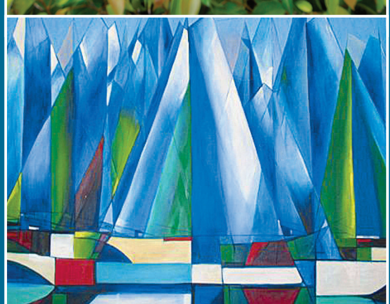


THE CENTRAL BANK OF THE BAHAMAS

ANNUAL REPORT

AND STATEMENT OF ACCOUNTS

2005

FOR THE YEAR ENDED 31 DECEMBER 2005

DIRECTORS AND SENIOR OFFICIALS

At December 31, 2005

BOARD OF DIRECTORS

Wendy M. Craigg - Chairman

Dr Pandora Johnson

Mr Carleton Williams, CBE

SENIOR OFFICIALS

Wendy M. Craigg - Governor

Bert A. Sherman - Manager, Computer

Cecile M. Sherman - Manager, Banking

Sylvia L. Carey - Manager, Human Resources

Cassandra C. Nottage - Manager, Bank Supervision

Rochelle A. Deleveaux - Legal Counsel

Michael D. Foot - Inspector, Banks and Trust Companies

Gerard L. Horton - Manager, Exchange Control

John A. Rolle - Manager, Research

Keith T. Jones - Manager, Accounts

Shari L. Scavella - Internal Auditor

Selvin I. Basden - Deputy Manager, Administration

Mission Statement

To foster an environment of monetary stability
conducive to economic development, and
to ensure a stable and sound financial system

Contents

Notes: Throughout this Report, the sign "$" means the Bahamian dollar unless otherwise noted.

5 April, 2006

Dear Prime Minister:

In accordance with Section 30 (1) of the Central Bank of The Bahamas Act, Chapter 321, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2005. Included with this report is the Annual Statement of Accounts of the Bank for the year.

Respectfully yours,

Wendy Craigg
Governor

The Rt. Hon. Perry G. Christie
Prime Minister and Minister of Finance
Office of the Prime Minister
Sir Cecil V. Wallace-Whitfield Center
Cable Beach
Nassau, N.P., Bahamas

ECONOMIC AND MONETARY REVIEW

DOMESTIC ECONOMIC DEVELOPMENTS

Preliminary indications are that, despite the rise in global oil prices and devastating hurricanes, the growth momentum of the Bahamian economy was sustained during 2005, buoyed by robust levels of foreign investment, strong consumer spending and construction activity. Tourism output was also positive, underpinned by the strengthening in the US economy and gains in room revenues (see Table 1). Although firming, the overall price environment remained moderate. Favourable credit conditions supported growth in bank credit, which led to a reduction in liquidity. Strong aggregate demand, combined with higher prices for oil imports boosted the trade deficit and eclipsed the improvement in the services account balance. The near doubling in the current account deficit was financed by a combination of strengthened capital inflows associated with foreign investment projects and a reduction in external reserves. The fiscal situation benefited from the overall improved economic environment, through increased revenue collections, leading to a reduction in the comparative fiscal deficit for the first half of FY 2005/06.

Bank liquidity fell by 29.5% to $191.5 million, representing a smaller 4.2% of Bahamian dollar deposit liabilities compared to 6.5% in 2004. However, average monthly liquidity was more than a third higher at $260.3 million, and the broader excess liquid assets advanced by almost 10.0% for a monthly average of $253.5 million. These conditions precipitated a narrowing in the average interest rate spread by 32 basis points to 7.12% as commercial banks' weighted average deposit rate contracted by 61 basis points to 3.22%, compared to a 93 basis point fall in the weighted average loan rate to 10.34%. The average 90-day Treasury bill rate also softened by 41 basis points to 0.14% and the Central Bank's Discount and the commercial banks' Prime rates were cut by 50 basis points each, to 5.25% and 5.50%, respectively.

Money supply (M3) expansion slackened to 9.2% from 10.4%, placing the overall stock at $4,830.2 million. This outturn reflected a slowdown in the growth of both demand and savings deposits, to 9.9% and 13.1% respectively, whereas the rate of increase for fixed deposits firmed to 6.1% and to 10.6% for currency in active circulation.

Domestic credit growth for 2005 more than doubled to 12.9%, for an outstanding stock of $5,899.5 million. Reflecting increased loan disbursements for several tourism development projects, foreign currency credit grew by 14.1%. Growth in Bahamian dollar credit also strengthened to 12.7% from 7.4% in 2004. The rate of increase

TABLE 1: Selected Economic Indicators (% Change)

	2002	2003	2004	2005
Occupied Hotel Room Nights	0.8	-1.4	3.1	4.6
Total Arrivals	5.3	4.3	8.9	0.9
Money Supply (M2)	3.3	4.2	10.8	8.4
Total Mortgages Outstanding	11.0	8.1	11.2	15.9
Electricity Generation (mwh)	5.6	5.4	-0.8	5.5
Water Consumption (gals.)	6.3	-0.7	8.3	n/a
Retail Price Index	2.2	3.0	1.0	2.2

SOURCE: Central Bank of The Bahamas

in private sector credit more than doubled to $614.3 million (14.2%) and was dominated by a sustained upturn in housing loans of $261.4 million (17.4%). Net claims on Government, mainly in Bahamian dollars, expanded by $95.4 million (17.4%), outpacing the $40.6 million (8.0%) rise registered in 2004, and lending to the rest of the public sector declined further by $37.4 million (11.0%).

Preliminary indications are that the Government's budget deficit for the first six months of FY2005/06 narrowed by 15.0% to $71.3 million from the comparable period of FY2004/05. Total revenues expanded by 17.1% to $544.9 million, reflecting a 13.2% improvement in tax collections largely associated with the robust growth in consumer demand and enhanced property tax yields. Expenditures were higher by 12.2% at $616.1 million, primarily on account of hurricane-related transfers to non-profit organizations, increased salary payments for select civil service employees and infrastructural works. Budgetary financing during the first half of the fiscal year consisted of $75.0 million in newly issued government securities and $3.1 million in external funding. On a calendar year basis, the Direct Charge on Government registered a 6.5% increase to $2,234.5 million at end-2005. Adjusting for an 13.1% rise in Government's contingent liabilities, the National Debt expanded by 7.7% to $2,731.9 million at end-2005.

Supported by growth in air visitor volumes, particularly in the latter half of the year, and solid gains in room rates, tourism output remained resilient in 2005. Following a 4.3% growth in 2003, and a 8.9% improvement to a record 5.0 million tourist arrivals in 2004, total arrivals grew marginally by 0.9% to 5.05 million in 2005. Benefiting from the strength of the US economy, air arrivals rose by 4.4% to 1.5 million, extending the 1.5% increase achieved in 2004. Sea visitors, which account for 70.0% of total arrivals, fell slightly by 0.5% to 3.5 million, to contrast with 2004's 12.3% upturn. On a port of entry basis, total arrivals to New Providence were mostly unchanged, while Grand Bahama experienced an 11.2% decline, reflecting the continuing adverse effects of hurricane activity and the resulting hotel closures. Arrivals to the Family Islands, on the other hand, recovered by 9.5% to 1.4 million, from the 0.9% contraction in 2004. Growth in stopover expenditure was underpinned by the 9.2% boost in estimated hotel room revenues throughout The Bahamas, which more than doubled the 4.1% increase for 2004. Average nightly room rates also strengthened by 4.4% to $156.56 by end-December 2005.

Domestic inflation, measured by changes in the average Retail Price Index, accelerated to 2.2% from 1.0% in 2004. The firming in the inflation rate was mainly attributed to increased costs for medical care & health (3.4%), education and food & beverages (3.2% each), housing (2.6%)—the most heavily weighted category; other goods & services (1.9%), furniture & household operation (1.3%) and recreation & entertainment services (0.3%), which were partly offset by cost reduction for clothing & footwear (2.2%).

Indications are that construction output intensified during 2005, amid the favourable economic climate and competitive mortgage interest rates, which supported residential construction, and a significant level of foreign investment projects. Total mortgage loan disbursements for 2005 rose by 53.2% to $496.3 million, the bulk of which was for private housing construction, which expanded significantly by 52.0% to $454.8 million. In tandem, mortgage commitments for new construction and repairs, a leading indicator of construction activity, almost doubled in number to 1,883 with a corresponding value of $229.1 million.

On the external account, preliminary estimates point to a substantial widening in the current account deficit to $622.8 million, as high and volatile oil prices and strengthened domestic demand contributed to a 13.9% increase in the trade deficit to $1,626.2 million. The services account surplus, benefiting from relatively stable levels of travel receipts, improved by 1.4% to $1,024.6 million. The income account deficit contracted by over one-fifth to $106.5 million, amid a significant reduction in net investment payments to $33.4 million, and net transfer receipts declined significantly by 66.0% to $85.4 million, mainly on account of a reduction in hurricane-related insurance claims.

On the capital and financial account, the estimated surplus broadened by 38.3% to $429.5 million—inclusive of higher private foreign direct investments. The public sector recorded a lower net external debt repayment of $8.5 million, while banking sector transactions were reversed to a net inflow of $47.6 million, primarily on account of financing provided to various resident designated entities. Total net financial inflows were 36.7% higher at $489.9 million, with gains in both direct equity and real estate investments.

FISCAL OPERATIONS

Given favourable economic conditions and heightened import demand, indications are that the fiscal situation improved for the first half of FY2005/06, as increased revenue collections exceeded the growth in expenditure. This trend is expected to continue during the remainder of the fiscal year, based on the positive outlook for domestic economic activity.

FY2004/05 Performance

Preliminary results for FY2004/05 indicated a widening in the deficit on central Government's overall balance, from $166.4 million in FY2003/04 to $175.5 million, which was $12.1 million (7.4%) above budgeted expectations (see Table 2). Total outlays increased by 9.4% to $1,214.9 million, while improving economic conditions supported growth in revenue collections of 10.1% to $1,039.4 million, although 1.2% short of the target.

