller contractions were recorded for selective taxes on services, of $4.1 million to $35.4 million and for motor vehicle taxes, of $2.1 million to $20.6 million. In contrast, other "miscellaneous taxes" more than doubled to $49.4 million, with more modest gains for property taxes, business and professional licence fees and departure taxes, of $7.2 million, $5.2 million and $0.4 million, respectively.

Non-tax receipts declined marginally, by 0.4% ($0.8 million) to $193.5 million, although 37.4% over the budget target. Fines, forfeits and administrative fees were lower by 13.4% ($13.5 million) at $87.3 million; while proceeds from the sale of government property narrowed by $0.6 million to $0.4 million. Income-related collections rose strongly by 14.4% ($13.3 million) to $105.7 million, buoyed by an upturn in income from 'other' sources, by 13.6% to $103.7 million.

TABLE 6: Fiscal Indicators (B$ Millions)

	FY2007/08	FY2008/09	FY2009/10	FY2010/11	
	Actual	Actual	Actual	Approved Estimates	Preliminary[1] Estimates
Government Revenue	1,424.1	1,324.2	1,302.5	1,517.2	573.5
as % of GDP	19.4%	18.0%	17.5%	19.9%	7.6%
Government Expenditure	1,575.0	1,685.5	1,642.1	1,733.5	789.4
as % of GDP	21.4%	23.0%	22.0%	22.7%	10.5%
Surplus/(Deficit)	(150.8)	(361.3)	(339.5)	(216.3)	(215.9)
as % of GDP	(2.1)	(4.9)	(4.6)	(2.8)	(2.9)

SOURCE: Ministry of Finance

Compiled according to the IMF's Government Finance Statistics Format. [1] July - December, 2010

Expenditure
Current outlays—which accounted for 85.0% of total expenditure—contracted by 1.9% ($26.8 million) to $1,395.9 million, and were 2.4% lower than budget estimates. The 17.9% fall-off in purchases of goods and services overshadowed the 1.2% advance in personal emoluments, and resulted in a 5.6% contraction in consumption outlays to $844.8 million (4.1% below budgeted estimates). In contrast, transfer payments firmed by 4.5% ($23.8 million) to $551.1 million, underpinned by the 15.7% increase in interest expenses to $178.5 million, amid a build-up in debt obligations. Subsidies and other transfers narrowed by 0.1% to $372.6 million, as a decline in transfers to non-profit institutions outpaced an increase in those to households.

Capital expenditures advanced by 12.1% to $156.8 million, but were 24.9% below budget. The outcome reflected a 29.3% expansion in infrastructure spending to $143.4 million—buoyed by higher outlays related to the harbour redevelopment project and road construction investments. Transfers to public corporations amounted to $3.3 million, compared to a negligible amount in the previous period. However, outlays for the acquisition of assets fell by two-thirds to $9.3 million, associated mainly with declines in land and 'other' subcomponents, by $3.7 million to $4.6 million and by $13.6 million to $4.7 million, respectively. Further, transfers to non-financial public enterprises contracted by $1.5 million to $0.8 million.

Over FY2009/10, the Government utilized a combination of domestic and external financing to service its obligations. Of the $282.0 million in Bahamian dollar borrowings, the bulk was from banks by way of Government bonds (74.4%), with smaller portions related to Treasury bills (20.3%) and loans and advances (5.3%). In addition, external borrowings totalled $318.3 million, inclusive of a US$300 million external bond issue and $18.2 million in loan financing.

First Six Months of FY2010/11

As economic conditions appeared to stabilize in 2010, Government's tax receipts improved over the first six months of FY2010/11; however, overall revenues declined by 8.8% ($55.4 million) to $573.5 million, due to lower non-tax collections. Despite gains in current spending, total expenditure contracted by 2.0% to $789.4 million, mainly reflecting declines in net lending to public entities. As a result of these developments, the overall fiscal deficit deteriorated by 22.0% to $215.9 million.

Revenue
Disaggregated data revealed a modest increase in tax collections, by 1.5% ($7.7 million) to $507.0 million, to represent roughly 88.4% of total receipts. Growth in international trade and transactions tax receipts, by 6.5% ($17.9 million) to $294.2 million, was owing to broad-based gains in import, stamp and excise taxes, of 5.4%, 11.2% and 10.8%, respectively. The improvement in the tourism sector buoyed the gain in departure taxes, by 33.1% ($9.4 million), and support from higher room rates led to hotel occupancy taxes rising by 67.8% ($6.4 million). The streamlining of the system used to determine vehicle licence fees contributed to a 27.5% ($2.2 million) increase in motor vehicle taxes to $10.2 million. In contrast, other non-import linked stamp taxes fell by 20.7% ($16.0 million) to $61.4 million, as lower property sales depressed associated stamp taxes, by 23.1% ($20.8 million). This negated the 23.0% ($5.2 million) increase in financial stamp taxes, stemming from the hike in fees on bank transactions. In addition, other "miscellaneous" taxes and business and professional fees fell by a lesser 9.0% ($3.0 million) and 16.3% ($2.5 million), respectively.

Non-tax revenue for the six months was nearly halved (48.7%) to $66.5 million. This reflected a 76.5% ($65.9 million) decline in income from 'other' sources to $20.2 million, from the previous period when proceeds from the sale of a business entity buoyed the two-fold rise in non-tax collections.

Expenditure

Outlays fell by 2.0% to $789.4 million, due mainly to an almost two-thirds decline in net lending to $22.5 million ($37.8 million) compared to the previous year. Current expenditure grew by 3.2% to $687.1 million, as the goods and services segment advanced by 11.5% to $128.1 million, buoyed by higher rents, communications and utilities costs. In addition, transfer payments expanded by 5.8% ($15.5 million) to $280.3 million. The increase in external interest payments on debt obligations, by 79.9% to $23.2 million, reflected the commencement of interest payments on the US$300 million external bond, and a smaller 3.5% gain in internal payments. Subsidies and other transfers firmed modestly by 1.5% to $183.9 million, attributed to higher transfers to households and abroad, which outstripped declines in those to non-profit institutions and subsidies to public entities. In a slight offset, wages and salaries decreased by 2.6% to $278.6 million, due in part to the reordering of work times for employees of some Government agencies.

In contrast, capital outlays retreated marginally by 0.7% ($0.5 million) to $79.9 million, owing to a reduction in infrastructure spending, by 16.3% ($12.2 million) to $62.7 million. Transfers to public corporations contracted by half to $1.1 million. However, asset acquisitions firmed by $12.9 million to $16.0 million, owing mainly to land purchases from a local oil company.

Financing

Budgetary financing for the six-month period comprised Bahamian dollar borrowings of $283.6 million, the majority of which was in the form of Government bonds (82.9%), and the remainder by way of loans and advances ($48.6 million). Internal foreign currency financing totalled $70.0 million in loans and advances, while borrowings in the external market accounted for a much smaller $7.5 million. Debt repayments, at $58.8 million, were largely to meet Bahamian dollar obligations.

National Debt

For calendar year 2010, the Direct Charge on the Government grew by $382.8 million (11.5%) to $3,703.2 million, accounting for an estimated 49.1% of GDP. Bahamian dollar claims, at 78.9% of the total, expanded by $307.0 million (11.7%) to $2,922.5 million, while foreign currency debt rose by $75.7 million to $780.7 million. By creditor composition, Bahamian dollar debt was mainly held by commercial banks (36.5%), followed by other "miscellaneous" sources (29.9%), public corporations (24.0%), the Central Bank (9.4%) and other local financial institutions (0.2%).

The Government's contingent liabilities fell by $32.9

Table 7: Debt Indicators (B$ Millions)

	2008p	2009p	2010p	Projections 2011[1]
a. External Debt	443.1	766.7	897.9	927.9
as % of GDP	6.1	10.4	11.9	12.0
b. Internal F/C Debt	416.8	422.9	495.0	409.0
as % of GDP	5.7	5.7	6.6	5.3
c. Total F/C Debt	859.9	1,139.6	1,343.0	1,286.9
as % of GDP	11.8	15.4	17.8	16.7
d. Debt Service Ratio[2]	3.1	2.9	3.3	5.7
e. Direct Charge	2,766.6	3,320.4	3,703.2	3,747.6
as % of GDP	37.9	45.0	49.1	48.6
f. National Debt	3,213.1	3,901.4	4,251.3	4,359.4
as % of GDP	44.0	52.9	56.4	56.5

SOURCE: Treasury Accounts, Treasury Statistical Printouts and Public Corporations' Quarterly Report

[1] Based on contractual obligations and planned borrowings

[2] Excludes refinancing activities

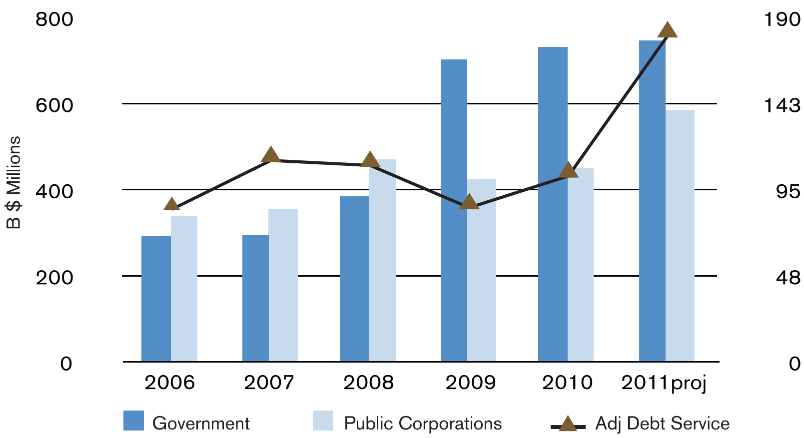
million (5.7%) to $548.1 million. Consequently, the total National Debt was higher by $349.9 million (9.0%) at $4,251.3 million at end-2010, although slowing from 2009's $688.3 million (21.4%) gain to $3,901.4 million. As a percentage of GDP, the National Debt firmed by 3.5 percentage points to an estimated 56.4%, compared to the 8.9 percentage point hike to 52.9% in 2009. (See Table 7.)

Foreign Currency Debt

During 2010, the foreign currency debt obligations of the public sector rose by $203.4 million (17.9%) to $1,343.0 million, an estimated 17.8% of GDP, as new drawings of $371.6 million outweighed the $168.2 million in amortization payments. Government's obligations (58.1% of total debt) rose by $75.7 million (10.7%) to $780.7 million; while the public corporations' component firmed by $127.7 million (29.4%) to $562.3 million.

Total debt service for the public sector fell to $232.8 million from $618.4 million in 2009, when both Government and a public entity conducted significant refinancing activities. As a result, Government's debt service payments were lower by $214.7 million at $56.9 million, and accounted for 24.4% of the total. Similarly, public corporations' payments contracted by $170.9 million to $175.9 million. As a proportion of goods and non-factor payments, the debt service, adjusted for refinancing activities, rose by 40 basis points to 3.3%. Government debt service as a percentage of revenues firmed by 1.9 percentage points to 4.6%.

Public Sector F/C Debt



The majority of the foreign currency debt was held by private capital markets (44.7%), followed by commercial banks (31.0%), others (14.5%), multilateral institutions (9.5%) and bilateral institutions (0.3%). The average maturity of the debt was virtually unchanged at 14.8 years.

MONEY, CREDIT AND INTEREST RATES

Liquidity

During 2010, bank liquidity firmed robustly, in the context of sustained anaemic consumer demand conditions and net foreign currency receipts, including a significant one-time inflow of funds to capitalize a local banking subsidiary. These developments also served to boost external reserves over the year, although below the year-earlier gain, given the lower level of Government's foreign currency borrowings. Credit conditions remained constrained, as loan arrears and non-performing loans deteriorated further, amid a weak employment and business environment. However, a slowing in the increment to provisions and positive contributions from non-core transactions, tempered the contraction in banks' overall profitability.

Average monthly liquidity, as measured by banks' net free cash reserves, rose by 11.7% to $263.7 million, extending 2009's 0.8% expansion. As a result, year-end liquidity was 44.1% higher than in

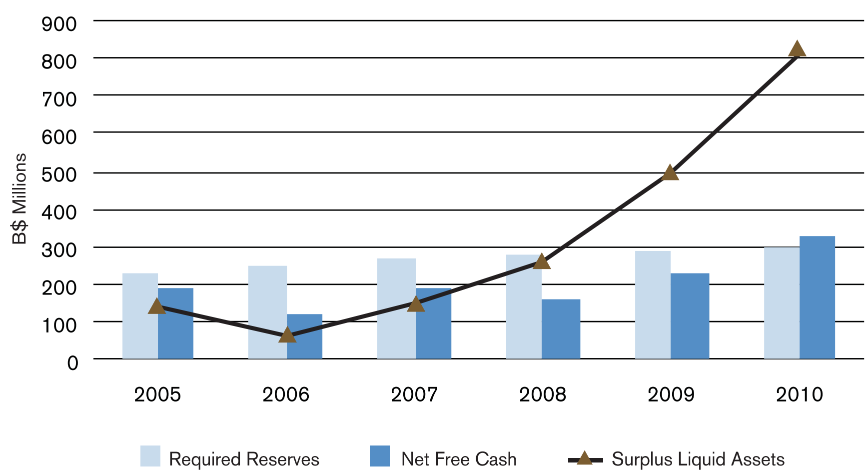
2009, at $330.6 million, and represented 5.5% of total Bahamian dollar liabilities vis-à-vis 4.0% a year earlier. Average monthly surplus liquid assets—a broader measure of bank liquidity—strengthened by 39.7% to $624.8 million over the year, and stood at $808.4 million at end-2010, for an increase of 63.6% over 2009. As a consequence, excess liquid assets were 85.4% over the statutory minimum, up from 53.2% in 2009.

Money Supply

Money supply growth strengthened over the course of 2010. Narrow money (M1), which comprised 21.6% of the overall money stock, advanced by $51.1 million (4.0%) to $1,334.7 million—to extend 2009's $9.1 million (0.7%) gain. The outcome reflected a 6.0% upturn in the more heavily weighted demand deposits, and a 6.4% decline in currency in circulation.

Reflecting higher levels of savings and fixed deposits, broad money (M2) advanced by $165.4 million (2.9%), up from the year-earlier gain of $77.8 million (1.4%). Savings deposits grew by $20.3 million (2.0%), in contrast to a $24.9 million (2.4%) contraction in 2009; and fixed deposit growth of nearly $94.0 million (2.7%) was in line with the previous year's expansion, with the slowdown in the growth of private sector balances offset by a reversal in public sector deposits to a $30.3 million build-up. Collectively, higher growth in savings by residents bolstered the holdings of Bahamian dollar deposits at commercial banks by $152.6 million (2.7%), compared to a marginal increase a year earlier, for a year-end total of $5,875.7 million.

Bank Liquidity



Resident foreign currency deposits contracted by $7.4 million (3.2%), in contrast to a $30.5 million (15.1%) rise in 2009. Despite the decline in foreign currency deposits, accretions to Bahamian dollar balances underpinned a $158.0 million (2.6%) advance in overall money (M3) to $6,190.3 million by end-2010.

Domestic Credit

Led by higher public sector borrowing activities, total domestic credit grew by 5.1% ($408.4 million), after expanding by 1.7% in 2009. Growth was concentrated in the Bahamian dollar component, which increased by 5.0% ($364.5 million) to double the previous year's 2.5% expansion. Banks' foreign currency claims rose by 5.7% ($43.9 million), relative to a 5.4% contraction in 2009.

Increased budgetary requirements were evidenced in a nearly four-fold hike in net credit to Government, by 38.1% ($389.6 million), vis-à-vis growth of $99.9 million in 2009 and were mainly in the form of Government bonds. Claims on the public corporations also firmed by 10.0% ($41.9 million), a turnaround from 2009's 6.3% contraction.

By contrast, generally subdued—although improving—demand conditions, contributed to a decline in credit to the private sector, by 0.4% ($23.2 million) compared to a 0.9% ($59.1 million) increase a year earlier (see Table 8). In terms of the major categories, personal lending—which accounted for 71.8% of total private sector credit—rose by 0.7% ($35.7 million) to $5,080.5 million, reflecting growth in housing-related lending, by 4.4% ($120.2 million), after a similar 4.8% advance in 2009. However, overdrafts and consumer credit fell by 30.0% ($32.0 million) and 2.4% ($52.4 million), respectively, following the year-earlier reductions of 2.1% and 2.3%.

TABLE 8: Flow of Credit in The Financial System (B$ Millions)

	Outstanding as at 2008	Absolute Changes 2009	2010	Outstanding as at 2010
Destination				
Government (net)	924.0	99.9	389.6	1,413.5
Central Bank	198.8	(17.9)	80.5	261.4
Domestic Banks	725.2	117.8	309.1	1,152.1
Rest of Public Sector	448.3	(28.4)	41.9	461.8
Central Bank	7.3	(0.3)	(0.6)	6.4
Domestic Banks	441.0	(28.1)	42.5	455.4
Private Sector	6,536.8	59.1	(23.2)	6,572.7
Consumer	2,244.4	(51.0)	(52.5)	2,140.9
Mortgages	2,705.8	128.6	14.3	2,848.7
Other loans	1,586.6	(18.5)	15.0	1,583.1
Financing				
Liabilities (Net of Government)	5,924.0	108.3	158.0	6,190.3
Currency	205.8	2.0	(13.3)	194.5
Total deposit liabilities	5,718.2	106.3	171.3	5,995.8
International Reserves	562.9	253.1	44.4	860.4
Other Net External Liabilities ( ) = increase	(703.8)	21.9	(23.6)	(705.5)
Capital and Surplus	1,868.0	174.6	242.8	2,285.4
Other (net)	23.8	(122.7)	(26.8)	(125.6)

SOURCE: The Central Bank of The Bahamas

A further breakdown of consumer credit showed broad-based declines for the majority of categories, with the exception of debt consolidation loans, which grew further by 9.0% ($53.4 million), vis-à-vis 10.3% in 2009. The largest contractions were recorded for private car ($32.1 million), miscellaneous ($26.6 million), credit card ($15.6 million), travel ($13.2 million) and home improvement ($7.5 million) loans. More modest declines, of between $2.0 million and $2.5 million, were noted for land purchases, furniture and education, while the remaining sectors registered reductions of under $2.0 million.

As regards other categories of private sector credit, significant net repayments were recorded for tourism ($61.5 million), entertainment and catering ($17.3 million) and construction ($11.6 million), and more modest declines for manufacturing ($4.5 million), private financial institutions ($2.8 million), fisheries ($1.5 million) and agriculture ($0.6 million). In contrast, credit accretions were posted for miscellaneous ($15.2 million), distribution ($14.1 million), professional and other service ($11.8 million), transportation ($7.2 million) and mining and quarrying ($2.6 million) loans.

Interest Rates

In interest rate developments, the weighted average interest rate spread on commercial banks' loans and deposits widened by 82 basis points to 7.61 percentage points. This was based upon a 47 basis point rise in the weighted average loan rate to 11.05%, and a 35 basis point decrease in the corresponding deposit rate to 3.44%.

Movements in lending rates were mixed, with consumer loan rates firming by 52 basis points to 13.21% and commercial mortgage rates advancing by 19 basis points to 8.79%. In contrast, the average rate on residential mortgages and overdrafts moved lower by 10 basis points to 8.15% and by 80 basis points to 10.87%, respectively.

As bank liquidity continued to accumulate, broad-based interest rate reductions were registered for all deposit categories. The savings deposit rate declined by 21 basis points to 1.94%, while the average rate range on fixed balances fell to 3.19% - 4.04% from 3.55% - 4.37% in 2009.

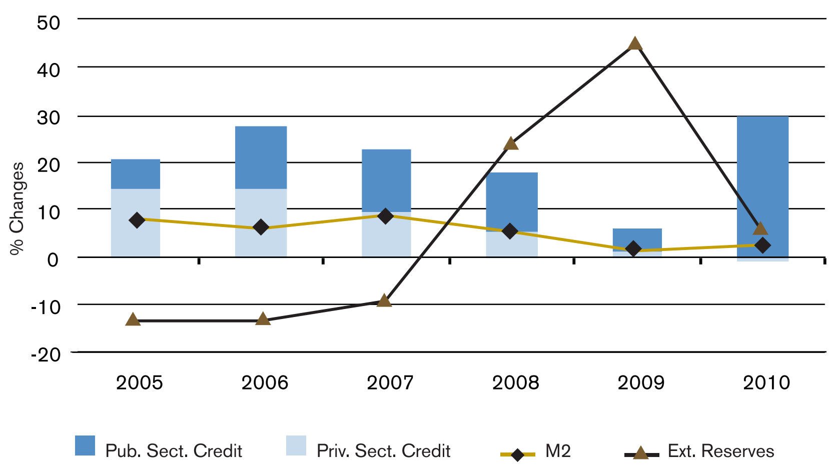
In terms of other key rates, the average 90-day Treasury bill rate decreased by 39 basis points to 2.23% in 2010; however, both the Central Bank's Discount rate and the commercial banks' Prime rate remained unchanged at 5.25% and 5.50%, respectively.

Net Foreign Assets

The financial system's net foreign asset position improved by $20.9 million (15.6%) to $154.9 million in 2010, mainly on account of a stronger accumulation of external reserves.

Growth in external reserves, of $44.4 million (5.4%) to $860.4 million at end-December 2010, represented a sharp slowdown from 2009's $253.0 million (45.0%) gain, which was bolstered by Government's external borrowings and the receipt of $178.9 million in IMF Special Drawing Rights. Net foreign exchange inflows related to real sector activities combined with receipts from the sale of a local business, boosted external reserves moderately over the first half of the year, to peak at $904.1 million by month-end May. However, the seasonal decline in the balances, after the winter tourist season, was halted as a result of the strong foreign currency inflows related to a bank's capitalization exercise in November. On average, external reserve balances stood $100 million higher than in 2009 at $819.9 million.

Monetary Developments



An examination of the underlying foreign exchange transactions revealed a decline in the net purchase to $19.1 million from $57.1 million in 2009, as the 13.3% falloff in total purchases outpaced the 10.3% decrease in total sales. Specifically, the net purchase from commercial banks increased more than six-fold to $237.3 million; while the net purchase from the Government fell by 59.7% to $114.9 million, reflecting the comparatively lower level of foreign currency borrowings. Conversely, increased demand for foreign currency to facilitate imports fuelled a hike in the net sale to public corporations of $66.2 million (24.8%) to $333.1 million. By end-2010, external reserves represented an estimated 21.7 weeks of non-oil merchandise imports, up from 20.8 weeks in 2009. By law, the Central Bank is required to keep, at a minimum, external balances equivalent to 50.0% of its demand liabilities. Factoring in this requirement, “useable reserves” contracted by $17.0 million to $433.3 million at end-December 2010.

Domestic banks’ net foreign liability position expanded by $23.6 million (3.5%) to $705.5 million in 2010, in contrast to a $21.9 million (3.2%) decline a year earlier, due in part to increased claims on the Government.

COMMERCIAL BANKING SECTOR DEVELOPMENTS

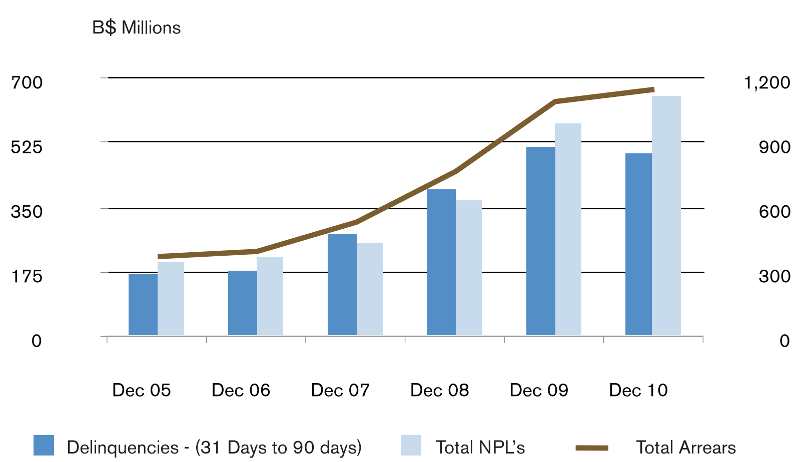
Despite the moderate growth in deliquencies and non-performing loans, the banking system remained stable during 2010, as capital ratios were well in excess of the Bank’s requirements and banks continued to increase bad debt provisions and restructure loans where prudent.