The revenue performance was led by an 11.3% gain in tax collections to $925.1 million, but lagged the budget target by 1.9%. Although 13.1% lower than budgeted, property taxes registered the most significant growth of 43.3% based on improved receipts from commercial, owner-occupied, and foreign-owned properties. Benefiting from an upswing in room revenues, selected taxes on tourism-related services exceeded projections, posting growth of 39.9%. Intakes of business and professional licence fees and motor vehicle taxes both surpassed FY2003/04 levels, although more than 12.0% below their respective budget estimates. Conversely, departure taxes lagged both the previous fiscal year's and budget estimates, by 3.5% and 0.6%, respectively. Taxes on international trade and transactions registered a gain of 3.6%, as import taxes strengthened by $3.5 million (0.9%) over FY2003/04 but fell short of the budget by 10.2%. More significant increases were posted for all other stamp taxes, reflecting a near doubling in collections from realty transactions valued in excess of

TABLE 2: Government's Budget (B$'000)

	FY2002/03	FY2003/04	FY2004/05		FY2005/06	
	Actual	Actual	Approved Estimates	Preliminary Estimates	Approved Estimates	Preliminary[1] Estimates
Government Revenue	901,791	943,760	1,051,623	1,039,376	1,132,774	544,859
Government Expenditure (i+ii+iii)	1,089,407	1,110,139	1,215,049	1,214,903	1,310,185	616,109
i) Recurrent Expenditure	962,551	993,987	1,067,259	1,053,095	1,145,691	547,093
ii) Capital Expenditure	83,797	80,890	117,296	90,374	132,901	49,964
iii) Net Lending	43,059	35,262	30,494	71,434	31,593	19,052
Surplus/(Deficit)	(187,616)	(166,379)	(163,426)	(175,527)	(177,411)	(71,250)

SOURCE: Ministry of Finance

Compiled according to the IMF's Government Finance Statistics Format.[1] July - December, 2005

$250,000.00. Other tax categories also recorded moderate gains, except for export taxes, which contracted.

Non-tax receipts of $104.1 million eclipsed both the budget and the previous fiscal year levels, by $6.5 million. Receipts were 9.4% higher for fines, forfeits and administrative fees from the previous fiscal year, and proceeds from sales of government property rose threefold to $2.0 million.

On the expenditure side, recurrent outlays were higher by 5.9% at $1,053.1 million, representing 86.7% of the total, but were some 1.3% lower than the budget estimate. Purchases of goods and services advanced by $13.7 million (6.9%) to $210.4 million, and personal emoluments, which constituted 43.0% of the total, rose by $10.9 million (2.5%) to $452.3 million—largely reflecting salary increases for the uniformed branch of Government and outlays for new recruits. Under transfer payments, the $30.1 million (12.4%) hike in subsidies and other transfers to $272.9 million was associated with hurricane relief assistance payments to households and non-profit institutions.

Ongoing infrastructural works, which included general road maintenance and school repairs, led to an 11.7% rise in capital expenditures to $90.4 million, although some 23.0% below the approved allocation. Reflecting increased budgetary support to the local airline, net lending to public corporations, at $71.4 million, more than doubled both the budget and FY2003/04 outcomes. Budgetary financing for FY2004/05 included Bahamian dollar borrowings of $325.1 million, of which $306.4 million was obtained from the sale of government securities. Debt amortization comprised the retirement of $92.6 million of outstanding Bahamian dollar obligations and $5.8 million in foreign currency debt.

2005/06 Budget

Approved by Parliament in June 2005, the Budget for FY2005/06 reiterated Government's commitment to fiscal consolidation and focused on pursuing policies that would strengthen the Bahamian economy, while giving priority to social development. The Budget targeted a reduction in the GFS deficit to GDP ratio to 2.8% from 2.9% in FY2004/05, and ongoing improvement in the debt to GDP ratio which currently stands at 38.0%.

The Budget introduced no new taxes but focused on measures to enhance revenue administration which included, replacement of manual revenue collection systems with cash based systems and the use of major credit cards by all revenue collecting agencies to facilitate payment of fees and taxes due to Government. Other changes announced targeted improvements to the assessment process for real property taxes, by adding more properties to the register, recouping of real property tax arrears from homeowners, increasing transparency of the compilation of revenue data and stamp tax amendments to close the loopholes. Additional measures focused on introducing Compliance Officers to undertake review and analytical work in connection with revenue administration in the areas of hotel room, stamp, business licence and ticket taxes, and revising the Casino Act to provide for payment of casino taxes to the Gaming Board. Parliament also approved the elimination of customs duties and stamp duty on imports for building materials used by private schools, as well as customs duties on all musical instruments and on selected materials required for computers.

Revenue and grants receipts, relative to the preliminary outcome for FY2004/05, are projected to grow by 9.0% to $1,132.8 million, equivalent to a 7.7% improvement over the FY2004/05 budget. Approved expenditure—including net lending to public corporations—was placed higher at $1,310.2 million, a stable advance of 7.8% relative to both the previous fiscal year and budget estimates.

In terms of revenue performance, tax receipts are budgeted to rise by 10.9% above the previous year's intake to $1,026.4 million, based on anticipated gains in business and professional license fees (16.8%), customs (18.5%), property (18.3%), departure (18.1%), and motor vehicle (27.6%) taxes. Non-tax receipts are estimated to remain relatively unchanged at $104.2 million compared to FY2004/05, with anticipated reductions in income from fines and administrative fees and property sales being offset by gains in income from public enterprises and other sources. It is also anticipated that the overall revenue outcome would be supplemented by capital revenue of $0.8 million and grants totalling $1.4 million.

On the expenditure side, the combined recurrent and capital expenditure budgets grew by an estimated $135.1 million (11.8%) to $1,278.6 million for FY2004/05, while provisions for net lending were 55.8% lower at $31.6 million.

Current expenditure, at $1,145.7 million, exceeded the FY2004/05 preliminary estimates by $92.6 million (8.8%). The wage bill, which comprised the largest single component (44.1%), is set to grow by 11.8%, based on provisions for pay increases for select groupings of the Civil Service, including nurses and teachers. Purchases of goods and services at 21.3% of the total, are anticipated to increase by 15.8%. Allocations for transfer payments are up by 1.6% to $396.4 million, led by a 13.7% hike in interest charges, while subsidies and other transfer payments are forecasted to decline by 3.6%, following extraordinary payments related to the hurricane relief effort.

Approved capital expenditures were 47.1% higher at $132.9 million, comprising enhanced allocations for the acquisition, construction and maintenance of assets. By functional classification, allotments for economic services—primarily public works projects—were augmented by 65.1% to $65.4 million; for education, by 26.8% to $19.5 million; health, by 21.5% to $13.2 million; defence, by 85.5% to $5.0 million and for general public services, by 13.2% to $22.6 million.

The 2005/06 Budget envisaged an overall deficit of $177.4 million, some 1.1% above the preliminary outcome for FY2004/05 and 2.9% of GDP. Total local borrowings are estimated at $201.6 million, with a further $30.6 million being provided from external sources. Given the scheduled debt servicing and projected funding profile, the Direct Charge on Government is likely to increase by $177.3 million to approximately $2,411.8 million by end-FY2005/06, boosting the National Debt to an estimated $2.9 billion.

First 6 Months of FY2005/06

Provisional estimates of budgetary operations for the first six months of FY2005/06 indicated a curtailment in the overall deficit to $71.3 million from $83.8 million in the year-earlier period. Estimated revenues increased by 17.1% to $544.9 million, due mainly to an expansion in tax receipts, and represented approximately 48.1% of budgeted expectations. Total expenditures, including net lending, rose by 12.2% to $616.1 million, constituting roughly 47.0% of the approved target, with growth partly associated with a significant hike in transfers to non-profit institutions and increased salaries for select civil service employees. Capital spending also advanced nearly two-fold, reflecting investments in infrastructure.

Tax receipts, which contributed approximately 92.2% of total revenue, were higher by 13.2% at $502.6 million, mainly on account of significant growth in departure, customs and stamp taxes. Amid more buoyant tourism activities, selective tourism taxes increased by 10.3% to $10.4 million, inclusive of a 22.7% rise in room occupancy taxes which offset the decline in gaming revenues. Benefiting from administrative enhancements, collections of business and professional licence fees improved by 11.9% to $17.9 million; motor vehicle taxes, by 11.3% to $6.9 million and departure taxes, by 18.4% to $28.7 million. Firming economic conditions translated into gains in international trade and transaction taxes, of 33.7% to $275.8 million, based on equally strong growth in import taxes (32.5%), stamp taxes (36.6%) and export taxes (57.6%). Stamp duties from other activities also grew by 48.8%, whereas other miscellaneous taxes were reduced by 39.4%.

Growth in non-tax revenue intensified by $18.1 million to $39.1 million, led by a $14.6 million hike in receipts from fines, forfeits and administrative fees, due to operational enhancements to systems used to collect immigration fees. Income from public enterprises and other sources also rose by $2.2 million and $0.8 million, respectively, and proceeds from property sales were higher at $0.6 million.

On the expenditure side, recurrent spending rose by $61.8 million (12.7%) to $547.1 million (88.8% of the total). Personal emoluments, the largest (44.3%) component of the total, increased by 7.9% to $242.3 million, and purchases of goods and services were higher by 11.4% at $94.1 million. Transfer payments advanced by $34.5 million (19.6%) to $210.6 million. This was led by a 25.6% hike in subsidies and non-interest transfers, on account of a more than two-fold rise in provisions to non-profit institutions to $35.6 million, which included $6.5 million for activities of the National Disaster Preparedness Committee. Transfers to households also advanced by 13.1% to $30.9 million, and subsidies to other quasi-autonomous agencies, including the Public Hospital Authority, grew by 6.6% to $73.8 million. Interest payments were up by 6.7% to $59.8 million.

Capital outlays expanded by $23.2 million (86.5%) to $50.0 million, led by a $20.2 million hike in allocations for capital formation, which included building expansions, school repairs, road construction and general maintenance work. In addition, expenditures for acquisition of assets, mainly land, rose by $3.4 million, whereas net lending to public entities was scaled back by 48.4% to $19.1 million.

For the first six month of FY2005/06, budgetary financing included a $75.0 million domestic bond issue and $3.1 million drawings on external loans. Scheduled amortization covered $10.0 million in Bahamian dollar debt and $1.1 million in foreign currency loans. For the 2005 calendar year, the Direct Charge on Government increased by $136.6 million (6.5%) to $2,234.5 million. Bahamian dollar claims, which accounted for 87.2% of the total, rose by $135.4 million (7.5%) to $1,948.7 million. By creditor composition, the majority of Bahamian dollar debt was held by public corporations (39.2%), followed by private and institutional investors (29.4%), commercial banks (23.8%), the Central Bank (7.4%) and Other Local Financial Institutions (0.2%).

For 2005, Government's contingent liabilities increased by 13.1% to $497.5 million, principally influenced by accretions to guaranteed debt of the Bahamas Mortgage Corporation, the Airport Authority and the Clifton Heritage Authority. Consequently, the stock of outstanding National Debt advanced by $194.2 million (7.7%) to $2,731.9 million at end-December 2005, following a $134.2 million (5.6%) increase in 2004.

Foreign Currency Debt

Public sector foreign currency debt contracted by $10.8 million (1.9%) to $550.5 million at end-2005 (see Table 3), following a $37.6 million (6.3%) decline in 2004, as new drawings ($42.1 million) were offset by repayments ($52.8 million). At 51.9% of the total, Government's share increased by $1.2 million (0.4%) to $285.8 million. The remaining $264.8 million (48.1%) was held by public corporations, a decline of $11.9 million (4.3%).

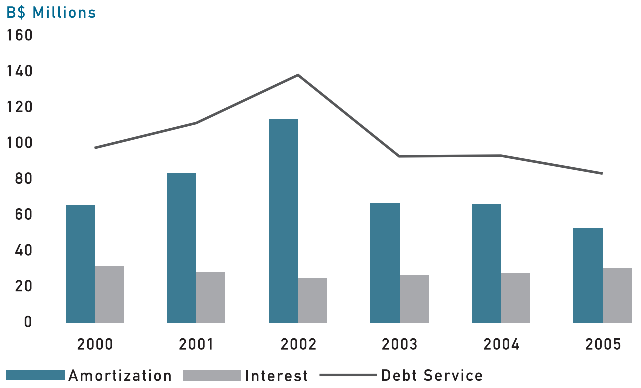
According to the creditor profile, private capital market

Table 3: Public Sector Foreign Currency Debt (B$ Millions)

	2003[p]	2004[p]	2005[p]
A. EXTERNAL DEBT	363.5	342.8	334.6
i) Government	288.5	284.6	285.8
ii) Public Corporations	75.0	58.2	48.8
of which Gov't Guaranteed	62.7	53.6	48.3
B. INTERNAL F/C DEBT	235.5	218.5	215.9
i) Government	-	-	-
ii) Public Corporations	235.5	218.5	215.9
of which Gov't Guaranteed	165.7	159.1	170.8
C. TOTAL F/C DEBT	599.0	561.3	550.5
D. DEBT SERVICE RATIO	3.7	3.4	2.9

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

FOREIGN CURRENCY DEBT SERVICE



investors held the largest share of the foreign currency debt (40.9%), followed by commercial banks (39.2%), and multilateral institutions and other miscellaneous creditors (19.9%). The average maturity of the debt was slightly in excess of 14 years, with over 95% of the liabilities denominated in US dollars.

Despite the 10.5% hike in interest charges, total debt service declined by 11.0% to $83.1 million, as amortization payments were lowered by 19.9%. Measured against exports of goods and non-factor services, debt service softened to 2.9% from 3.4% in 2004. Government's foreign currency debt service to total revenue also narrowed to 1.9% from 2.7% in 2004.

REAL SECTOR

Tourism

Healthy growth in air arrivals, supported by sustained expansion of the US economy and firming hotel revenue receipts, contributed to a positive tourism outcome during 2005, despite the adverse impact of the hurricane season in the second half of 2004. Following the 8.9% improvement to a record 5.0 million visitors in 2004, total visitor arrivals grew marginally by 0.9% to 5.05 million (see Table 4). However, overall output was buoyed by an intensification in air arrivals growth to 4.4% from 1.5% in 2004. Cruise arrivals weakened by 0.3% to 3.35 million, to contrast with a 13.1% upturn in 2004.

By major ports of entry, air arrivals to New Providence firmed by 11.6% but, with the more dominant sea component contracting by 5.5%, overall growth was only marginally improved by 0.1% (see Table 5). The 9.5% recovery in Family Islands' visitor count reflected gains in both air and sea visitors, by 2.9% and 10.8%, respectively. Although registering momentum in the final quarter of 2005, total arrivals to Grand Bahama experienced a loss of 11.2%, under the continuing effects of the disruption caused by three hurricanes over an eleven month period. Consequently, air arrivals weakened by 20.6%, and sea visitors, by 5.9%.

Hotel sector performance indicators signalled an increase in overall tourism output, buttressed by price appreciation and increased room night sales. Total hotel revenues firmed by 9.2% vis-à-vis growth of 4.1% in 2004, occupied room nights improved by 4.6%, and average nightly room rates strengthened by 4.4% to $156.56. Hotel occupancy rates rose to 70% from 66%. In New Providence, room revenues increased by 9.1%, as the 9.4% growth in hotel rooms sold countered the 0.3% fall in the average room rate to $166.00. For Grand Bahama, the 21.6%

TABLE 4: Tourism Statistics

			% Change	
	2004	**2005**	**2004**	**2005**
Air Arrivals	1,450,313	1,514,532	1.5	4.4
Sea Arrivals	3,553,654	3,536,174	12.3	-0.5
Total	5,003,967	5,050,706	8.9	0.9
Occupied Room Nights	2,169,926	2,270,027	3.0	4.6
Hotel Occupancy	66%	70%	7.1	6.1
Avg. Daily Room Rate(B$)	149.96	156.56	4.1	4.4

SOURCE: The Bahamas Ministry of Tourism

TABLE 5: Growth in Tourist Arrivals (%)			
PORTS OF ENTRY	**2004**	**2005**	**2005 Market Share**
Nassau/Paradise Island	12.2	0.1	58.6
Grand Bahama	15.7	(11.2)	12.8
Rest of Family Islands	(0.9)	9.5	28.5
TOTAL	**8.9**	**0.9**	**100.0**

SOURCE: The Bahamas Ministry of Tourism

rise in the average room rates to $110.22, negated the 11.3% fall in the number of hotel rooms sold, to provide for room revenue gains of 7.8%. The performance for the Family Islands was equally positive as room revenues were up by 15.7%, based on an 11.3% rise in average room rates to $190.44 and growth of 3.9% in the number of rooms sold.

The improvement underway in the tourism industry is anticipated to continue in 2006, supported by the positive outlook for growth in the US economy and ongoing investments in the industry which should help to offset the weakness in the Grand Bahama market.

Construction

Indications are that construction output registered significant improvement over 2004, reflecting sustained high levels of residential mortgage lending activity, hurricane repairs, as well as robust foreign investments in tourism-related projects. Medium-term prospects appear equally encouraging for both residential and commercial construction investments, based on outstanding commitments, and a number of major tourism projects scheduled to come on stream.

Total mortgage loan disbursements increased substantially by 53.2% during 2005, although it must be noted that some portion of mortgage lending is used for non-construction related activity. By category, residential disbursements advanced to $454.8 million—surpassing last year's $299.3 million, while accretions to commercial disbursements almost doubled to $41.5 million.

Mortgage commitments for new construction and repairs, as reported by domestic banks, insurance companies and the Bahamas Mortgage Corporation, totalled 1,883 compared to 1,175 in 2004, with a corresponding value of $229.1 million. The residential component accounted for the majority (97.1%) of disbursements, valued at $214.5 million, which was 71.9% higher than 2004. Commercial drawdowns, at $14.6 million, improved more than two-fold, and represented 2.9% of total commitments.

For 2005, outstanding mortgages increased by 15.9% to $2,159.4 million. Loans for residential investments, at 91.5% of the total, rose by 16.1%, whereas commercial loans expanded by 13.9% and constituted 8.5% of total claims. The bulk of these loans were disbursed by domestic banks (87.1%), followed by insurance companies (8.6%) and the Bahamas Mortgage Corporation (4.3%). Average interest rates softened for both residential and

TABLE 6: Average Annual Percentage Changes in Retail Price Index, New Providence

(Oct./Nov. 1995 = 100)

Group	**Weight**	**2004**	**2005**
Food & Beverage	138.3	2.95	3.15
Clothing & Footwear	58.9	0.32	(2.22)
Housing	328.2	0.03	2.59
Furniture & Household Operation	88.7	0.39	1.27
Medical Care & Health	44.1	6.75	3.42
Transportation & Communication	148.4	1.99	2.54
Recreation, Entertainment & Services	48.7	(3.44)	0.28
Education	53.1	1.78	3.18
Other Goods & Services	91.6	(0.51)	1.89
ALL ITEMS	1,000.0	0.96	2.17

SOURCE: Department of Statistics

commercial loans, by 4 basis points each to 8.4% and 9.2%, respectively.

Prices

Consumer price inflation quickened to 2.2% from 1.0% in 2004 (see Table 6). Apart from the influence of the oil price hikes on various components of the Retail Price Index, domestic factors contributed to average cost increases for medical care & health (3.4%), food & beverages (3.2%), education (3.2%), and housing (2.6%)—the most heavily weighted category—and lesser gains for other goods & services (1.9%), and furniture & household operation (1.3%). Conversely, average prices for clothing and footwear fell by 2.2%.

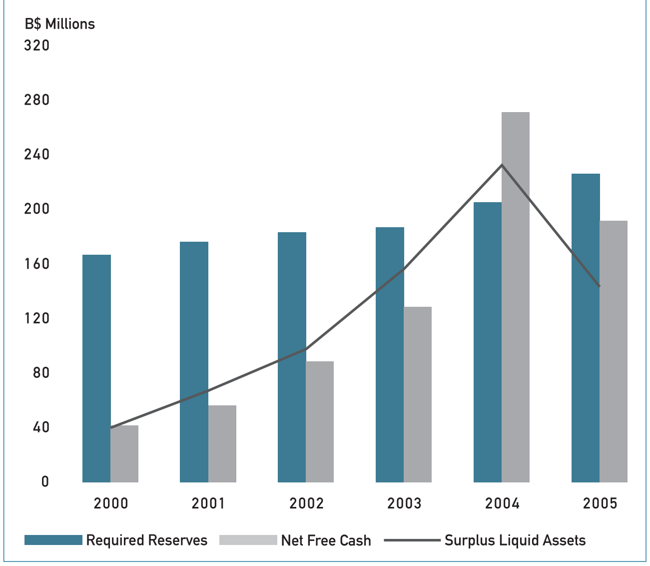
MONEY, CREDIT AND INTEREST RATES

Monetary conditions during 2005 featured a reduction in bank liquidity, occasioned by the strong build-up in credit, following the removal of the Central Bank's credit restrictions in August 2004, the easing in interest rates and generally improved economic fundamentals. Consequently, both the weighted average deposit and lending rates contracted, although the interest rate spread declined, given the larger decrease in the average lending rate.