Credit Quality

Credit quality indicators of the commercial banking sector continued to deteriorate in 2010, though at a slackened rate, as business and labour market conditions remained challenging. Total private sector loans at least 30 days in arrears expanded by $56.6 million (5.2%) to $1,146.7 million, which was substantially below the $324.3 million (42.4%) rise to $1,090.1 million in 2009. Similarly, the ratio of arrears to total loans advanced by 4.1 percentage points to 18.3%, a slowdown from a 5.2 percentage point gain in 2009. A breakdown of arrears by average age revealed that growth was solely attributed to a lengthening in the non-performing component–arrears in excess of 90 days and on which banks have ceased accruing interest. These firmed by $74.3 million (12.9%) to $650.7 million over the year and the corresponding ratio, by 1.1 percentage points to 10.4%. Conversely, 31- 90 days loan delinquencies decreased by $17.8 million (3.5%) to $495.9 million, resulting in a 37 basis point decline in the relevant ratio to 7.9% of total loans.

In terms of the main categories, mortgage arrears–which are generally well collateralized–grew at the fastest pace, of $86.4 million (16.3%) to $617.9 million, although less than the $167.2 million (45.9%) increase in the prior year, resulting in a 2.3 percentage point rise in the corresponding arrears ratio to 20.7%. Commercial loan delinquencies advanced by $19.7 million (8.3%) to $255.3 million, a slowdown from the $74.4 million (46.2%) gain in 2009. At end-December, the corresponding commercial loan arrears ratio stood 1.9 percentage points higher at 24.7%. In contrast, consumer loan arrears contracted by $49.5 million (15.3%) to $273.5 million in 2010, to reverse 2009’s $82.7 million (34.4%) advance and lower the attendant proportion to total loans by 1.7 percentage points to 13.0%.

Total Loan Arrears



In keeping with sound credit risk management practices, commercial banks continued to increment provisions against loan losses, by $47.5 million (22.2%) to $261.1

million, resulting in a 70 basis point rise in the ratio of provisions to total loans to 4.1%. Similarly, provisions firmed as a percentage of arrears and non-performing loans, by 3.1 and 2.9 percentage points, to 22.7% and 39.9%, respectively.

Bank Profitability

Reflecting mainly a decline in interest revenues and increases in provisions against loan losses, banks' net income contracted by 2.3% ($5.0 million) to $208.6 million in the twelve-months through September 2010, a slowdown from the 26.2% ($75.7 million) reduction in 2009.

Interest income declined by 1.6% ($12.1 million); however, with the broad-based reduction in deposit rates, the net interest margin expanded by 2.3% ($11.4 million) to $501.0 million. Amid the softness in business activity, revenues from commission and foreign exchange transactions decreased by 10.1% ($2.5 million) to $21.9 million, extending last year's 19.0% ($5.7 million) decline. Banks' costs from operations firmed by $4.4 million (1.7%) to $272.6 million, owing to higher occupancy and other "miscellaneous" costs, which offset a reduction in staff-related expenses. As a result, the net operating earnings margin widened by 1.8% ($4.5 million) to $250.3 million. Other non-operating expenses grew by $17.9 million to $149.6 million, owing to an almost 90% increase in loan provisions and a more modest uptick in depreciation costs. However, transactions relating to non-core activities—which include fee-based income, were reversed, from a net loss of $16.9 million in 2009 to a net gain of $8.5 million in 2010. As a result, banks' net income fell by a mere $4.9 million to $208.6 million, compared to a $75.7 million reduction in 2009.

In light of these developments, changes in banks' profitability ratios to average domestic assets were mixed. Specifically, the gross earnings margin widened by 12 basis points to 5.73% of average assets, as the 15 basis point rise in the interest margin to 5.49% outpaced the 3 basis point decrease in the commission and forex income ratio to 0.24%. Similarly, despite the 6 basis points firming in the operating cost ratio to 2.99%, the net earnings margin increased by 7 basis points to 2.75%. However, as hikes in non-operating costs outweighed higher earnings from other "miscellaneous" income, the net income ratio contracted by 4 basis points to 2.29% of average assets.

Capital Market Trends

As domestic economic conditions stabilized, capital market activity strengthened in 2010, to its highest level since the establishment of the Bahamas International Securities Exchange (BISX) ten years ago. The outturn reflected two significant block trades over the year; however, when these transactions are extracted from the analysis, annual trading volumes and values declined relative to 2009.

Inclusive of these transactions, the volume of securities traded on the Exchange more than doubled, to approximately 10.9 million shares, with the corresponding value increasing more than four-fold to $110.2 million. Share volumes, net of these extraordinary transactions, fell by 21.9%, and the related value decreased by 15.9% to $22.3 million. The BISX All-Share Index registered a more modest 4.2% decline to 1,499.5 points, after moving lower by 8.6% in 2009.

The total number of securities publicly traded on the Exchange decreased by one to twenty-three (23), as one company was delisted during the year. There were eighteen (18) common share listings, one preference share listing and four tranches of debt. Collectively, listed securities recorded a market capitalization of $2.905 billion, a $0.11 billion decrease from 2009.

INTERNATIONAL TRADE AND PAYMENTS

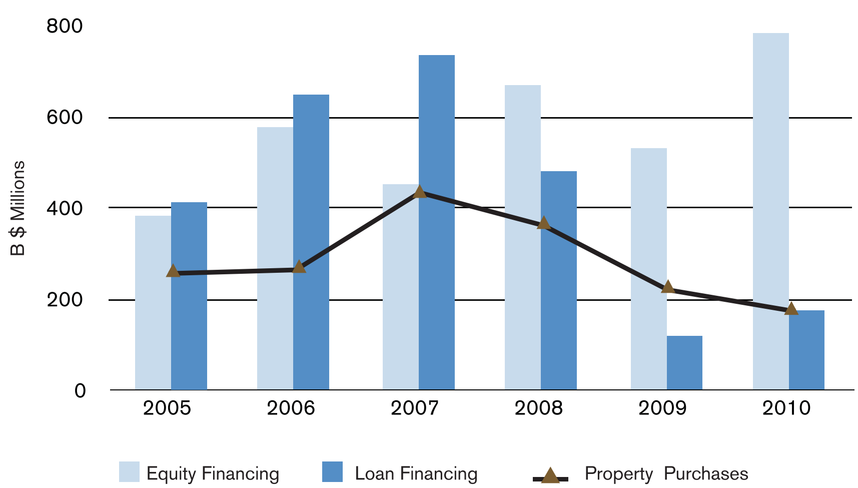
Preliminary data for 2010 suggests a modest improvement in the estimated current account deficit, by 2.6% ($23.5 million) to $869.8 million, due mainly to a tourism-led expansion in the services account surplus, which outpaced a deterioration in the goods deficit and higher net income outflows. On the capital and financial account, the surplus was relatively stable at $1,111.9 million, as a sharp reduction in other "miscellaneous" investments negated a capital investment-led surge in net direct investment inflows. (See Table 9).

TABLE 9: Balance of Payments Summary (B$ Millions)

	2008p	2009p	2010p
I. CURRENT ACCOUNT	(1,229.0)	(893.3)	(869.8)
i) Merchandise Trade (net)	(2,243.2)	(1,824.7)	(1,871.0)
Exports	955.8	710.7	711.3
Imports	3,199.0	2,535.3	2,582.4
of which: Oil	1,166.4	668.0	695.8
ii) Services (net)	1,131.0	1,070.0	1,224.2
of which: Travel	1,839.2	1,688.9	1,831.3
iii) Income (net)	(77.8)	(152.2)	(220.4)
iv) Current Transfers (net)	(38.9)	13.5	(2.6)
II. CAPITAL AND FINANCIAL ACCOUNT	1,212.2	1,114.6	1111.9
i) Capital Account (Transfers)	(8.1)	(7.2)	(3.6)
ii) Financial Account	1,220.3	1,121.8	1115.5
of which: Direct Investment	860.2	664.0	870.6
III. NET ERRORS AND OMISSIONS	125.5	31.7	(197.5)
IV. CHANGES IN EXTERNAL RESERVES[1]	(108.7)	(253.0)	(44.4)

SOURCE: The Central Bank of The Bahamas; [1]( ) = increase.

Foreign Investment Inflows



The estimated trade deficit widened, by $46.4 million to $1,871.0 million, vis-à-vis an 18.7% decline in 2009. Net non-oil merchandise imports edged up by 1.0% ($14.3 million) to $1,403.2 million, while the firming in international oil prices, combined with increased volumes, led to oil imports expanding by 4.2% ($27.9 million) to $695.8 million. Double digit gains were recorded for almost all oil product categories, with the per barrel price of propane gas rising by 20.3% to $65.34; aviation gas, by 15.8% to $146.87; motor gas, by 11.6% to $95.96 and jet fuel, by 9.6% to $98.75. In a modest offset, the per barrel cost for gas oil fell by 13.2% to $77.78.

The estimated services account surplus broadened by $154.2 million (14.4%) to $1,224.2 million. Contributing to this outturn were higher travel-related inflows of $142.4 million (8.4%) to $1,831.3 million, benefitting from growth in the key stopover segment. The surplus was also supported by a reduction in net transportation outflows, of $44.5 million (16.6%) to $223.0 million, amid higher revenues from port fees. The net payment for other "miscellaneous" and construction services fell by 3.0% to $306.2 million and by 24.2% to $15.7 million, in the context of subdued foreign direct investment activity, while royalty and licence fee payments narrowed by $6.9 million to $10.6 million. Net outflows for Government services also fell by 50.4% to $43.1 million. In contrast, the net outflow for insurance services rose by 78.5% to $165.2 million, and net receipts from offshore companies' local expenses moved lower by 14.0% to $156.6 million.

The income deficit worsened by $68.3 million (44.9%) to $220.4 million. This was primarily explained by a hike in domestic companies' interest and profit repatriations, by $30.7 million (23.5%) to $161.4 million, with banks' accounting for 57% of the increase. Net outflows for official transactions rose by almost four-fold to $31.6 million, as the build-up in the stock of foreign currency debt boosted Government's interest payments by $21.3 million to $46.4 million. Additionally, salaries and other compensation paid to non-residents more than doubled to $27.4 million from $11.8 million in 2009.

Current transfers were reversed to a net outflow of $2.6 million from a net receipt of $13.5 million a year earlier. The net outflow on account of the private sector increased by $16.7 million to $89.9 million, reflecting gains in workers remittance payments and other "miscellaneous" transfers, while Government's net inflow increased marginally by $0.6 million to $87.4 million.

Developments in the capital and financial account reflected a reduction in the other "miscellaneous" investment category, by $204.3 million (43.1%) to $270.2 million. Public sector net inflows decelerated to $131.3 million, from a $503.5 million surge in 2009 which was associated with Government's US$300.0 million external bond issue and a $178.9 million increase in SDR allocations under the IMF's global initiative. Other private investments, mainly consisting of loan financing, were reversed, to a net receipt of $115.4 million from a net repayment of $7.2 million a year earlier. Short-term capital transactions through the domestic banking system resulted in a net inflow of $23.6 million, a turnaround from a net outflow of $21.9 million in 2009. In contrast, net direct investment inflows improved by 31.1% ($206.7 million) to $870.6 million, as a non-resident entity's capitalization of its domestic bank contributed to a 56.2% rise in equity inflows to $722.3 million. This overshadowed a 26.4% decline in land purchases to $148.3 million, amid the softness in the second home market. Buoyed by growth in equity investments, net portfolio investment outflows increased by $8.7 million to $25.4 million—the majority of which related to the Bank's BDR programme. Investments in debt securities abroad steadied at $12.4 million, while migrants' net capital transfers were halved to $3.6 million in 2010.

As a result of these developments and after adjusting for possible net errors and omissions, the surplus on the overall payments balance, which corresponded to the change in the Central Bank's external reserves, narrowed by $208.6 million to $44.4 million.

DOMESTIC ECONOMIC OUTLOOK FOR 2011

The domestic economic recovery is expected to gain some momentum in 2011, amid the ongoing improvements in developed markets, which should provide further gains for the tourism sector—particularly the high value-added stopover component. In addition, construction activity, which was supported by the public sector over the last two years, should strengthen as a result of the commencement of several varied-scaled foreign investment projects. These developments will eventually have spill over effects on other real sector activity over the medium term thereby broadening the favourable impact on employment conditions. Inflationary pressures are likely to increase, amid the upward trajectory in fuel costs, which has occurred as a result of the global recovery and political tensions in a major oil producing region. In particular, the transportation and energy sectors, whose costs are directly correlated with international fuel prices, are expected to be significantly affected.

Government's near-term fiscal performance is anticipated to be impacted by a number of significant one-off revenue inflows, which should provide some support for the overall deficit. However, medium-term prospects will depend on the extent of the economic recovery, as well as the measures implemented to increase revenue and restrain growth in expenditure.

The outturn for the external account balance will be influenced by ongoing oil price developments and the usual hikes in non-oil imports occasioned by elevated levels of FDI activity. Some offset should be provided by tourism led gains in the services account surplus, as a result of the projected expansion in the tourism sector. With the anticipated net inflows related to foreign investment activity and one-time payments, the capital account surplus should improve.

On the monetary side, liquidity conditions are expected to remain relatively buoyant over the year. Key influences are the anticipated measured recovery in domestic demand, which is still constrained by a combination of the general weakness in economic activity and both high unemployment and consumer indebtedness. This environment, along with anticipated foreign investment inflows, should help to maintain external reserves at levels above international benchmarks.

INTERNATIONAL ECONOMIC DEVELOPMENTS

The global recovery, which commenced in the second half of 2009, gained impetus in 2010, reinforced by sustained growth in the export-led economies of Asia and comparatively modest improvements in the United States and Europe, as consumer demand rebounded. However, significant headwinds remained, as evidenced by the fiscal challenges which confronted several euro zone economies and required the introduction of fiscal austerity measures combined with substantial loans from international agencies. Given the anaemic pace of the recovery in many economies, unemployment rates stayed elevated and inflation was relatively mild. In this environment, central banks in developed markets either maintained their accommodative monetary policy stance or implemented new measures aimed at supporting the recovery. Stock prices generally moved higher, buoyed by positive investor sentiment and higher than expected corporate profits; while the low interest rate environment and concerns over the pace of the recovery in the United Sates, prompted investors to increase investments in non-dollar denominated assets, leading to the Dollar depreciating against several major currencies.

Preliminary data from the IMF indicated that advanced economies rebounded by 3.0% in 2010, from a year-earlier contraction of 3.4%. In the United States, where the growth momentum picked up pace in the fourth quarter, real GDP expanded by 2.8% in 2010, in contrast to a 2.6% contraction in 2009. The improvement reflected gains in private inventory investment, personal consumption and federal Government spending linked to the 2008 fiscal "stimulus" measures. Economic conditions in the United Kingdom remained fragile, although real output rose by an annualized 1.4% in 2010, relative to a 4.9% contraction in 2009. The euro zone also recorded modest growth of 1.7%, a revival from 2009's 3.1% downturn, and was supported mainly by improvements in Germany's export-based economy; whereas fiscal austerity measures implemented in countries such as Greece and Ireland, reined in economic growth. Despite the implementation of monetary policy tightening measures throughout the year, China's economic growth accelerated by 1.1 percentage points to 10.3% in 2010, propelled by surging industrial production and higher exports. Fuelled by the export sector, Japan's economy grew by 3.9%, reversing a year-earlier decline of 6.3%.

Global employment conditions remained challenging amid the slow pace of the expansion in most of the largest economies. Indicative of the modest economic recovery in the United States, the jobless rate fell modestly by 5 basis points to 9.4%. Weak economic conditions pushed the unemployment rate in the euro zone higher to 10.0% in December, from 9.9% a year earlier; while the jobless rate in the United Kingdom stabilized at 7.9%. Stronger economic performance in China, allowed for the creation of 11.7 million jobs, with a decline in the unemployment rate of 2 basis points to 4.1%. The jobless rate for Japan also softened, to 4.9% from 5.2% at end 2009.

Although the increase in aggregate demand, which accompanied the global economic recovery, led to moderate gains in oil and food prices over the year, inflation remained relatively benign among the developed economies. The United States' inflation rate slackened to 1.5% from 2.7% in 2009, amid a decline in clothing prices and slowing related costs. In the United Kingdom, the rate of inflation rose to 3.7% from 2.9% in 2009, and higher costs for transport and housing in the euro area caused an acceleration in average prices to 2.2%, up from 0.9% in 2009. In China, annual inflation accelerated by 2.7 percentage points to 4.6% in 2010, reflecting broad-based price gains, while prices in Japan were unchanged relative to the previous year.

Commodity prices firmed during 2010, buoyed by robust growth in demand among the emerging markets. The average price of oil rose by 26.5% to $80.32 per barrel, and the year-end price of $93.49 per barrel, was approximately 20.0% higher than the end-December 2009 level. The uncertainty caused by the continuing European sovereign debt crisis, led investors to shift investments to relatively "safe" assets. Consequently, the average price of gold rose by 25.7% during 2010, following an increase of 12.0% in 2009, to a year-end $1,420.78 per troy ounce. Similarly, average prices for silver rose by 40.1% to $30.92 per troy ounce at end-December.

The majority of developed economies' central banks either maintained or increased their accommodative monetary policy measures, in an attempt to support the nascent recovery. The US Federal Reserve kept its key policy rate unchanged, in the range of 0.00%-0.25%, during the year and announced in November, a plan to purchase a further $600 billion of longer-term Treasury securities over a six-month period. Similarly, the Bank of England held its Bank rate at 0.5% and continued its £200 billion programme to purchase Government debt, funded by the issuance of Central Bank reserves. Developments were more challenging within the euro area, as the fear of debt defaults among a few of the area's southern members prompted the European Central Bank (ECB) to launch its "Securities Markets Programme" in May, which allowed the ECB to purchase member Governments' bonds in the secondary debt markets. The Bank also maintained interest rates at historic lows during the year. In Asia, developments were mixed, as the Bank of Japan left its uncollateralized overnight call rate in the range of 0.0% and 0.1% during 2010, and commenced the purchase of ¥35 trillion in assets, mainly Government bonds, to provide further support to the economy. To slow the rapid rise in the prices of several categories of assets, the People's Bank of China tightened monetary policy, raising its RMB reserve requirement for depository financial institutions by 50 basis points on six different occasions within the year. The Bank also increased its benchmark deposit and lending rates, each by a total of 0.5 percentage points, and in July implemented a managed float for its exchange rate, based on a basket of currencies.

Currency market developments featured a broad-based depreciation of the US Dollar against most of the major currencies, amid concerns over the state of the United States' recovery and the persistently low levels of interest rates. As a consequence, the Dollar retreated relative to the Swiss Franc and Canadian dollar, by 9.8% to CHF 0.93 and 5.2% to CAD $0.99, respectively. Similarly, it depreciated against the Japanese Yen, by 12.7% to ¥81.16, and by 3.5% versus the

Chinese Yuan to CYN6.59. In contrast, amid the uncertainty in Europe, the Dollar appreciated vis-à-vis the British Pound by 3.6% to £0.64 and gained 7.0% relative to the euro, to €0.74.

Stock prices were relatively volatile during 2010, although on average markets moved higher, supported by an improved economic outlook and better than expected corporate profits. In the United States, the Dow Jones Industrial Average and the S&P 500 advanced by 11.0% and 13.2%, respectively. By end-2010, most of the major European indices also recorded gains; the United Kingdom's FTSE 100 and Germany's DAX, firmed by 9.0% and 16.1%, respectively; however, France's CAC 40 weakened by 3.3%. Developments in Asia were relatively subdued, with losses recorded for both the Japanese Nikkei (3.0%) and the Shanghia SE composite (14.3%).

Buoyed by modest growth in consumer demand, the United States trade deficit widened by $122.9 billion to $497.8 billion in 2010, owing to a 27.5% deterioration in the deficit on goods, which surpassed the 12.6% improvement in the services account surplus. In the United Kingdom, the trade deficit widened by £16.5 billion to £46.2 billion, as the 17.2% expansion in goods imports, particularly oil and intermediate goods, surpassed the 16.9% rise in exports. Robust growth in imports supported a contraction in the euro area's trade surplus by €15.9 billion to €0.7 billion. In contrast, indications are that Japan's trade surplus increased more than two-fold to ¥6.77 trillion, as a rebound in goods sold to other Asian markets bolstered exports by 24.4%; imports also increased by 17.7%. Conversely, China's trade surplus contracted by 6.4% to $183.1 billion, as strong domestic demand led to a 38.7% surge in imports, which outstripped a 31.1% gain in exports.

THE CENTRAL BANK OF THE BAHAMAS

Financial Statements

FOR THE YEAR ENDED DECEMBER 31, 2010

AND INDEPENDENT AUDITORS' REPORT

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Management Consultants
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Chartered Accountants and Advisors
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INDEPENDENT AUDITORS' REPORT

To the Directors of the Central Bank of The Bahamas:

Report on the financial statements

We have audited the financial statements of the Central Bank of The Bahamas (the "Bank") which comprise the statement of financial position as of December 31, 2010, and the related statements of comprehensive income, changes in equity and reserves and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Central Bank of The Bahamas as of December 31, 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000.

Deloitte & Touche

Chartered Accountants
Nassau, Bahamas
April 12 , 2011

BDO

Chartered Accountants
Nassau, Bahamas
April 12 , 2011

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF FINANCIAL POSITION

AS OF DECEMBER 31, 2010
(Expressed in Bahamian dollars)

	Notes	2010	Restated 2009	Restated January 1, 2009
ASSETS				
PROPERTY, PLANT AND EQUIPMENT	7	$ 12,081,505	$ 12,846,047	$ 13,209,026
EXTERNAL ASSETS	8			
Cash and deposits		65,131,136	225,889,428	205,828,879
Bank deposits maturing over 3 months		110,078,500	45,039,869	-
Marketable securities issued or guaranteed				
by foreign governments	9	499,675,042	356,181,606	347,389,540
International Monetary Fund:	10			
Bahamas reserve tranche		9,641,049	9,814,181	9,643,124
Special drawing rights		175,914,618	179,075,252	66,569
		860,440,345	816,000,336	562,928,112
DOMESTIC ASSETS				
Bahamas Development Bank bonds	11	4,065,096	4,119,945	4,064,317
Advances to Bahamas Government	12	113,344,229	97,905,809	72,431,539
Bahamas Government registered stock	13	164,374,766	105,802,118	126,274,640
Loans to Bahamas Development Bank	14	5,570,192	6,225,698	6,499,269
Bridge Authority bonds	15	853,377	809,289	794,090
Clifton Heritage Authority bonds	16	638,981	638,981	638,865
Bahamas Government Treasury bills		-	-	6,352,896
Currency inventory		9,674,466	10,254,646	7,166,972
Staff pension account	31	4,189,362	3,734,294	3,414,812
Receivables and other assets		9,477,735	8,103,446	7,448,018
		312,188,204	237,594,226	235,085,418
TOTAL ASSETS		$1,184,710,054	$1,066,440,609	$ 811,222,556

(Continued)

See notes to financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF FINANCIAL POSITION

AS OF DECEMBER 31, 2010
(Expressed in Bahamian dollars)

	Notes	2010	Restated 2009	Restated January 1, 2009
LIABILITIES, EQUITY AND RESERVES				
DEMAND LIABILITIES				
Notes in circulation	17	$ 289,766,556	$ 301,996,894	$ 305,961,648
Coins in circulation		18,084,623	17,831,103	17,600,463
Deposits by commercial banks	18	517,824,735	374,673,465	321,378,833
Deposits by Bahamas Government and Bahamas Government agencies	19	29,922,481	36,566,946	14,517,803
Deposits by international agencies		255,393	247,277	358,537
Accounts payable and other liabilities		2,527,609	2,501,680	2,586,852
Provision for Investment Currency Market		1,817,630	1,255,696	-
Group insurance subsidy benefit	32	1,933,998	1,849,583	1,770,663
Provision for payment into the Consolidated Fund		-	6,118,113	6,118,113
		862,133,025	743,040,757	670,292,912
OTHER LIABILITIES				
International Monetary Fund allocation of special drawing rights	20	191,710,685	195,112,834	15,780,878
EQUITY AND RESERVES				
Authorized and fully paid capital		3,000,000	3,000,000	3,000,000
Exchange equalization account	21	(136,428)	(238,345)	(138,510)
Contingency reserve		750,000	750,000	750,000
Other reserves		9,799,944	9,799,944	9,799,944
Building fund	21	6,980,403	6,980,403	6,980,403
General reserve	21	110,472,425	107,995,016	104,756,929
		130,866,344	128,287,018	125,148,766
TOTAL LIABILITIES, EQUITY AND RESERVES		$1,184,710,054	$1,066,440,609	$ 811,222,556

(Concluded)

See notes to financial statements.