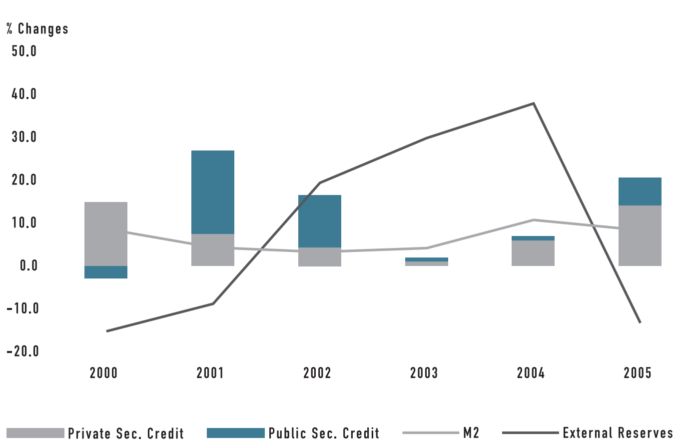
Liquidity

Average monthly liquidity, as measured by banks' free cash balances, advanced by 34.2% to $260.3 million during 2005. However, the year-end position contracted by 29.5% to $191.5 million, representing a smaller 4.2% of Bahamian dollar deposit liabilities compared to 6.5% in 2004. A similar pattern was observed for the broader liquid assets, which were reduced to 19.1% of the statutory minimum from 34.3% in 2004. Free cash balances and surplus liquid assets attained peak levels in June and May, at $291.2 million and $317.6 million, respectively.

BANK LIQUIDITY



MONETARY DEVELOPMENTS



Foreign Exchange

During 2005, generally increased domestic demand, including public sector net outflows associated with higher fuel payments, led to elevated net outflows of foreign exchange (see Table 7). The Bank's aggregated foreign currency sales rose by 31.6% to $845.0 million, while total purchases declined by 13.7% to $689.0 million. The net sale to other customers, mainly the public corporations, grew by 32.3% to $221.0 million, while the net purchase from Government rose more than four-fold to $43.8 million. Transactions with commercial banks, which represented 69.0% of total purchases, fell by 27.3% to $475.2 million, while sales increased by 33.1% to $454.0 million. Consequently, the Central Bank's net foreign currency sale of $156.0 million in 2005, represented a reversal from the $156.5 million net purchase in 2004.

During the first six months of 2005, the Bank's total purchase from commercial banks and the public sector declined by 7.1% to $407.0 million in 2004, whereas foreign currency sales widened by 18.2% to $326.1 million. The resulting net purchase for the

BOX 1

Monetary Policy During 2005

The Monetary Policy Committee (MPC) was established by the then Governor, in 1980 to promote efficiency and transparency in the formulation and conduct of monetary policy, and to ensure a well-organized decision-making process. The MPC also formulates recommendations for the Government on fiscal and exchange control matters, and reviews supervisory issues as they impact the domestic financial system. The MPC is chaired by the Governor and its membership includes several department heads. While the Governor is ultimately responsible for the policies promulgated by the Bank, the Committee formally assists this process, and credibility is ensured by the consensus nature of decisions, acted upon by the Governor.

During 2005, the MPC actively monitored economic developments along with indicators of domestic credit, liquidity and loan quality assessments to ensure that the evolution of these trends was consistent with financial sector and overall macroeconomic stability. Amid persistently high levels of excess liquidity, and the outlook for these conditions, the Central Bank, effective 14th February 2005, reduced its Discount Rate by 50 basis points to 5.25%. Commercial banks followed on 15th February 2005 with an equivalent reduction in their Prime Lending Rate to 5.5%.

The Bank, as part of its continuing effort to stimulate increased activity in the inter-bank market, with effect from 1 December 2005, reduced its buying and selling rates for US dollar balances, from US$1.0000/B$1.0025 and US$1.0000/B$1.0040 to US$1.0000/B$1.0000 and US$1.0000/B$1.0025, respectively. To provide increased flexibility to commercial banks in the course of their foreign currency operations, the Central Bank, also with effect from 1 December 2005, revised the determination of the Bahamian Dollar (B$) Open Position limit from the long established fixed $0.5 million long or short, to a flexible formula—established at the equivalent of five percent (5%) of each banks' Bahamian Dollar Tier 1 Capital, subject to a maximum of $5.0 million. Concurrent with this change, the B$ open position was eliminated from the calculation of banks' net eligible liquid assets in the Liquid Asset Reserve requirements. The capital estimate used for the revised B$ open limit for 2005 was derived from balance sheet data filed with the Central Bank for the period ending 31 December 2004. For subsequent years' calculations, the Bank will utilize banks' balance sheet data as at 30 September of that year and revisions, if any, to the limits will be notified to take effect on 1 January of each year. The Bank issued revised operating circulars and notices to banks outlining these revisions.

The MPC continued to monitor developments in the payments system modernization initiative and developed a set of proposals for the gradual liberalization of exchange control restrictions on the capital account for consideration by the Government. In addition, the Bank took further steps to enhance public disclosure on the economic data informing the monetary policy formulation process, principally through the publication of its Monthly Economic and Financial Developments Reports, which cover data and analysis on selected trends monitored by the Bank.

period was approximately 50.0% less at $80.9 million. In the second half of the year, purchases receded further to $282.0 million from the $360.6 million in 2004 which was boosted by an estimated $200 million in hurricane claims. Sales, however, intensified to $518.9 million from $366.3 million, on account of higher fuel payments and increased private sector credit.

Given these developments and taking into account income on investment balances, external reserves contracted by $89.0 million (13.3%) to $578.8 million, in contrast to the $183.5 million (37.9%) increase in 2004. Reserve

TABLE 7: Central Bank Foreign Exchange Transactions (B$'000)												
	COMMERCIAL BANK			GOVERNMENT			OTHER			TOTAL		
Period	Purchases	Sales	Net Purchase/ (Sale)	Purchases	Sales	Net Purchase/ (Sale)	Purchases	Sales	Net Purchase/ Sale	Purchases	Sales	Net Purchase/ (Sale)
Qtr.I	203,355	68,630	134,725	36,555	30,679	5,876	2,424	35,415	(32,991)	242,334	134,724	107,610
Qtr.II	158,797	79,330	79,467	34,009	31,160	2,849	2,831	30,593	(27,762)	195,637	141,083	54,554
Qtr.III	98,645	94,985	3,660	18,151	28,540	(10,389)	4,149	51,040	(46,891)	120,945	174,565	(53,620)
Qtr.IV	192,772	98,051	94,721	42,354	29,736	12,618	4,567	63,954	(59,387)	239,693	191,741	47,952
2004	**653,569**	**340,996**	**312,573**	**131,069**	**120,115**	**10,954**	**13,971**	**181,002**	**(167,031)**	**798,609**	**642,113**	**156,496**
Qtr.I	146,198	83,676	62,522	41,822	24,329	17,493	3,778	35,020	(31,242)	191,798	143,025	48,773
Qtr.II	139,306	77,258	62,048	54,923	48,523	6,400	20,973	57,277	(36,304)	215,202	183,058	32,144
Qtr.III	88,404	148,278	(59,874)	36,579	28,757	7,822	4,946	85,768	(80,822)	129,929	262,803	(132,874)
Qtr.IV	101,277	144,817	(43,540)	45,400	33,279	12,121	5,360	77,971	(72,611)	152,037	256,067	(104,030)
2005	**475,185**	**454,029**	**21,156**	**178,724**	**134,888**	**43,836**	**35,057**	**256,036**	**(220,979)**	**688,966**	**844,953**	**(155,987)**

SOURCE: Central Bank of The Bahamas

balances, which averaged $697.9 million for the year, reached a record month-end peak of $792.9 million in May. At year's end, reserves were equivalent to an estimated 19.5 weeks of non-oil merchandise imports compared to 23.3 weeks at end 2004. By law, the Central Bank is required to keep, at a minimum, external balances which are equivalent to 50.0% of its demand (currency and deposit) liabilities. After discounting the external balances for this amount, the "useable reserves" stood at $257.8 million, a decline of $42.5 million from 2004.

Money Supply

Money growth remained strong in 2005, at 9.2%, albeit slightly below the 10.4% for 2004. Narrow money (M1), which comprised 25.8% of the overall stock, rose by 10.0% to $1,247.6 million, compared with a 25.0% expansion in 2004. Reflecting a shift in public corporations' balances, growth in demand deposits receded more than two-fold to 9.9% from 28.2% in 2004, while the rate of increase in currency in active circulation firmed slightly to 10.6%.

Similarly, the rate of expansion in broad money (M2) slowed to 8.4% from 10.8% in 2004. Savings deposits growth, mainly attributed to the private sector, tapered to 13.1% ($101.9 million) from 14.9% ($101.1 million), while fixed deposits gains advanced to $146.3 million (6.1%) from $94.4 million (4.1%).

Compared to 2004's decline of $4.4 million (4.3%), residents' foreign currency deposits rebounded by $47.3 million (48.8%). However, overall money (M3) growth slackened to $408.7 million (9.2%), for an end-year stock of $4,830.2 million, compared with the previous year's expansion of $418.2 million (10.4%) and more modest growth of $167.1 million (4.4%) in 2003.

Bahamian dollar fixed deposits remained the largest component of the money stock (52.9%), followed by demand (21.8%) and savings (18.3%) deposits. The remainder consisted of currency in the hands of the public (4.0%) and foreign currency deposits of residents (3.0%). Categorized by holder, private individuals held the largest share (57.4%) of Bahamian dollar deposits liabilities. This was followed by business firms (27.6%), the public sector (8.3%), private financial institutions (3.6%) and 'others' (3.1%)—which included institutional investors.

A further analysis of deposits showed that holdings in individual balances under $10,000 represented some 90.1% of accounts, but only commanded 8.2% of the aggregate value. Placements valued between $10,000 and $50,000 held an estimated 6.8% of the accounts and 13.7% of the value. In contrast, balances valued over $50,000 constituted 78.1% of the total value, but only 3.1% of the aggregate number.

Domestic Credit

Growth in domestic credit accelerated to $672.3 million (12.9%) from $253.2 million (5.1%) in 2004 and $33.6 million (0.7%) in 2003. Alongside a strengthened expansion in Bahamian dollar credit, to 12.7% from 7.4% in 2004, loan disbursements relative to tourism developments boosted foreign currency lending by 14.1% vis-à-vis a year-earlier 9.9% contraction.

Sustained increases in household debt elevated private sector credit growth to $614.3 million (14.2%) from $244.8 million (6.0%) in 2004 (see Table 8). Growth in the Bahamian dollar component almost doubled to $518.1 million (13.1%) and resumed strongly for foreign currency claims, to $96.2 million (25.2%), following 2004's contraction of $29.5 million (7.2%).