The financial statements, as approved by the Board of Directors and authorized for issuance on April 12, 2011, are signed on its behalf by:

Governor

Director

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED DECEMBER 31, 2010
(Expressed in Bahamian dollars)

	Notes	2010	Restated 2009
INCOME			
Interest on foreign investments	22	$ 12,873,035	$ 14,505,036
Interest on loans	22	1,758,134	1,270,883
Interest on domestic investments	22	7,212,595	7,601,243
Unrealized exchange gain (loss)	22	101,917	(99,835)
Interest expense	22	(557,766)	(214,965)
Other income	22	3,260,423	1,322,830
Total income		24,648,338	24,385,192
EXPENSES			
Staff costs	23	14,037,353	12,992,463
General and administrative	23	6,367,079	6,527,221
Depreciation	7	1,664,580	1,758,712
Total expenses		22,069,012	21,278,396
NET INCOME		2,579,326	3,106,796
OTHER COMPREHENSIVE INCOME			
Actuarial gains on defined benefit pension scheme	31	-	31,456
TOTAL COMPREHENSIVE INCOME		$ 2,579,326	$ 3,138,252

See notes to financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CHANGES IN EQUITY AND RESERVES

YEAR ENDED DECEMBER 31, 2010
(Expressed in Bahamian dollars)

	Authorized and Fully Paid Capital	Exchange Equalization Account	Contingency Reserve	Other Reserve	Building Fund	General Reserve	Total
Balance at January 1, 2009 (as previously stated)	$ 3,000,000	$ (138,510)	$ 750,000	$ 9,799,944	$ 6,980,403	$106,527,592	$ 126,919,429
Correction of prior years' errors (Note 6)	-	-	-	-	-	(1,770,663)	(1,770,663)
Balance at January 1, 2009 (restated)	3,000,000	(138,510)	750,000	9,799,944	6,980,403	104,756,929	125,148,766
Transfer of unrealized exchange loss	-	(99,835)	-	-	-	99,835	-
Net income	-	-	-	-	-	3,106,796	3,106,796
Other comprehensive income							
Actuarial gains on defined benefit pension scheme	-	-	-	-	-	31,456	31,456
Balance at December 31, 2009 (restated)	3,000,000	(238,345)	750,000	9,799,944	6,980,403	107,995,016	128,287,018
Transfer of unrealized exchange gain		101,917				(101,917)	-
Net income	-	-	-	-	-	2,579,326	2,579,326
Balance at December 31, 2010	$ 3,000,000	$ (136,428)	$ 750,000	$ 9,799,944	$ 6,980,403	$110,472,425	$ 130,866,344

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2010

(Expressed in Bahamian dollars)

	Notes	2010	Restated 2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income		$ 2,579,326	$ 3,106,796
Adjustments for non-cash items:			
Amortization of (discount) premium on marketable securities	9	(523,462)	442,993
Depreciation	7	1,664,580	1,758,712
Interest income		(25,604,004)	(24,579,833)
Interest expense		557,766	214,965
Net cash used in operating activities before changes in operating assets and liabilities		(21,325,794)	(19,056,367)
Decrease (increase) in operating assets:			
Currency inventory		580,180	(3,087,674)
International Monetary Fund - special drawing rights		(68,383)	152,216
Receivables and other accounts		(1,879,743)	(1,030,819)
(Decrease) increase in operating liabilities:			
Notes in circulation		(12,230,338)	(3,964,754)
Coins in circulation		253,520	230,640
Deposits by commercial banks		143,151,270	53,294,632
Deposits by Bahamas Government and Bahamas Government agencies		(6,644,465)	22,049,143
Deposits by international agencies		8,116	(111,260)
Investment Currency Market provision		561,934	1,255,696
Accounts payable and other liabilities		181,547	(53,535)
Net cash from operating activities		102,587,844	49,677,918

(Continued)

See notes to financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2010
(Expressed in Bahamian dollars)

	Notes	2010	Restated 2009
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	9	$ (202,210,075)	$(186,544,380)
Proceeds from maturities/redemptions of marketable securities	9	60,000,000	176,481,305
Purchase of property, plant and equipment	7	(900,038)	(1,395,733)
Advances (made to) repaid by Bahamas Government	12	(15,000,000)	(25,000,000)
Purchase of Bridge Authority bonds	15	(43,300)	(14,900)
Purchases of Bahamas Government registered stock	13	(141,086,245)	(17,693,900)
Proceeds from sales and maturities of Bahamas Government registered stock	13	83,319,800	37,808,845
Repayments of loans by Bahamas Development Bank	14	600,000	325,000
Purchase of Bahamas Government Treasury bills		(53,912,766)	(162,200,384)
Proceeds from the sale and maturities of Bahamas Government Treasury bills		53,912,766	168,527,514
Additions to Bank deposits maturing over 3 months		(65,038,631)	(45,039,869)
Interest received		23,714,179	25,209,450
Net cash used in investing activities		(256,644,310)	(29,537,052)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payment to the Consolidated Fund		(6,118,113)	-
Interest paid		(519,168)	(167,682)
Net cash used in financing activities		(6,637,281)	(167,682)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(160,693,747)	19,973,184
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		225,993,278	206,020,094
CASH AND CASH EQUIVALENTS AT END OF YEAR		$ 65,299,531	$ 225,993,278
CASH AND CASH EQUIVALENTS ARE COMPRISED OF THE FOLLOWING:			
Cash and deposits		$ 65,131,136	$ 225,889,428
Cash on hand (included in receivables and other accounts)		168,395	103,850
		$ 65,299,531	$ 225,993,278

See notes to financial statements.

(Concluded)

1. GENERAL INFORMATION

The Central Bank of The Bahamas (the "Bank") was established under the Central Bank of The Bahamas Act, and was continued under the Central Bank of The Bahamas Act, 2000 (the Act). Its main place of business is located at Frederick Street, Nassau, Bahamas. The Bank's principal business is the provision of central banking facilities for the Commonwealth of The Bahamas. In accordance with the Act, it is the duty of the Bank to promote and maintain monetary stability and credit and balance of payments conditions conducive to the orderly development of the Bahamian economy; in collaboration with the financial institutions, to promote and maintain adequate banking services and high standards of conduct and management therein; and to advise the Minister on any matter of a financial or monetary nature referred by him to the Bank for its advice.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

The following new and revised IFRSs have been applied in the current period and have affected the amounts reported in these financial statements. Details of other new and revised IFRSs applied in these financial statements, but that have had no material effect on the amounts reported, are set out in section 2.2. There are other standards and interpretations that are not relavant to operations of the Bank and are not included.

2.1 New and revised IFRSs affecting presentation and disclosure only

Amendments to IAS 1 - Presentation of Financial Statements (as part of improvements to IFRSs issued in 2009)	The amendments to IAS 1 clarify that an entity may choose to present the required analysis of items of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements. The Bank has opted to show items of other comprehensive income in the Statement of Changes in Equity.

2.2 New and revised IFRSs applied with no material effect on the financial statements

The following new and revised IFRSs have also been adopted in these financial statements. The application of these new and revised IFRSs has not had any material impact on the amounts reported for the current and prior years but may affect the accounting for future transactions or arrangements.

Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items hedged	The amendments provide clarification on two aspects of hedge accounting: identifying inflation as a risk or portion, and hedging with options.
Improvements to IFRSs issued in 2009	Except for the amendments to IAS 1 described earlier in section 2.1, the application of Improvements to IFRSs issued in 2009 has not had any material effect on amounts reported in the financial statements.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs) (Continued)

2.3 New and revised IFRSs in issue but not yet effective

The Bank has not applied the following new and revised IFRSs that have been issued but are not yet effective.

IFRS 7 The amendments to IFRS 7 titled Disclosures – Transfer of Financial Assets increase the disclosure requirements for transactions involving transfers of financial assets. The amendment is effective for annual periods beginning on or after July 2011. The amendments also clarify the required level of disclosures about credit risk and collateral held, and provide relief from disclosures previously required regarding renegotiated loans which is effective for annual periods beginning on or after January 2011.

IFRS 9 Financial Instruments issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition. The amendment is effective for annual periods beginning on or after January 2013, with earlier application permitted.

IFRIC 14 This amendment provides entities with the ability to recognize an asset for prepayments of minimum funding requirement contributions. The amendment is effective for annual periods beginning on or after January 2011.

IAS 24 Related Party Disclosures (as revised in 2009) modifies the definition of a related party and simplifies disclosures for government-related entities. The amendment is effective for annual periods beginning on or after January 2011, with earlier application permitted.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Statement of compliance

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

b. Basis of preparation

The financial statements have been prepared under the historical cost basis except for financial instruments that are measured at fair values, as explained in the accounting policies below. Historical cost is generally based on the fair value of consideration given in exchange for assets.

c. Revenue recognition

Revenue is recognized when it is probable that the economic benefits will flow to the Bank and the amount of revenue can be measured reliably; revenue is measured at the fair value of the consideration received or receivable. Interest income is accrued on a time basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

d. Leases

The Bank as lessee

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

e. Foreign currency translation

i. Functional currency and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates. The financial statements are presented in Bahamian dollars; the Bahamian dollar is the Bank's functional and presentation currency.

ii. Transactions and balances

Transactions in currencies other than Bahamian Dollars are converted at the rates of exchange ruling at the time of the transactions. Balances in currencies other than Bahamian Dollars at the statement of financial position date are converted at the rate of exchange prevailing at that date.

The net change in the Bank's assets and liabilities arising from movements in currency exchange rates is included in the statement of comprehensive income and, in accordance with Sections 32(2)(a) and 32(2)(b) of the Act, the unrealized portion is transferred to an exchange equalization account.

f. Borrowing costs

Borrowing costs are recognized in the period in which they are incurred.

g. Retirement plan

The Bank's retirement plan is a contributory defined benefit plan with participants being permanent employees who joined the Bank prior to age 55. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each statement of financial position date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Bank's pension obligations and the fair value of the plan's assets are amortized over the expected average remaining working lives of the participating employees. Past service costs arising from plan amendments are recognized immediately to the extent that the benefits are already vested, and otherwise are amortized on a straight-line basis over the average period until the benefits become vested. Contributions are made by employees at 5% and the difference by the Bank, which amounted to 11.50% (2009 restated: 8.2%).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The amount recognized in the statement of financial position represents the present value of the retirement benefit obligation as adjusted for the unrecognized actuarial gains and losses and unrecognized past service costs, and reduced by the fair value of plan assets. Any asset arising as a result of this calculation is limited to the unrecognized actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

h. Fiduciary items

No account is taken in these financial statements of assets held or liabilities incurred by the Bank in a fiduciary capacity.

i. Property, plant and equipment

Property, plant and equipment are recorded at historical cost less accumulated depreciation and are assessed for indicators of impairment at the end of each reporting period. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefit associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they occur.

Depreciation is provided in equal annual installments so as to write off the cost of assets, other than land which is not depreciated, over their estimated useful lives. The following rates are used:

	Rate
Buildings and renovations	2% - 20%
Office equipment	20% - 33%
Computer software	33% - 50%
Office furniture and fittings	20%
Other fixed assets	20% - 33%

Any gain or loss arising on the disposal of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying value of the asset and is recognized in the statement of comprehensive income.

The Bank reviewed the estimated useful lives of property, plant and equipment at the end of the reporting period. Management's expectations did not differ from previous estimates, therefore, no changes were made to the estimated useful lives of property, plant and equipment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

j. Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

k. Financial instruments

Financial assets and financial liabilities are recognized on the Bank's statement of financial position when the Bank has become a party to the contractual provisions of the instrument.

l. Financial assets

Financial assets represent a contractual right to receive cash or another financial asset or to exchange financial assets or financial liabilities with another entity under conditions favourable to the Bank.

For those financial assets carried at fair value, they are ranked into Levels 1 to 3, based on the degree to which the fair value is observable:

Level 1 - Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Classification of financial assets

The Bank classifies its financial assets in the following categories: loans and receivables, available-for-sale and held-to-maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

i. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than, (a) those that the Bank intends to sell immediately or in the short term, (b) those that the Bank, upon initial recognition, designates as available-for-sale, or (c) those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available-for-sale.

Accounts set out below are classified as loans and receivables originated by the Bank and not held-for-trading. These amounts are stated at amortized cost, using the effective interest rate method less any provision for impairment.

- Advances to Bahamas Government
- Loans to Bahamas Development Bank
- Bahamas Government registered stock
- Bahamas Development Bank bonds
- Bridge Authority bonds

Section 29(1)(c) of the Act requires that the total amount of Government issued or guaranteed securities held at any time by the Bank, which mature beyond five years after their date of issue, shall not exceed 20% of the demand liabilities of the Bank. At the financial position date, such securities held by the Bank, which matured beyond five years after their date of issue, was approximately 20.00% (2009 restated 13.50%) of demand liabilities, excluding provision for payment into the Consolidated Fund.

The Act further requires that any holdings of Government issued or guaranteed securities should not have maturities extending beyond 20 years from the date of their acquisition. The Bank held no securities maturing beyond 20 years, at either December 31, 2010 or 2009 restated.

ii. Available-for-sale

Available-for-sale (AFS) financial assets are non-derivatives that are either designated as AFS or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Changes in the carrying amount of AFS monetary financial assets relating to foreign currency rates, interest income calculated using the effective interest method and dividends on AFS equity investments are recognized in profit or loss. Other changes in the carrying amount of available-for sale financial assets are recognized in other comprehensive income.

Bahamas Government Treasury bills are classified as available-for-sale financial assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

iii. Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale.

Marketable securities issued or guaranteed by foreign governments and Clifton Heritage Authority bonds are classified as held-to-maturity investments, and are stated at amortized cost, using the effective interest rate method. Such investments are subject to review for impairment.

Financial assets at amortized cost and the effective interest method

Debt instruments are measured at amortized cost, if both of the following conditions are met:

a. the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and

b. the contractual terms of the instrument give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt instruments meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method less any impairment, with interest revenue recognized in the Statement of Comprehensive Income.

The effective interest method is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

m. Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from date of acquisition and demand deposits.

n. Impairment of financial assets

Financial assets that are measured at amortized cost are assessed for indicators of impairment at the end of each reporting period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Bank assesses at each year end date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the assets' carrying amount and the present value of estimated future cash flows, discounted at the financial assets' original effective interest rate.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is decreased and the decrease is recognized in the statement of comprehensive income.

o. Derecognition of financial assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership, and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received

p. Currency inventory

Banknotes and coins are recorded at cost upon receipt of stock and are placed into inventory. They are subsequently expensed when issued into circulation.

q. Numismatic coins

Numismatic coins, which are specially minted or packaged as collectors' items and are not issued for monetary purposes, are not included in coins in circulation. Any profit or loss arising from the sale of these coins is included in the statement of comprehensive income.

r. Financial liabilities

Financial liabilities are any liabilities that are contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Bank; or a contract that will or may be settled in the Bank's own equity instrument.

Financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method, where applicable. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

s. Derecognition of financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

t. Investment Currency Market provision

A provision account has been established to recognize the Bank's obligations to investors, who might redeem premiums paid upon repatriation of foreign currency previously purchased.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Such accounting estimates and judgments are disclosed in Notes 3 (g), (i), (j) and (n).

5. CHANGE IN CLASSIFICATION

The Bank changed the classification of Bahamas Government Treasury bills from held-to-maturity investments to available-for-sale financial assets. The Bank is obligated to purchase and sell these Treasury bills from participating institutions. Management is of the opinion that the newly adopted policy results in the financial statements providing more reliable and relevant information on the financial position and results of operation. At the year end date, the Bank did not hold any Bahamas Government Treasury bills (2009 restated: nil).

6. CORRECTION OF PRIOR YEARS' ERRORS

The Central Bank pays a portion of the group life and health insurance (GLHI) premium for retirees who elect to remain covered by the Bank's GLHI policy after retirement. Subsidized premiums for retirees' health benefits were incorrectly expensed when incurred rather than during the periods when the employees' services were rendered.

(Expressed in Bahamian dollars)

6. CORRECTION OF PRIOR YEARS' ERRORS (Continued)

This change has been applied retrospectively. As a result, the following adjustments have been made to the 2009 financial statements:

Statement of Financial Position as of January 1, 2009 restated:	Increase in group insurance subsidy benefit liability: $1,770,663	Decrease in opening general reserve: $1,770,663
Statement of Comprehensive Income for year ended December 31, 2009 restated:	Increase in group insurance subsidy benefit expense: $78,920	Decrease in Comprehensive Income : $78,920
Statement of Financial Position as of December 31, 2009 restated:	Increase in group insurance subsidy benefit liability: $1,849,583	Decrease in general reserve: $1,849,583

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2010
(Expressed in Bahamian dollars)

7. PROPERTY, PLANT AND EQUIPMENT

	Land $	Buildings and Renovations $	Office Equipment $	Computer Software $	Office Furniture and Fittings $	Other Fixed Assets $	Total $
COST							
As of January 1, 2010	2,452,938	12,765,340	8,758,302	7,693,954	6,038,342	326,454	38,035,330
Additions	-	329,876	276,479	66,586	227,097	-	900,038
Disposals	-	-	-	(30,240)	-	(43,012)	(73,252)
As of December 31, 2010	2,452,938	13,095,216	9,034,781	7,730,300	6,265,439	283,442	38,862,116
ACCUMULATED DEPRECIATION							
As of January 1, 2010	-	5,536,092	6,586,628	6,995,864	5,755,169	315,530	25,189,283
Charge for the year	-	468,346	568,594	462,871	153,845	10,924	1,664,580
Disposals	-	-	-	(30,240)	-	(43,012)	(73,252)
As of December 31, 2010	-	6,004,438	7,155,222	7,428,495	5,909,014	283,442	26,780,611
NET BOOK VALUE							
As of December 31, 2010	2,452,938	7,090,778	1,879,559	301,805	356,425	-	12,081,505
COST							
As of January 1, 2009	2,452,938	12,650,562	10,340,938	6,855,075	3,406,046	383,507	36,089,066
Additions	-	117,925	448,898	713,175	115,735	-	1,395,733
Reclassifications	-	(3,147)	(2,031,534)	125,704	2,516,561	(57,053)	550,531
As of December 31, 2009	2,452,938	12,765,340	8,758,302	7,693,954	6,038,342	326,454	38,035,330
ACCUMULATED DEPRECIATION							
As of January 1, 2009	-	5,108,237	7,802,367	6,545,655	3,082,965	340,816	22,880,040
Charge for the year	-	431,002	807,598	341,115	147,230	31,767	1,758,712
Reclassifications	-	(3,147)	(2,023,337)	109,094	2,524,974	(57,053)	550,531
As of December 31, 2009	-	5,536,092	6,586,628	6,995,864	5,755,169	315,530	25,189,283
NET BOOK VALUE							
As of December 31, 2009	2,452,938	7,229,248	2,171,674	698,090	283,173	10,924	12,846,047

(Expressed in Bahamian dollars)

8. EXTERNAL ASSETS

External assets comprise those assets defined by Section 18(1) of the Act. The Act also requires that the value of external assets shall not at any time be less than 50% of the value of the aggregate of the notes and coins in circulation and other demand liabilities of the Bank. At year end, external assets represented approximately 99.79% (2009 restated 109.81%) of such liabilities, excluding provision for payment into the Consolidated Fund.

9. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS

Section 18(1) of the Act requires that marketable securities issued or guaranteed by foreign governments, which mature beyond 5 years, shall at no time constitute more than 30% in value of the Bank's external assets. At December 31, 2010, marketable securities held by the Bank, which mature after 5 years, constituted 27.30% (2009 restated 17.99%) of the Bank's external assets.

The movement in marketable securities is as follows:

	2010	**Restated 2009**
Beginning balance	$ 352,927,483	$ 343,307,401
Purchases	202,210,075	186,544,380
Redemptions/maturities	(60,00,000)	(176,481,305)
Amortization of discount (premium)	523,462	(442,993)
Ending balance	495,661,020	352,927,483
Add: Accrued interest	4,014,022	3,254,123
Total	$ 499,675,042	$ 356,181,606

The fair value of these securities at the year end date was $503,751,975 (2009 restated: $356,847,794). These securities bear interest at rates varying between 1.12% and 5.00% (2009 restated: 1.88% and 6.50%).

10. INTERNATIONAL MONETARY FUND

Bahamas Tranche

The International Monetary Fund (IMF) reserve tranche represents the amount by which The Bahamas' quota of Special Drawing Rights (SDR) with the IMF exceeds subscription payments as noted below:

	2010		2009	
	SDR (Millions)	$	SDR (Millions)	$
Quota	130	200,666,527	130	204,270,075
Subscription payments in promissory notes	(119)	(183,867,348)	(119)	(187,104,584)
Subscription payments in currency	(5)	(7,158,130)	(5)	(7,351,310)
Reserve tranche	6	9,641,049	6	9,814,181

The reserve tranche was purchased from the Government of The Bahamas in 1976. Subsequent to that purchase, the Bank has funded 25% of each increase in the IMF subscriptions of The Bahamas by issuing interest-free promissory notes which are payable on demand. In the opinion of the Directors, it is not probable that an outflow of resources employing economic benefits will be required to settle these promissory notes, which total $51,174,812 (2009 restated: $67,184,256). Consequently, this amount is regarded as a contingent liability and is not recognized in the Bank's statement of financial position.

SDR Holdings

	2010		2009	
	SDR	$	SDR	$
Beginning balance	114,186,847	179,009,638	43,219	66,569
Additional holdings from:				
General allocation	-	-	96,592,667	151,078,784
Special allocation	-	-	17,590,684	27,690,004
Remuneration & other charges	(25,298)	(38,954)	(39,723)	(59,827)
Currency movement	-	(3,157,932)	-	234,108
Ending balance	114,161,549	175,812,752	114,186,847	179,009,638
Add: Accrued interest		101,866		65,614
Total		175,914,618		179,075,252

The SDR is an international reserve asset created by the IMF in 1969 to supplement its member countries' official reserves. The IMF may allocate SDRs to members in proportion to their IMF quotas. Such an allocation provides each member with an asset (SDR holding) and an equivalent liability (SDR allocation). See also Note 20.

(Expressed in Bahamian dollars)

11. BAHAMAS DEVELOPMENT BANK BONDS

The movement in the Bahamas Development Bank bonds is as follows:

	2010	Restated 2009
Balance	$ 4,000,000	$ 4,000,000
Add: Accrued interest	65,096	119,945
Total	$ 4,065,096	$ 4,119,945

These bonds bear interest at the Bahamian prime rate of 5.50% with $2,000,000 maturing on August 1, 2025 and November 1, 2025 respectively.

12. ADVANCES TO BAHAMAS GOVERNMENT

Sections 28(3) and 28(4) of the Act require that advances to the Government, which may be outstanding at any one time, shall not exceed the lesser of either (a) 10% of the annual average ordinary revenue of the Government over the three preceding years, for which the accounts have been laid before Parliament, or (b) the estimated ordinary revenue of the Government for the year.

At the year end date, advances to the Government were 9.40% (2009 restated: 9.90%) of the lesser of such revenues.

The advances, which are repayable on demand, are as follows:

Rate	2010	Restated 2009
0.00%	$ 37,018,608	$ 37,018,608
0.08%	4,969,000	5,969,000
1.09%	-	19,000,000
2.04%	20,000,000	-
2.21%	20,000,000	-
2.25%	10,000,000	10,000,000
2.69%	20,000,000	25,000,000
	$ 111,987,608	$ 96,987,608

(Expressed in Bahamian dollars)

12. ADVANCES TO BAHAMAS GOVERNMENT (Continued)

The movements on the advances for the year are as follows:

	2010	Restated 2009
Beginning balance	$ 96,987,608	$ 71,987,608
Additions	48,600,000	25,000,000
Redemptions/maturities	(33,600,000)	-
Ending balance	111,987,608	96,987,608
Add: Accrued interest	1,356,621	918,201
Total	$ 113,344,229	$ 97,905,809

13. BAHAMAS GOVERNMENT REGISTERED STOCK

The movement in Bahamas Government registered stock is as follows:

	2010	Restated 2009
Beginning balance	$ 104,521,055	$ 124,636,000
Purchases	141,086,245	17,693,900
Redemptions/maturities	(83,319,800)	(37,808,845)
Ending balance	162,287,500	104,521,055
Add: Accrued interest	2,087,266	1,281,063
Total	$ 164,374,766	$ 105,802,118

Bahamas Government registered stock bear interest at rates ranging between 5.53% and 8.75% (2009 restated: 5.53% and 8.75%).

(Expressed in Bahamian dollars)

14. LOANS TO BAHAMAS DEVELOPMENT BANK

This balance is comprised of three Government Guaranteed loan facilities made available in accordance with Section 29(l) (f) of the Act.

The movement in loans to Bahamas Development Bank is as follows:

	2010	Restated 2009
Beginning balance	$ 6,150,000	$ 6,475,000
Repayments	(600,000)	(325,000)
Ending balance	5,550,000	6,150,000
Add: Accrued interest	20,192	75,698
Total	$ 5,570, 192	$ 6,225,698

The loans bear interest at 2.00% (2009 restated: 2.00%), with $1,050,000 and $4,500,000 maturing on October 21, 2018 and October 28, 2024, respectively.