On a sectoral basis, personal loans, which accounted for the largest share (71.6%) of private claims, advanced by 13.9% ($431.2 million) vis-à-vis 9.5% ($268.1 million) in 2004. This comprised an almost twofold hike in consumer credit of $174.6 million (11.7%), and extended growth in housing loans—mainly residential mortgages—of $261.4 million (17.4%). Conversely, personal overdrafts recorded a net repayment of $2.6 million (4.6%), following a $5.5 million (10.9%) rise in 2004.

A disaggregation of consumer debt indicated higher net lending for consolidation of debt ($66.4 million), credit cards ($22.0 million), home improvement ($20.1 million) and furnishings & domestic appliances ($3.3 million). The net advance was reduced for the miscellaneous category ($38.2 million), land purchases ($24.5 million), education ($0.8 million) and commercial vehicles ($0.8 million). Meanwhile, a net repayment was posted for private cars of $2.8 million.

Among other private sector claims (see Table 9), significant advances were registered for

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

	Outstanding as at 2003	Absolute Changes 2004	Absolute Changes 2005	Outstanding as at 2005
DESTINATION				
Government (net)	506.5	40.6	95.4	642.5
Central Bank	108.4	33.5	(19.9)	122.0
Commercial Banks	393.7	7.2	114.8	515.7
Other Financial Local Institutions	4.4	(0.1)	0.5	4.8
Rest of Public Sector	372.9	(32.2)	(37.4)	303.3
Central Bank	7.3	1.3	(0.3)	8.3
Commercial Banks	365.6	(33.5)	(37.1)	295.0
Other Financial Local Institutions	-	-	-	-
Private Sector	4094.6	244.8	614.3	4953.7
Commercial Banks	3,947.9	251.8	607.2	4,806.9
Other Financial Local Institutions	146.7	(7.0)	7.1	146.8
FINANCING				
Liabilities to the private sector & rest of the public sector	4003.3	418.2	408.7	4830.2
Currency	160.1	16.5	18.7	195.3
Demand deposits	836.4	209.3	122.1	1,167.8
Savings deposits	682.4	101.7	101.6	885.7
Fixed Deposits	2324.4	90.7	166.3	2,581.4
International reserves	484.3	183.5	(89.0)	578.8
Other net external liabilities ( ) = increase	(628.1)	64.3	(47.2)	(611.0)
Capital and surplus	1129.8	89.8	83.3	1,302.9
Other (net)	302.9	7.0	(44.1)	265.8

SOURCE: Central Bank of The Bahamas

miscellaneous loans ($72.7 million), tourism ($69.6 million), construction ($64.0 million), professional & other services ($9.7 million), fisheries ($2.3 million), agriculture ($1.2 million) and entertainment & catering ($19.2 million). Conversely, there were net repayments for distribution ($27.2 million), transport ($12.8 million), manufacturing ($7.7 million), mining & quarrying ($2.4 million) and private financial institutions ($0.2 million).

Growth in banking sector claims on the public sector advanced by 6.5% ($58.0 million), with net claims on Government, concentrated in local currency, more than doubled to $95.4 million (17.4%). Public corporations registered a higher net repayment of $37.4 million (11.0%), compared to $32.2 million (8.6%) last year.

Interest Rates

Interest rate developments were influenced by liquidity conditions together with the discrete downward adjustments in the benchmark rates—the Central Bank's Discount rate and the commercial banks' Prime rate—by 50 basis points each to 5.25% and 5.50%, respectively. In this context, the weighted average loan rate fell by 93 basis points to 10.34% and the counterpart deposit rate, by 61 basis points to 3.22%. Consequently, the interest rate spread narrowed by 32 basis points to 7.12%. The average 90-day Treasury bill rate also moderated by 41 basis points to 0.14%.

On the lending side, average rates on commercial mortgages softened by 107 basis points to 8.10%; for overdrafts, by 81 basis points to 10.86%; for consumer loans, by 74 basis points to 12.22% and for residential mortgages, by 73 basis points to 8.08%. For deposits, the average savings rate moderated by 31 basis points to 2.26%, and the average range for fixed deposit rates was lowered to 3.13%-3.62% from 3.69%-4.46% in 2004.

Net Foreign Assets

The financial system's external balance (see Table 10) switched from a net asset of $104.3 million in 2004 to a net liability of $32.2 million in 2005, as a result of a decline in external reserves and an inflow of funds to support resident designated entities' foreign currency credit requirements. Consequent on the latter, domestic banks' net foreign liabilities were higher by $47.2 million (8.4%) at $611.0 million, to contrast with a $64.3 million (10.2%) decrease in 2004. The Central Bank's external reserves narrowed by $89.0 million (13.3%) to $578.8 million; however, due to a significant reserve build-up in the first half of the year, the average monthly level was 12.6% higher at $697.9 million.

Asset Quality

Quarterly surveys indicate an improvement in domestic banks'

TABLE 9: Sectoral Distribution of Bank Credit (B$ Millions)

Sector	2004		2005	
	$	%	$	%
Agriculture	9.1	0.2	10.3	0.2
Fisheries	12.3	0.2	14.7	0.3
Mining & Quarrying	17.7	0.4	15.3	0.3
Manufacturing	55.1	1.2	47.4	0.9
Distribution	205.9	4.4	178.7	3.3
Tourism	189.0	4.0	258.6	4.8
Entertainment & Catering	44.3	0.9	63.6	1.2
Transport	33.7	0.7	20.9	0.4
Construction	248.8	5.3	312.8	5.9
Government	78.2	1.7	150.7	2.8
Rest of Public Sector	313.5	6.7	265.8	5.0
Private Financial Institutions	20.2	0.4	20.0	0.4
Professional & Other Services	115.8	2.5	125.5	2.3
Personal	3,094.6	65.9	3,525.8	66.0
Miscellaneous	259.9	5.5	332.6	6.2
TOTAL	**4,698.1**	**100.0**	**5,342.7**	**100.0**

SOURCE: Central Bank of The Bahamas

asset quality during 2005. Strong growth in bank loans of 13% or $544 million contributed to a further reduction in total arrears as a percentage of banks' non-Government Guaranteed loans, to 8.3% from 9.4% in 2004 and 10.4% in 2003. Specifically, the rate of arrears for commercial loans contracted by 3.4 percentage points to 7.5%, with a 1 percentage point reduction for residential mortgages, to 8.8%. By contrast, loan arrears on consumer loans was slightly higher at 8.2%.

Non-performing loan facilities with 90 or more days past due payments, represented a slightly lower 4.5% of the systems' loans. Total loan loss reserves improved minimally by $2 million (2%) to $89 million at year-end, after the significant $10 million hike in 2004. Provisions, as a percentage of non-performing loans, approximated a stable 45%, and are expected to improve in 2006, as the system moves into closer compliance with the new Credit Risk Management Guidelines.

Bank Profitability

Favorable economic conditions and significant growth in domestic banks' earnings base, combined with a decline in bad debt expenses, underpinned an increase in bank profitability for the second consecutive year. In the four quarters through September 2005, the most recent annual period for which consolidated data are available, net income rose by $55.6 million (37.6%) to $203.8 million, more than double

TABLE 10: Foreign Assets Position (B$'000)

	2003	2004	2005
1. THE CENTRAL BANK			
EXTERNAL RESERVES (Beginning of the Year)	373,168	484,324	667,823
a. SALES TO:			
i) Commercial Banks	369,958	340,996	454,029
ii) Government	246,806	120,115	134,888
iii) Other Customers	170,325	181,002	256,036
iv) Total Sales	787,089	642,113	844,953
b. PURCHASES FROM:			
i) Commercial Banks	557,230	653,569	475,185
ii) Government	311,216	131,069	178,724
iii) Other Customers	15,779	13,971	35,057
iv) Total Purchases	884,225	798,609	688,966
c. Gold Bullion	-	-	-
d. Reserve Tranche	800	441	(775)
e. SDR Tranche	(87)	13	(21)
f. Other	13,307	26,549	67,756
g. Revaluation Gains (Losses) on Securites	-	-	-
INCREASE/(DECREASE)	111,156	183,499	(89,027)
EXTERNAL RESERVES (End of Year)	484,324	667,823	578,796
2. DOMESTIC BANKS			
NET FOREIGN ASSETS (Beginning of the Year)	(730,471)	(628,060)	(563,830)
a. Foreign Exchange Transactions	36,643	(3,740)	(3,996)
i) Net Purchase/(Sale): Central Bank	(187,272)	(312,573)	(21,156)
ii) Net Purchase/(Sale): Other Customers	223,915	308,833	17,160
b. Changes in Local Liabilities	398,541	488,862	582,009
c. Changes in Local Assets	296,130	424,632	629,216
INCREASE/(DECREASE) (During Year)	102,411	64,230	(47,207)
NET FOREIGN ASSETS (End of the Year)	(628,060)	(563,830)	(611,037)
3. TOTAL NET FOREIGN ASSETS (End of year)	(143,736)	103,993	(32,241)

SOURCE: Central Bank of The Bahamas

the $17.7 million (13.6%) hike in the comparative 2004 period. With the effective interest rate spread on Bahamian dollar loans and deposits increasing to 6.49% from 6.32%, the net interest margin grew by $45.5 million (15.6%) to $336.3 million. Commission and foreign exchange income rose by $3.3 million (13.3%) to $28.2 million, due to elevated transactions volume. However, operating costs advanced by $10.4 million (5.4%), mainly associated with increased staff expenses. "Other" income, net of depreciation and bad debt expenses, grew by $17.3 million (72.1%) to $41.2 million. In this regard, bad debt expenses receded, reflecting a reduction in loan-loss provisions relative to impaired loan servicing.

The return on assets ratio, net income, expressed as a portion of average balance sheet assets, firmed to 3.09% from 2.42% in 2004. The gross earnings margin, the combined ratio of net interest income and commissions and fee income, widened by 36 basis points to 5.53%, while efficiency improvements resulted in the operating cost ratio narrowing by 8 basis points to 3.06% of average assets. The contribution from other income (net of depreciation and other non-cash expenses) was higher by 24 basis points at 0.63%.

OTHER FINANCIAL SECTOR DEVELOPMENTS

During 2005, indicators of banking and investment funds activity, suggest that the financial sector experienced relatively stable balance sheet trends and employment conditions. Domestic capital market activity was buoyant, registering strong appreciation in the value of shares traded.

Banking Sector

As a result of the Central Bank's physical presence requirement policy, adopted for the banking sector in 2001, the number of banks and trust companies licensed to operate from within The Bahamas declined by 16 to 250 during 2005. The number of public licensees decreased by 8 to 149, and restricted and non-active operations fell by 8 to 101.