15. BRIDGE AUTHORITY BONDS

The movement in the Bridge Authority bonds is as follows:

	2010	Restated 2009
Beginning balance	$ 795,000	$ 780,100
Purchases	43,300	14,900
Ending balance	838,300	795,000
Add: Accrued interest	15,077	14,289
Total	$ 853,377	$ 809,289

These bonds bear interest at rates ranging from 1.00% to 1.63% (2009 restated: 1.00% to 1.50%) per annum over the Bahamian prime rate. The actual rates ranged between 6.50% to 7.13% at December 31, 2010, with $422,600, $398,900, $3,500 and $13,300 maturing on March 24 2014, 2019, 2024 and 2029, respectively.

16. CLIFTON HERITAGE AUTHORITY BONDS

The Bank is the registrar for the Clifton Heritage Authority bonds guaranteed by The Bahamas Government. The bonds, which mature on May 20, 2025, bear interest at 6%. The movement in the Clifton Heritage Authority bonds is as follows:

	2010	Restated 2009
Balance	$ 634,600	$ 634,600
Add: Accrued interest	4,381	4,381
Total	$ 638,981	$ 638,981

17. NOTES IN CIRCULATION

In accordance with the Act, the Bank has the sole authority to issue banknotes for circulation in The Bahamas. A breakdown, by denomination, is presented below.

Notes	2010	Restated 2009
$ 0.50	$ 636,204	$ 630,994
$ 1.00	19,635,544	19,323,680
$ 3.00	1,826,199	1,799,001
$ 5.00	9,452,500	9,399,065
$ 10.00	13,394,830	13,613,610
$ 20.00	46,138,940	46,403,600
$ 50.00	81,997,900	85,682,200
$ 100.00	116,602,400	125,062,700
Other banknotes	82,039	82,044
	$ 289,766,556	$ 301,996,894

18. DEPOSITS BY COMMERCIAL BANKS

Deposits by commercial banks include current account balances deposited as statutory reserves in accordance with Section 19 of the Act. The remaining funds deposited in the current account are used to facilitate settlement and to effect foreign currency transactions.

The present level of the statutory reserves applicable to commercial banks is 5% of total Bahamian dollar deposit liabilities, of which at least 4% must be placed on deposit with the Bank. These deposits are interest free and are repayable on demand, subject to maintenance of minimum balances required by the Act.

19. DEPOSITS BY INTERNATIONAL AGENCIES

The Bank is designated as the fiscal agency for the Commonwealth of The Bahamas. Deposits by international agencies include deposits in Bahamian currency by the World Bank, the International Monetary Fund, the Inter-American Development Bank, the Caribbean Development Bank and the Commission of the European Development Fund. These deposits are interest free and are repayable on demand.

(Expressed in Bahamian dollars)

20. INTERNATIONAL MONETARY FUND ALLOCATIONS OF SPECIAL DRAWING RIGHTS

	2010		2009	
	SDR	**$**	**SDR**	**$**
Beginning balance	124,413,351	195,041,632	10,230,000	15,756,958
Additional allocations from:				
General allocation	-	-	96,592,667	151,078,784
Special allocation	-	-	17,590,684	27,690,004
Currency movement	-	(3,440,749)	-	515,885
Ending balance	124,413,351	191,600,883	124,413,351	195,041,631
Add: Accrued interest		109,802		71,203
Total		191,710,685		195,112,834

In accordance with a resolution of the Board of Governors of the IMF, effective December 11, 1978, The Bahamas became a participant in the Special Drawing Rights Department of the IMF, receiving a total allocation of SDR 10,230,000 between 1979 and 1981. A general allocation took effect on August 28, 2009 and a special allocation on September 9, 2009 and increased the Bank's allocations to SDR 124,413,351. The Special Drawing Rights allocation bore interest during the year at rates varying between 0.22% and 0.37% (2009 restated: 0.23% and 0.58%).

21. EQUITY AND RESERVES

Capital management - The Bank's objectives when managing capital, which is represented by equity and reserves on the face of the statement of financial position, are:

- To comply with the capital requirements outlined in Sections 6 and 7 of the Act;
- To safeguard the Bank's ability to continue as a going concern on its provision of central banking facilities for The Bahamas; and
- To maintain a strong capital base to support the development of the Bahamian economy.

Capital adequacy and the use of regulatory capital are monitored by the Bank's management, and in accordance with the guidelines established by the Act.

At December 31, 2010, the Bank's paid up capital was equal to the authorized capital of $3,000,000.

Exchange equalization account - Under the terms of Sections 32(2)(a) and 32(2)(b) of the Act, this account represents the net unrealized profits or losses arising from the revaluation of foreign currency assets and liabilities of the Bank at the statement of financial position date.

Building fund - Profit for the year ended December 31, 2008 of $6,980,403 before restatement, was transferred to a fund for construction of a building in the near future.

General reserve - Section 7(2) of the Act requires that, at the end of any year where the amount in the general

(Expressed in Bahamian dollars)

21. EQUITY AND RESERVES (Continued)

reserve exceeds twice the authorized capital of the Bank or 15% of its demand liabilities, whichever is greater, the excess shall be paid to the Consolidated Fund, unless the Minister of Finance determines otherwise.

The balance of the general reserve at the year end amounted to $110,472,425 (2009 restated: $107,995,016) equivalent to 12.81% (2009 restated: 14.53%) of demand liabilities.

22. INCOME

	2010	Restated 2009
Interest on foreign investments		
Demand deposits	$ 46,293	$ 43,494
Fixed deposits	658,021	1,427,280
Marketable securities	12,168,721	13,034,262
	12,873,035	14,505,036
Interest on loans		
Loans to Bahamas Development Bank	125,087	116,569
Government advances	1,352,231	913,073
Staff	280,816	241,241
	1,758,134	1,270,883
Interest on domestic investments		
Bahamas Development Bank bond	220,603	220,000
Bahamas Government Registered Stock	6,716,524	6,746,080
Bridge Authority bonds	54,610	52,399
Bahamas Government Treasury bills	182,782	544,584
Clifton Heritage bonds	38,076	38,180
	7,212,595	7,601,243
Unrealized exchange gain (loss)	101,917	(99,835)
Interest expense	(557,766)	(214,965)
Other income		
Bank statutory fines	59	71,357
Commission on foreign currency sales	900,271	699,801
Premium on Investment Currency Market	152,292	(11,626)
SDR Interest	510,978	146,772
Gain on marketable securities	1,508,273	-
Other	188,550	416,526
	3,260,423	1,322,830
Total income	$ 24,648,338	$ 24,385,192

(Expressed in Bahamian dollars)

23. EXPENSES

	2010	Restated 2009
Staff costs		
Salaries and wages	$ 11,043,910	$ 10,315,770
Group insurance plan	1,310,474	1,120,216
Staff pension fund	614,934	503,534
Staff training	244,234	295,552
National Insurance	279,418	263,945
Responsibility allowance	195,000	194,375
Other	349,383	299,071
	$ 14,037,353	$ 12,992,463
General and administrative		
Currency	$ 1,141,155	$ 1,105,572
Professional fees	1,559,668	1,546,416
Utilities	955,217	844,805
Repairs and maintenance	729,629	678,101
Rent	529,416	493,494
Insurance	217,942	214,404
Stationery and office supplies	90,360	126,345
Subscription and membership fees	174,715	173,329
Directors' remuneration	40,000	38,750
Other	928,977	1,306,005
	$ 6,367,079	$ 6,527,221

24. THE DEPOSIT INSURANCE CORPORATION

In accordance with Section 5(1) of the Protection of Depositors Act, 1999, the Bank has made an initial capital contribution of $500,000 in the Deposit Insurance Corporation (DIC). This represents 100% of the paid-up portion of the capital of DIC, which was established to manage the Deposit Insurance Fund set up to protect deposits placed with member institutions.

In the opinion of the Directors, the Bank does not have the power to govern the financial and operating policies of the DIC so as to attain benefits from its activities. Consequently, the Deposit Insurance Corporation is not treated as a subsidiary in these financial statements.

Additionally, the Directors do not consider that the investment in the DIC is recoverable, and, consequently the Bank has made a full provision against this investment.

(Expressed in Bahamian dollars)

25. COMMITMENTS & CONTINGENCIES

The Bank is committed to rent office space under a non-cancellable operating lease. The Bank is committed to the following future payments under the lease agreement:

2011	148,502
2012	66,042
2013	66,042
More than 3 years	44,028
Total	$ 324,614

The Bank is party to claims in the normal course of business, which are at various stages of the judicial process. The Bank is defending all such claims and is of the opinion that the outcomes, which cannot presently be determined, will not adversely affect its operations or financial position.

26. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities:

	2010	Restated 2009
EXTERNAL ASSETS		
Geographic Region		
North America	86.89%	91.19%
Europe	7.02%	8.81%
Other	6.09%	0%
Industry		
Financial Sector	100.00%	100.00%
OTHER ASSETS		
Geographic Region		
Bahamas	100.00%	100.00%
Industry		
Government Sector	100.00%	100.00%
DEMAND LIABILITIES		
Geographic Region		
Bahamas	99.97%	99.97%
Other	0.03%	0.03%
Industry		
Financial Sector	100.00%	100.00%
OTHER LIABILITIES		
Geographic Region		
North America	100.00%	100.00%
Industry		
Financial Sector	100.00%	100.00%

(Expressed in Bahamian dollars)

27. RELATED-PARTY TRANSACTIONS

The Bank is related in terms of common ownership to all Government of The Bahamas corporations and agencies. Transactions that the Bank has with such related entities are at amounts and terms established and agreed upon by the parties.

The Bank provides certain services to the Government of The Bahamas, in accordance with its mandate under Sections 26 to 29 of the Act.

The Bank's senior officials and directors are regarded to be its key management personnel.

The following balances and transactions relate to key management personnel:

a) Compensation:

	2010	Restated 2009
Senior officials' salaries and short-term benefits	$ 1,773,831	$ 1,756,689
Directors' remuneration	$ 34,375	$ 38,750

b) Loans:

	2010	Restated 2009
Beginning of the year	$ 680,771	$ 783,624
Advances during the year	407,191	40,948
Repayments during the year	(137,099)	(143,801)
End of the year	$ 950,863	$ 680,771

c) Post-employment pension and medical benefits:

	2010	Restated 2009
Pension payments	$ 654,379	$ 620,804
Gratuity	73,782	94,522
End of the year	$ 728,161	$ 715,326

28. FIDUCIARY ITEMS

The Bank held assets consisting of bank accounts and liabilities of dormant retail customers of $64,195,177 at December 2010 (2009 restated: $54,140,908); these amounts are excluded from the statement of financial position.

Dormant retail customer accounts, which are received in foreign currencies, are invested in the same currency. Foreign currency deposits are repaid by liquidating investments in the same currency.

29. FAIR VALUE OF FINANCIAL INSTRUMENTS

With the exception of marketable securities, whose fair value is as stated in Note 9, the Directors consider that all of the Bank's financial assets [including loans and receivables, with an aggregate carrying value of $288,142,598 (2009 restated: $211,391,870)] and financial liabilities are carried at amounts approximating their fair value.

30. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practices.

Risk management is carried out by the investment and monetary policy committees under policies approved by the Board of Directors. The committees identify, evaluate and hedge financial risks in close co-operation with the Bank's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk and financial instruments.

The most important types of risks are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk and interest rate risk.

Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular

30. FINANCIAL RISK MANAGEMENT (Continued)

segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the statement of financial position date. Credit exposures arise principally in loans and advances, debt securities and other bills in the Bank's asset portfolio. The Investment Committee monitors credit risk management and control and regular reports are provided to the Board of Directors.

The Directors do not consider that the Bank is exposed to any significant credit risk because its financial assets consist primarily of cash and securities issued or guaranteed by either foreign Governments or The Bahamas Government.

Market risk

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices. The Bank's exposure to market risk is from its financial investment portfolios.

The market risks arising from the Bank's activities are monitored by the Investment Committee and the Monetary Policy Committee. Regular reports are submitted to the Board of Directors and operating units.

Currency risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Bank's exposure to foreign exchange risk is limited because the net foreign currency exposure, excluding US dollars, is not material.

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may decrease or create losses in the event that unexpected movements arise. The level of mismatch of interest rate repricing that may be undertaken by the Bank is monitored frequently by the Investment Committee and the Monetary Policy Committee.

30. FINANCIAL RISK MANAGEMENT (Continued)

Certain of the Bank's financial assets and liabilities are exposed to interest rate risk. Marketable securities carry an average yield of 2.84% (2009 restated: 3.87%); however, if these securities had a reduced average yield of 2.67% (2009 restated: 2.99%), derived from their varying yields at the lower end of the spectrum, income for the year and equity at year end would have been reduced by $847,234 (2009 restated: $3,047,168). Had the yield been tilted towards the higher end of the spectrum, to 3.26% (2009 restated: 4.02%), income for the year and equity at year end would have increased by $2,093,167 (2009 restated: $539,345).