As at 30 June 2004, except for special managed arrangements approved by the Central Bank, all remaining licensees were required to have met the physical presence requirements. In keeping with this requirement, 205 licensees operated through physical presence at end-2005, compared to 213 at end-2004. A further 42 institutions continued under restrictive management arrangements approved by the Central Bank and 3 institutions were still in transition.

The latest balance sheet survey (end-June 2005) indicated that the total international assets of banks in The Bahamas approximated $316.5 billion, as compared to $6.9 billion (end-December 2005) in domestic assets held by 24 of the public licensees. Indications are that employment remained close to the 4,366 for 2004. Preliminary estimates point to some moderation in outlays following extraordinary capital acquisitions in 2004.

Insurance Sector

Data from the Office of Registrar of Insurance Companies for 2004, the latest available, showed continued strengthening in sector activity. Total assets at end-2004 exceeded $552 million and were mainly concentrated among life and health insurance companies. The number of licensed insurance operations in The Bahamas increased by 4 to 195 at end-2005, while the number of companies operating in the domestic sector totalled 9. The number of domestic brokers and agents, and external operators totalled 89 and 9, respectively.

Securities Industry

The Securities Commission reported that the total number of active investment funds operating from or within The Bahamas amounted to 653 at end-June 2005, compared to 838 in the previous year, with assets under management totalling an estimated US$164.1 billion. Based on the structure introduced under the Investment Funds Act 2003, the majority of the active mutual funds was registered as professional (380), followed by standard (121), recognized foreign funds (79) and SMART (Specific Mandate Alternative Regulatory Test) funds (73).

Capital Markets

For 2005, investors' positive outlook on the economy translated into significant growth in trading values on the Bahamas International Securities Exchange (BISX). Although the volume of securities traded decreased by 16.3% to 6.7 million shares, the value was significantly higher at $36.3 million for a gain of 49.4%. The BISX All Share Price Index surged by 30.0% to 1,350.7 points, following growth of 19.7% last year. Likewise, valuation represented in the broader Fidelity Capital Market Limited's Index (Findex), which also captures over-the-counter trading, grew by 28.4% to 551.9 points from 14.9% in the previous year. The market capitalization on BISX rose by 34.8% to $2.6 billion.

There were no new private capital offerings during 2005; the total number of publicly traded companies on the Exchange remained at 19. Inclusive of over-the-counter instruments (4) and mutual funds (4), the total number of securities trading locally stood at 27.

INTERNATIONAL TRADE AND PAYMENTS

Preliminary balance of payments data for 2005 indicates a near doubling in the estimated current account deficit to $622.8 million, reflecting a combination of higher prices for imported fuel, and robust growth in domestic demand associated with both the increased level of foreign investment projects and consumer spending. The consequent deterioration in the merchandise trade balance eclipsed the improvement in the services and income accounts and was covered through a combination of strengthened capital account inflows and a reduction in external reserves (see Table 11).

The trade deficit widened by an estimated 13.9% to $1,626.2 million, following a 7.3% hike in 2004. Volatility in the global oil market resulted in a steep 43.7% rise in the oil import bill to $525.2 million, with double digit gains across all products. In particular, the per barrel price for propane gas advanced by 35.1% to $47.62; for motor gas, by 37.7% to $76.06; aviation gas, by 19.0% to $120.91; jet fuel, by 47.2% to $76.23; Bunker 'C' fuel, by 5.9% to $25.22 and gas oil, by 56.3% to $71.04. Net non-oil merchandise imports expanded by 7.4% to $1,258.9 million.

Tourism led gains supported a 4% improvement in the services account surplus, to $1,024.6 million. Net travel receipts increased by 3.4% to $1,621.5 million, although moderating from the year-earlier gain of 8.0%. A positive contribution was also provided by the 6.7% hike in offshore companies' local expenses to $143.4 million and a decline in the deficit on the "Other Services" account, by 14.5% to $248.2 million. The net outflow for transportation services was higher by 16.4% at $290.2 million, and for local government, by 72.1% at $50.4 million. Reflecting increases in premiums, remittances of insurance services rose by 16.0% to $94.7 million.

Developments in the income account registered a 21.3% decline in the overall deficit to $106.6 million, due partly to a contraction in net investment income outflows which countered the rise in net workers' remittances. Net investment payments were halved to $33.4 million, reinforced by a reversal in commercial banks' transactions, from a net payment of $15.1 million in 2004 to a net receipt of $36.1 million in 2005. Net official transaction receipts also improved by $7.7 million to $8.7 million, mainly on account of Central Bank's investment income. In contrast, net labour remittances rose by 15.6% to $73.2 million. Net current transfer receipts were 66.0% lower at $85.3 million, primarily the result of an 81.4% reduction in inflows of hurricane-related insurance claims to $37.0 million. Workers' remittances increased by 33.1% to $10.8 million, while Government's net receipts softened by 0.9% to $59.1 million. Sustained foreign investment in tourism infrastructure, second homes and

BALANCE OF PAYMENTS

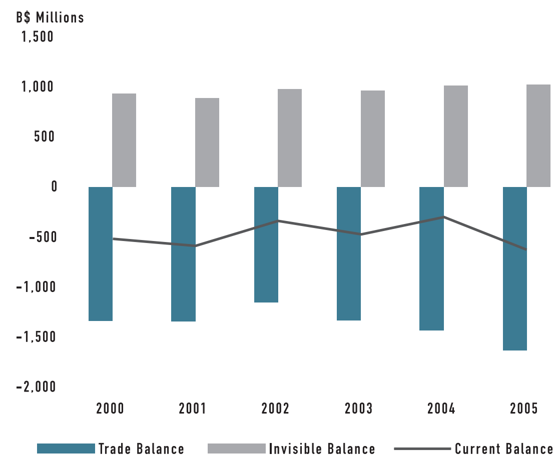


TABLE 11: Balance of Payments Summary (B$ Millions)

	2003p	2004p	2005p
I) CURRENT ACCOUNT	**(472.1)**	**(301.1)**	**(622.9)**
i) Merchandise Trade (net)	(1,330.7)	(1,427.5)	(1,626.2)
Exports	426.5	477.4	522.7
Imports	1,757.2	1,904.9	2,148.9
ii) Services (net)	962.3	1,010.9	1,024.6
Travel	1,452.7	1,568.9	1,621.5
Transportation	(187.5)	(249.3)	(290.2)
Other	(302.9)	(308.7)	(306.7)
iii) Income (net)	(152.4)	(135.3)	(106.6)
Compensation of Employees	(56.3)	(63.3)	(73.2)
Investment Income	(96.1)	(72.0)	(33.4)
iv) Current Transfers (net)	48.7	250.8	85.3
Government	53.9	59.7	59.1
Private	(5.2)	191.1	26.2
II) CAPITAL AND FINANCIAL ACCOUNT	498.0	310.6	429.6
i) Capital Account (Transfers)	(37.4)	(47.9)	(60.4)
ii) Financial Account	535.4	358.5	490.0
1. Direct Investment	190.3	273.7	360.3
2. Other Investments	345.1	84.8	129.7
Central Government Long Term Capital Flow (net)	196.0	(3.9)	1.2
Other Public Sector Capital	(143.5)	(16.8)	(9.7)
Banks	(102.4)	(64.6)	47.6
Other	395.0	170.1	90.6
III) NET ERRORS AND OMISSIONS	85.0	174.1	104.3
IV) CHANGES IN EXTERNAL RESERVES ( ) = increase	(110.9)	(183.6)	89.0

SOURCE: Central Bank of The Bahamas

timeshares elevated the estimated surplus on the capital and financial account by 38.3% to $429.5 million. Net migrant transfers moved up by 26.2% to $60.4 million, and net financial inflows advanced by 36.7% to $489.9 million. Direct investments expanded by $86.6 million to $360.3 million in 2005, reflecting firming in both equity and real estate inflows. Public sector net outflow for debt servicing was reduced to $8.5 million from $20.7 million in 2004. Underlying this was a reversal in central Government's transactions, from a net payment of $3.9 million to a net inflow of $1.2 million in 2005, and a 42.2% reduction in public corporations' net outflow to $9.7 million. Domestic banks' funding of various tourism projects explained the turnaround in their short-term capital flows, from a net outflow of $64.6 million in 2004 to a net inflow of $47.6 million in 2005.

After adjusting for possible errors and omissions, the overall payments balance as reflected in the change in Central Bank's external reserves, recorded a deficit of $89.0 million as compared to a $183.6 million surplus in 2004.

INTERNATIONAL ECONOMIC DEVELOPMENTS

In the context of high energy costs and continuing instability in the Middle East, the International Monetary Fund (IMF) estimates that global output growth slowed to 4.3% in 2005 from 5.1% in 2004. Reflecting less robust economic conditions, the employment situation remained sluggish among the major developed countries, while increased fuel expenditures led to the deterioration of the current account positions in several developed countries. As part of the inflation targeting framework, monetary policies of a number of major central banks focused on interest rate tightening. The expectation of higher returns in United States dollar denominated assets also sparked some appreciation in the value of the US dollar among foreign investors. Overall, the financial markets responded favorably to the generally positive economic growth indicators, which spurred significant appreciation of the respective market indices. Oil supply constraints, despite an expansion in production by the Organization of Petroleum Exporting Countries (OPEC), pushed the price of oil to record highs during the year.

Preliminary estimates are that output growth in the United States moderated to 3.5% from 4.2% in 2004, mainly reflecting contractions in inventory investment, a slowdown in consumer spending and softening in federal government expenditures. Growth in the euro-zone economies stabilized at an estimated 1.3% compared to 2.1% in 2004. The groupings' largest economy, Germany, registered a 0.9% increase in real value-added, a slowdown from the 1.6% recorded in the previous year; while France's GDP expansion softened to an estimated 1.5% from 2.0% in 2004. Amid a slowdown in services sector expansion, which is responsible for almost two-thirds of the economy, economic growth in the United Kingdom was reduced to 1.8% from 3.2% in 2004. Supported by elevated private consumption and strong export levels, Japan's GDP growth was higher at 2.8% from 2004's 2.3%. For developing countries, preliminary estimates indicate that the expansion in output slackened to an average 6.4% from 7.3% in 2004. More particularly, the economic expansion in Africa decelerated to a projected 4.5% from 5.3%; in Central and Eastern Europe, to 4.3% from 6.5%; developing Asia, to 7.8% from 8.2%; and the Western Hemisphere, to 4.1% from 5.6% in 2004. Given the elevated demand for oil during the year, output growth in Middle Eastern countries in general was stable at an estimated 5.4%.

Labor market conditions in the major economies remained sluggish during 2005 as economic activity showed no significant signs of improvement. For developed countries, the average jobless rate receded marginally to 6.1% from 6.3% in 2004. In the United States, the average unemployment rate improved to 4.9% from 5.4% in 2004, with significant gains observed in the professional and business services, health care and leisure and hospitality industries. For the Euro area, the unemployment rate stabilized at 8.4%, inclusive of a marginal improvement in Germany's rate to 9.5%. The United Kingdom's jobless rate advanced to 5.1% from 4.7%, while Japan's unemployment rate was slightly lower at 4.4%.

Despite the escalation in oil prices during 2005, inflation rates in the mainly service driven industrial countries remained relatively low. Average consumer prices in the United States firmed to 3.4% from 2.7% in 2004. In the euro zone, consumer prices rose by 2.2% from 2.4%, with Germany's rate relatively steady at 2.1%. The United Kingdom's inflation rate was also marginally higher at 1.9%, although meeting the Monetary Policy Committee's target of 2.0%; however, Japan's deflation persisted, with prices falling by 0.1%.

World commodity markets continued their uptrend for a fourth year, supported by higher energy and precious metal prices. Despite production hikes by OPEC, after reaching a peak of $66.93 at end-August in response to escalating Middle Eastern geopolitical tensions, benchmark crude oil prices finished 2005 44.4% higher at $57.63 per barrel. Continuing as one of the best safe haven investments in an economically volatile environment, gold, which began the year at $438.45, gained value steadily to close the year 17.9% higher at $517.0 per troy ounce. Silver prices also appreciated by 29.3% to $8.82 per ounce at end-2005, while price gains of other non-fuel primary commodities stabilized at around 5.5%.

Amid concerns of higher inflation in the short to medium term, monetary policy shifted towards tightening of interest rates, particularly in the United States and Euro zone economies. In the United States, the Federal Reserve Bank raised the target funds rate by 25 basis points on eight separate occasions throughout the year, to 4.25%, and in a similar fashion, the primary credit rate was increased to 5.25% from 3.25%. Expectations that euro-zone inflation would exceed its 2% target prompted the European Central Bank to raise its key financing rate, for the first time in five years, on 1 December, by 25 basis points to 2.25%. In contrast, fears of a slowdown in economic growth caused the Bank of England to lower its benchmark repo rate by 25 basis points in August to 4.50%. While retaining the discount rate at an historic low of 0.1%, the Bank of Japan continued to provide economic stimulus to the economy through expansions in its money market operations.

Currency market developments in 2005 featured an appreciation of the United States' dollar against the major currencies, owing to an improved US economic outlook and higher domestic interest rates. The largest appreciation was recorded against the Swiss Franc, by 15.2% to CF1.31. The dollar also gained in value against the Japanese yen, by 14.7% to ¥117.75; by 14.4% against the euro to €0.84 and by 11.3% against the pound sterling to £0.58. Conversely, the dollar weakened relative to the Canadian dollar by 3.3% to C$1.16.

Projections are that fiscal consolidation efforts of several major economies were mixed during 2005. In the US, the fiscal deficit improved by an estimated 0.1 percentage points to 3.5% of GDP, and for Japan, to 6.7% of GDP from 7.2% in 2004. On the contrary, the fiscal deficit to GDP ratios for the United Kingdom and the Euro zone are projected to have deteriorated marginally to 3.6% and 3.0% from 3.4% and 2.7 %, respectively. Meanwhile, Canada's fiscal surplus was trimmed to an estimated 0.5% of GDP from 0.7% in 2004.

Despite the challenges facing the global economy in 2005, equity markets registered price appreciation, although moderated, over the course of the year. As a measure of global trends, the Morgan Stanley All Country World Index growth was halved to 8.2% to finish the year at 162.02 points. In the United States, the Dow Jones Industrial Average (DJIA) was marginally lower by 0.6% to 10,717.5 points; however, the broader S&P 500 Index appreciated by 3.1% to 1,254.8 points. Performance was stronger for the European markets, as the United Kingdom's FTSE 100 Index rose by 16.7% to 5,618.8 points; France's CAC-40 Index, by 23.4% to 4,715.2 points; and Germany's DAX, by 27.1% to 5,408.3 points. Additionally, Japan's Nikkei-225 rallied by a sturdy 40.2% to 16,111.43 points, supported by a strong export sector.

Persistent firming in world energy prices contributed to a widening of the developed countries' external current account deficits, to an estimated 1.3% of GDP from 1.0% in 2004. The United States' current account shortfall deteriorated to an estimated 6.1% of GDP from 5.7% in 2004. Supported by a services trade surplus, the United Kingdom's current account balance stabilized at an estimated 1.9% of GDP. Canada's external surplus deteriorated to an estimated 1.5% of GDP from 2.2% in 2004, while preliminary evidence indicates a reversal in the euro area's current account position to a deficit of 0.4% of GDP from a surplus of 0.6% of GDP in 2004. In Germany, reinforced by a strong export sector, the current account surplus strengthened to an estimated 4.3% of GDP from 3.8% in 2004. Meanwhile, higher costs for fuel imports resulted in Japan's surplus declining to an estimated 3.3% of GDP vis-à-vis 3.7% in 2004.

BANKING

Currency Operations

The Central Bank of The Bahamas, through the Currency Unit of the Banking Department, is responsible for the issuance, redemption, and reissuance of Bahamas currency (banknotes and coins). As the issuer of currency, the Bank is responsible for recording all movements of currency in and out of circulation, and examining banknotes for reissue or destruction.

At end-2005, Bahamas currency in circulation totalled approximately $301.1 million, an increase of 17.99% over 2004. Bahamian dollar banknotes are issued in denominations of $0.50, $1, $3, $5, $10, $20, $50, $100, with a circulation value of $286.2 million at end-December 2005. Coins in circulation stood at approximately $14.9 million.

Currency in Circulation
(B$ Millions)

	Notes	Coins	Total
2004	$241.158	$14.039	$255.198
2005	$286.210	$14.893	$301.102
% Change	18.68	6.08	17.9

The Bank has the responsibility for designing, minting, and printing of all currency necessary to maintain adequate stocks. In August 2005, the Bank introduced into circulation its newly designed $10 banknote, the first in its family of **CRISP** (Counterfeit Resistant Integrated Security Product) banknotes, which is designed to take advantage of improved technology by incorporating specific security features. The Bank will continue to phase in its CRISP family of banknotes, with the planned introduction of its newly designed $20 and $50 denominations during 2006.

Foreign Exchange Transactions

For the eleven months to November 2005, the Central Bank's buying and selling rates for US dollars from/to clearing and commercial banks remained unchanged at US$1.00 = B$1.0025 and US$1.00 = B$1.0040, respectively and at par for cash transactions. However, effective 1st December 2005, these rates were reduced to US$1.00 = B$1.00 (buy) and US$1.00 = B$1.0025 (sell), respectively. Foreign exchange rates for the quotation of 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 Central Bank maintained the policy of adding a commission of one half of one percent to the mid-rate.

The highest and lowest pound Sterling/Bahamian dollar rates employed by the Bank during 2005 were as follows:-

	Buying	Selling	Date Employed
Highest	1.9314	1.9411	March 8, 2005
Lowest	1.7096	1.7181	December 22, 2005

Relations with Public Sector

As the official registrar for the Government, the Bank maintained its functions of overseeing the issuance and redemption of Registered Stocks and Treasury bills and accommodating a secondary market for these securities. As registrar and transfer agent, the Bank also oversees the issuance and records shifts in ownership of domestic debt securities on behalf of the general public sector. The Banks' current Register includes securities of the Bridge Authority, the Bahamas Mortgage Corporation, and the Bahamas Development Bank.

By law, the maximum amount that the Government can borrow by way of Treasury bills is 20 percent of the lesser of ordinary revenues, as projected in the latest budgetary estimates approved by Parliament, or the average of the latest three years of audited accounts which have been tabled in Parliament. The issuance of an additional $13.1 million in Treasury bills increased the undiscounted value to $192.5 million during 2005. Amid continual rollovers of maturing certificates, the Bank rediscounted $5.0 million in bills from public corporations. By creditor profile, the commercial banks and National Insurance Board continue to hold the entire stock of Treasury bills. The average pricing of the bills outstanding is shown in Table 12.

During 2005, the value of Bahamas Government Registered Stocks outstanding increased by 7.5% to $1,669.0 million (see Table 13). The Bank arranged four issues during the year, totalling $181.4 million, and redeemed a scheduled $65.0 million. Bonds issued during 2005 maintained the upper range for the maturity on domestic debt at 20 years, but the effective cost of the outstanding debt was reduced given the downward adjustment in the Prime rate, although the variable interest rates being paid on the lower range of yields offered remained at 0.03125% above commercial banks' Prime rate.

The value of outstanding Bridge Authority bonds remained at $28.0 million, with the maturity structure situated between 2014 - 2029. Variable yields ranged between the Prime rate of 6.000% plus 1.000% - 1.625% per annum.

The level of Bridge Authority bonds outstanding remained at B$28.0 million. The maturity structure for existing bonds ranged between 2014 - 2029. Variable yields on bonds range between the Nassau Prime Rate of 5.500% plus 1.000%-1.625% per annum.

Table 12: Bahamas Government Treasury Bills (B$ Millions)

	2004	2005
Bills Outstanding	**179.4**	**192.5**
Average Pricing		
Tender Rate (%)	99.85	99.85
Discount Rate (%)	0.32	0.35
Re-discount Rate (%)	0.82	0.85

Source: Central Bank of The Bahamas

Table 13: Bahamas Government Registered Stocks (B$ Million)

	2004	2005
Outstanding (Beginning of yr)	**1,386.9**	**1,552.6**
Add: New Issues	223.3	181.4
Less: Maturities	57.6	65.0
Outstanding (End of year)	**1,552.6**	**1,669.0**
Interest Yield		
Variable Rates (Prime + Add-On)		
Prime	6.00%	5.50%
Add-On	0.03125% - 1.50%	0.03125% - 1.25%
Fixed Rates	5.75% - 10.50%	5.75% - 10.50%
Maturity Range	2005 - 2024	2006 - 2033

Source: Central Bank of The Bahamas

Relations with Banks

In accordance with Section 19 of the Central Bank of The Bahamas Act 2000, banks are required to maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since being established in 1974, the reserve ratio has remained at 5.0%, with a minimum 80% to be held in deposit balances at the Central Bank. In line with growth in the Bahamian dollar deposit base, required reserves rose by 10.6% to $186.1 million at end-2005. Banks' excess balances at end-December 2005 stood at $146.0 million, representing some 51.0% of their total deposits held with the Central Bank and 39.0% lower than in 2004.