At December 31, 2010, should interest rates have risen by 50 basis points, with all other variables remaining constant, the increase in equity and net income for the year would amount to approximately $867,701 arising from funds placed on cash and deposits (2009 restated: $1,983,991). If interest rates had decreased by 50 basis points, the decrease in equity and net income for the year would amount to approximately $867,701 (2009 restated: $1,983,991).

Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due, and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Bank manages its foreign liquidity risks through appropriate structuring of its foreign investment portfolios to ensure that the maturity profiles of foreign assets sufficiently match those of foreign commitments. This is monitored and managed on a regular basis. In addition, the Bank's foreign investment portfolio comprises mainly short-term, highly liquid investment instruments.

Liquidity risk management process

The Bank's liquidity risk management process, as carried out within the Bank, includes:

- day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met, inclusive of replenishment of funds as they mature. The Bank maintains an active presence in global money markets to enable this to happen;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring statement of financial position liquidity ratios against internal and statutory requirements; and
- managing the concentration and profile of debt and financial instrument maturities.

(Expressed in Bahamian dollars)

30. FINANCIAL RISK MANAGEMENT (Continued)

The table below analyses financial assets and liabilities of the Bank into relevant maturity rankings, based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts in the table are the undiscounted cash flows. Balances due within twelve months equal their carrying balances as the impact of discounting is not significant.

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
As of December 31, 2010						
Period of maturity						
Financial Assets						
Cash and deposits	$ 65,131,136	$ -	$ -	$ -	$ -	$ 65,131,136
Bank deposits maturing over 3 months	-	-	110,078,500	-	-	110,078,500
Marketable securities issued or guaranteed by foreign governments	-	15,214,502	15,307,055	233,780,313	235,373,172	499,675,042
International Monetary Fund:						
Bahamas reserve tranche	9,641,049	-	-	-	-	9,641,049
Special drawing rights	175,914,618	-	-	-	-	175,914,618
Bahamas Development Bank bond	-	-	-	-	4,065,096	4,065,096
Advances to Bahamas Government	113,344,229	-	-	-	-	113,344,229
Bahamas Government registered stock	-	-	209,527	1,439,042	162,726,197	164,374,766
Loans to Bahamas Development Bank	-	-	-	-	5,570,192	5,570,192
Bridge Authority bonds	-	-	-	430,051	423,326	853,377
Clifton Heritage Authority bonds	-	-	-	-	638,981	638,981
Staff pension fund	-	-	-	-	4,189,362	4,189,362
Receivables and other accounts	7,912,886	-	-	-	1,564,849	9,477,735
Total financial assets	$ 371,943,918	$ 15,214,502	$125,595,082	$235,649,406	$414,551,175	$1,162,954,083

(Expressed in Bahamian dollars)

30. FINANCIAL RISK MANAGEMENT (Continued)

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
As of December 31, 2010						
Period of maturity						
Liabilities						
Notes in circulation	$ 289,766,556	$ -	$ -	$ -	$ -	$ 289,766,556
Coins in circulation	18,084,623	-	-	-	-	18,084,623
Deposits by commercial banks	517,824,735	-	-	-	-	517,824,735
Deposits by Bahamas Government and Bahamas Government agencies	29,922,481	-	-	-	-	29,922,481
Deposits by international agencies	255,393	-	-	-	-	255,393
Accounts payable and other liabilities	2,527,609	-	-	-	-	2,527,609
Provision for Investment Currency Market	1,817,630	-	-	-	-	1,817,630
Group Insurance Subsidy Benefit	-	-	-	-	1,933,998	1,933,998
International Monetary Fund allocation	191,710,685	-	-	-	-	191,710,685
Total financial liabilities	1,051,909,712	-	-	-	1,933,998	1,053,843,710
Net liquidity gap, December 31, 2010	$ (679,965,794)	$ 15,214,502	$125,595,082	$ 235,649,406	$ 412,617,177	$ 109,110,373

(Expressed in Bahamian dollars)

30. FINANCIAL RISK MANAGEMENT (Continued)

2009 Comparison

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
As of December 31, 2009						
Period of maturity						
Financial Assets						
Cash and deposits	$ 60,741,343	$165,148,085	$ -	$ -	$ -	$ 225,889,428
Bank deposits maturing over 3 months	-	-	45,039,869	-	-	45,039,869
Marketable securities issued or guaranteed by foreign governments	10,167,153	5,122,778	20,112,292	173,985,293	146,794,090	356,181,606
International Monetary Fund:						
Bahamas reserve tranche	9,814,181	-	-	-	-	9,814,181
Special drawing rights	179,075,252	-	-	-	-	179,075,252
Bahamas Development Bank bond	-	-	-	-	4,119,945	4,119,945
Advances to Bahamas Government	97,905,809	-	-	-	-	97,905,809
Bahamas Government registered stock	-	409	7,120	201,053	105,593,536	105,802,118
Loans to Bahamas Development Bank	-	-	-	-	6,225,698	6,225,698
Bridge Authority bonds	-	-	-	403,420	405,869	809,289
Clifton Heritage Authority bonds	-	-	-	-	638,981	638,981
Staff pension fund	-	-	-	-	3,734,294	3,734,294
Receivables and other accounts	6,823,116	-	-	-	1,280,330	8,103,446
Total financial assets	$ 364,526,854	$170,271,272	$ 65,159,281	$174,589,766	$ 268,792,743	$ 1,043,339,916

(Expressed in Bahamian dollars)

30. FINANCIAL RISK MANAGEMENT (Continued)

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
As of December 31, 2009						
Period of maturity						
Liabilities						
Notes in circulation	$ 301,996,894	$ -	$ -	$ -	$ -	$ 301,996,894
Coins in circulation	17,831,103	-	-	-	-	17,831,103
Deposits by commercial banks	374,673,465	-	-	-	-	374,673,465
Deposits by Bahamas Government and Bahamas Government agencies	36,566,946	-	-	-	-	36,566,946
Deposits by international agencies	247,277	-	-	-	-	247,277
Accounts payable and other liabilities	2,501,680	-	-	-	-	2,501,680
Provision for Investment Currency Market	1,255,696	-	-	-	-	1,255,696
Group Insurance Subsidy Benefit	-	-	-	-	1,849,583	1,849,583
International Monetary Fund allocation	195,112,834	-	-	-	-	195,112,834
Total financial liabilities	930,185,895	-	-	-	1,849,583	932,035,478
Net liquidity gap, December 31, 2009	$ (565,659,041)	$170,271,272	$65,159,281	$ 174,589,766	$ 266,943,160	$ 111,304,438

(Expressed in Bahamian dollars)

31. CONTRIBUTORY DEFINED BENEFIT RETIREMENT PLAN

The movement in the contributory defined benefit obligation over the year is as follows:

	2010	Restated 2009
Present value of obligation at start of year	$ 36,468,841	$ 31,734,047
Interest cost	2,142,719	1,945,170
Current service cost	1,384,810	1,308,411
Benefits paid	(1,177,958)	(1,245,913)
Actuarial (gain) loss on obligation	(2,550,691)	2,727,126
Present value of obligation at end of year	$ 36,267,721	$ 36,468,841
Fair value of plan assets at start of year	$ 41,925,136	$ 39,592,536
Expected return on plan assets	2,625,906	2,469,114
Contribution paid - by employer	952,390	675,582
Contribution paid - by employees	404,300	396,911
Benefits paid	(1,177,958)	(1,245,913)
Actuarial (loss) gain on obligation	(172,677)	36,906
Fair value of plan assets at end of year	$ 44,557,097	$ 41,925,136

The actuarial gain at December 31, 2010 represented 7.03% (2009 restated loss: 7.48%) of the plan liabilities; and the actuarial loss was 0.39% (2009 restated gain: 0.08%) of the plan assets.

The amount recognized as an asset in the statement of financial position in respect of the Bank's contributory defined benefit plan is as follows:

	2010	Restated 2009
Present value of funded obligations	$ (36,267,721)	$ (36,468,841)
Fair value of plan assets	44,557,097	41,925,136
	8,289,376	5,456,295
Unrecognized actuarial gains	(4,100,014)	(1,722,001)
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	$ 4,189,362	$ 3,734,294

(Expressed in Bahamian dollars)

31. CONTRIBUTORY DEFINED BENEFIT RETIREMENT PLAN (Continued)

Summary of plan investments, in accordance with IAS19:

	2010	Restated 2009
Bahamas Government registered stock	$ 43,350,900	$ 40,566,600
Other bonds	326,100	472,000
Shares“	235,000	300,000
Total investments	$ 43,912,000	$ 41,338,600

The expense recognized in the statement of comprehensive income in respect of the Bank’s contributory defined benefit plan is as follows:

	2010	Restated 2009
Current service cost	$ 980,509	$ 911,500
Interest cost	2,142,719	1,945,170
Expected return on plan assets	(2,625,906)	(2,469,114)
Net actuarial (gain) loss recognized in year	-	(31,456)
	$ 497,322	$ 356,100

Movements in the net assets recorded in the statement of financial position are as follows:

	2010	Restated 2009
Net assets at beginning of year	$ 3,734,294	$ 3,414,812
Net expense recognized in net income	(497,322)	(356,100)
Employer contributions	952,390	675,582
	$ 4,189,362	$ 3,734,294

The Bank intends to contribute approximately 11.60% of gross payroll to the plan during 2011 (2010: actual 11.50%).

Principal actuarial assumptions used at the statement of financial position date are as follows:

	2010	Restated 2009
Discount rate	5.75%	5.75%
Expected return on plan assets	5.75%	6.25%
Expected rate of salary increase at age 18	6.50%	6.75%
Expected rate of salary increase at age 59	2.50%	3.00%
Average expected remaining working lives of employees (years)	14.9	15.4

The actual return on plan assets during the year was $2,506,020 (2008 restated: $2,383,097). The expected return on plan assets has been arrived at using a weighted average return approach.

(Expressed in Bahamian dollars)

32. GROUP HEALTH INSURANCE SUBSIDY

The movement in the group health insurance subsidy over the year is as follows:

	2010	Restated 2009
Present value of obligation at start of year	$ 1,948,795	$ 1,770,663
Interest cost	112,890	102,717
Current service cost	57,489	55,235
Benefits paid	(85,964)	(79,032)
Actuarial (gain) loss on obligation	(40,852)	99,212
Present value of obligation at end of year	$ 1,992,358	$ 1,948,795

Contribution paid - by employees' and employer's & voluntary contributions	$ 85,964	$ 79,032
Benefits paid	(85,964)	(79,032)
	$ -	$ -

The actuarial gain at December 31, 2010 represented 2.05% (2009 restated loss: 5.09%) of the plan liabilities.

The amount recognized as a liability in the statement of financial position in respect of the Bank's group health insurance subsidy is as follows:

	2010	Restated 2009
Present value of the obligation at the end of the year	$ 1,992,358	$ 1,948,795
Fair value of plan assets	-	-
	1,992,358	1,948,795
Unrecognized actuarial gains (losses)	(58,360)	(99,212)
Net liability calculated in accordance with paragraph 54 of International Accounting Standard 19	$ 1,933,998	$ 1,849,583

(Expressed in Bahamian dollars)

32. GROUP HEALTH INSURANCE SUBSIDY (Continued)

The expense recognized in the income statement in respect of the group health insurance subsidy is as follows:

	2010	Restated 2009
Current service cost	$ 57,489	$ 55,235
Interest cost	112,890	102,717
	$ 170,379	$ 157,952

Movements in the net liability recorded in the statement of financial position are as follows:

	2010	Restated 2009
Net liability at beginning of year	$ 1,849,583	$ 1,770,663
Net expense recognized in net income	170,379	157,952
Employer contributions	(85,964)	(79,032)
	$ 1,933,998	$ 1,849,583

Principal actuarial assumptions used at the statement of financial position date are as follows:

	2010	Restated 2009
Discount rate	5.75%	5.75%
Expected return on plan assets	0.00%	0.00%
Expected rate of salary increase at age 18	6.50%	6.75%
Expected rate of salary increase at age 59	2.50%	3.00%
Average expected remaining working lives of employees (years)	16.0	16.5

The historic buildings on the front cover are:
Balcony House (pink building) and **Verandah House** (green building), both of which appeared on a 1788 town map of Nassau. The Central Bank acquired these buildings in 1985. Today, Balcony House is a museum and Verandah House is being used as a training facility for financial services.

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