Banks also maintain balances at the Central Bank to facilitate the cheque clearing arrangements, which continue to be managed by the Central Bank. The volume of cheques processed declined by 4.9% to 3.9 million at end-December 2005. There was, however, a 7.3% hike in associated value to 7,812.6 million. The Bank continued to use the Society Worldwide Interbank Financial Telecommunication (SWIFT) network to transmit high speed messages relative to international business.

Payments System Modernization

The Central Bank and the Clearing Banks Association have been actively involved in a project to modernize the domestic payment system, towards promoting safety and efficiency of operational framework. A key milestone was achieved on 25th May 2004 with the implementation of the Bahamas Inter-bank Settlement System (BISS), a real time gross settlement system (RTGS). This allows for large value and time critical payments to be settled through balances maintained at the Central Bank, in real time and on an individual basis in the order in which they are transmitted. Once a payment instruction has settled in BISS, it is final and irrevocable, thereby mitigating risks. BISS has a liquidity management facility to allow banks access to intra-day credit from the Central Bank, collaterized by Government bonds held in an electronic depository with the Bank and repayable by the close of the business day. Transactions have increased steadily over the years; the system processed an average of 76 transactions daily during 2005, with an average value of $31.53 million.

The project to replace the current manual system of cheque clearing with an automated clearinghouse (ACH) reached a critical stage in 2005, with the creation of working groups to define and oversee the project, and the recent engagement of World Bank experts to support the activity of the working groups and assist in a review of the Vision Statement and service requirements. Revised milestones were established for the introduction of the system, with the automation of cheques by end-June and the introduction of direct debit and credit payment services by end-December 2006.

Investment Currency Market

Through the Banking Department, the Bank continued to provide investment dollars to residents to facilitate, among other things, overseas purchases of shares/securities and real estate. The premium bid and offered rates were unchanged at 20% and 25%, respectively. The Investment Currency Market opened the year with a balance of $2,811,137.57. Purchases totaled $84,934.10 and sales, $194,592.10, for a closing balance of $2,701,479.57 at end-2005.

EXCHANGE CONTROL

During 2005, the Exchange Control Department continued to examine its internal systems and procedures to enable greater operational efficiency in the delivery of service to the public. In addition, the Department conducted meetings with Authorized Dealers, aimed at strengthening their reporting regime, and provided support to the statistical efforts of the Research and Bank Supervision Departments.

In an effort to provide enhanced guidance to Authorized Dealers, individuals and institutional customers on the operations of exchange controls, the Department drafted an information resource document entitled "Guide to Exchange Controls in The Bahamas", which is presently being organized for online publication in early 2006.

In 2005, the Government accepted the set of proposals submitted by the Central Bank regarding the liberalization of Exchange Control restrictions on capital account transactions (see Box 2). Broadly speaking, these measures aimed at enhancing opportunities for investments abroad by Bahamians and at facilitating meaningful development of the domestic capital market. In preparation for communicating the measures to Authorized Dealers and the general public, the Department engaged in consultations regarding the administrative guidelines that would govern the amended regime with the relevant stakeholders—including Authorized Dealers, BISX, the Securities Commission and BISX licensed brokers.

At end-2005, the number of Authorized Dealers and Authorized Agents operating domestically stood at eight (8) and seventeen (17), respectively (see the Bank's website for list).

BOX 2
APPROVED REVISIONS TO EXCHANGE CONTROL REGIME GOVERNING CAPITAL ACCOUNT TRANSACTIONS[1]

1. INVESTMENT CURRENCY MARKET RATE STRUCTURE

Bid/offer rates to be reduced to 12.5%/10%, from 25%/20%. Current investors, should they desire, will be allowed up to 31st March 2006 to liquidate their original capital investments (excluding capital gains & income) through the ICM at the old offer rate of B$1.20 = US$1.00.

2. OVERSEAS PORTFOLIO INVESTMENTS BY RESIDENTS

a) Employee Stock Option/Share Purchase Plans (ESOPs/ ESPPs): Bahamian employees of foreign-owned institutions in The Bahamas may invest up to $25,000 per annum (previously $10,000 established in May 1995) in shares of the employer, at the official rate.

b) Publicly Traded Foreign Securities Listed on BISX as BDRs: On an annual basis, up to 5% of the external reserves at previous year's end, but not to exceed $25 million, will be allocated for funding the structuring of BDR products, at the official rate of exchange.

c) National Insurance Board (NIB): granted a maximum of $25 million annually for foreign investments, at the official rate of exchange.

3. TIME SHARE PURCHASES

Each family unit, defined as a marital unit or persons over 18 years of age, is permitted an investment of $25,000, once every ten years, at the official rate.

4. CAPITAL TRANSFERS ABROAD LINKED TO EMIGRATION

For Bahamians taking up residency abroad, the amount available for conversion, at the official rate, is increased to $250,000 from $125,000 per family, per annum.

5. ARRANGEMENTS AFFECTING TEMPORARY RESIDENTS & PERMANENT RESIDENTS (WITH RESTRICTED RIGHT TO WORK)

a) B$ Credit Facilities: Temporary Residents may borrow up to a maximum of B$50,000 (increased from $6,000) for consumer related purposes. Temporary Residents, who have resided and worked in The Bahamas for at least three years, may borrow up to a maximum of B$200,000 to finance owner-occupied dwellings. Where the proposed transaction exceeds $200,000, or where the residency requirement is not met, the entire transaction must be funded in foreign currency.

b) Investments in Domestic Securities: Temporary Residents and Permanent Residents (with restricted right to work) may now: i) invest in obligations of companies listed on BISX up to an aggregate of 10% of the respective issue/offering; and ii) invest in public sector securities for which the Central Bank acts as registrar, subject to an overall limit of $100,000 per person/entity.

6. INVESTMENT IN DOMESTIC SECURITIES BY RESIDENT DESIGNATED ENTITIES

Companies designated resident for Exchange Control purposes, with no term restrictions on their operations in The Bahamas, and that in the normal course of their business activities invest in securities (i.e. insurance companies and other financial service providers (brokerage houses), may invest in: i) equities of companies listed on BISX, up to a limit of 10% of the issue/ offering, per investing entity; and ii) other private and public sector securities, without limit.

7. CROSS BORDER LISTINGS

Bahamian companies listed on BISX may list equity securities on principal CARICOM exchanges (i.e. Barbados, Jamaica, ECU and Trinidad & Tobago), subject to a limit of 10% of issued and outstanding voting share capital, and up to a maximum of $20.0 million. Foreign companies listed on principal CARICOM exchanges (see above) may list issued and outstanding equity securities on BISX. The at cost value of net capital invested [purchases less sales] any such public offering via BISX may not, at the time of listing/offering, in the aggregate, exceed $5.0 million per quarter and a maximum of $20 million per annum.

[1] Changes became effective 13th January 2006.

Box 3
XXXVII Annual Monetary Studies Conference

Following in-depth planning and organization, the Department hosted a successful and informative 37th Annual Conference of Monetary Studies, during November 1-4, 2005, at the British Colonial Hilton Hotel. The Conference focused on the theme, "Regional Economic Integration: Issues and Challenges." Presenters were invited from a number of regional and international organizations, including ECLAC's Sub-Regional office for the Caribbean, the International Monetary Fund, the University of The West Indies, the Bank for International Settlements, and regional central banks. This panel diversity served to enrich the conference with a wealth of expertise and allowed for meaningful and stimulating exchanges. Other guests included persons from both the public and private sectors.

During the opening session of the Conference, Mrs. Wendy Craigg, Governor of the Central Bank of The Bahamas, welcomed the delegates and the Hon. James Smith, Minister of State for Finance gave the feature address. The Conference was divided into morning and afternoon sessions, with participants making presentations which focused on various sub-topics of the overall theme of the Conference. The Department presented three papers entitled: Money and Financial Stability: Issues for CARICOM Economies in the Domestic Sector; Financial Sector Reform in The Bahamas: An Industry Assessment of the Legal and Regulatory Initiatives and Emerging Challenges from the Global Sector; and Regional Integration and the Correlation Among Major Stock Markets in the Caribbean.

The Adlith Brown Memorial Lecture was delivered by Dr. Marion Williams, Governor of the Central Bank of Barbados, who presented on the topic, "Foreign Exchange Reserves: How Much is Enough?"

RESEARCH

During the year, the Research Department investigated a number of issues in support of the Bank's Monetary Policy Committee, and provided information and advice to the Government and other domestic and international agencies. Topics covered in papers prepared under the Department's 2005 Research Agenda included capital market developments, stock market co-integration in the Caribbean, and exchange control liberalization measures.

Other research papers completed during the year examined the economic impact of the 2004 hurricanes on the island of Abaco through the viewpoint of the insurance industry and Government expenditure. Papers were also written on pension fund reform, the feasibility and likely consequences of the value added tax on The Bahamas and the impact of rising oil prices on The Bahamas. These papers were presented in a quarterly Round Table discussion series, which was a new initiative for the Department in 2005.

The Department conducted a number of surveys during 2005, including the Financial Sector Survey, the Pension Fund Survey, the Annual Banking Survey, the Semi-Annual Survey of Economic Activity and the Gross Economic Contribution of Banks and Trust Companies to The Bahamas.

In response to the needs of the Bank's Monetary Policy Committee, the Department undertook the regular review of policy initiatives and updated its forecasts of monetary and credit conditions.

The Department, through a number of initiatives, continued to strengthen its data collection and compilation capabilities. These included: preliminary analysis of an online reporting system for external data providers, as well as the hosting of a FAME database management workshop.

To modernize library services, the Bank initiated a project aimed at introducing new technology, including the implementation of ASKSAM—an electronic cataloguing resource.

The Department continued to maintain the Bank's website, which has become a critical outlet for the dissemination of the Bank's publications and statistics.

BANK SUPERVISION

The Bank Supervision Department is responsible for the licensing and supervision of banks and trust companies. In 2005, the Department's activities focused on

TABLE 14: Banks and Trust Companies Licensed in The Bahamas										
	PUBLIC			RESTRICTED			NON-ACTIVE			
	B&T	B	T	B&T	B	T	B&T	B (Nom)	T	TOTAL
December 2004	87	53	17	7	5	86	7	3	1	266
Add Licenses issued in 2005	1	1	1	0	0	6	0	0	0	9
Less Licenses revoked in 2005	5	6	0	2	2	8	2	0	0	25
Sub Totals	83	48	18	5	3	84	5	3	1	250
Licenses upgraded or downgraded	-1	0	1	-1	0	0	0	0	1	0
December 2005	82	48	19	4	3	84	5	3	2	250

B=Bank, T=Trust, T(Nom)=Nominee Trust

Note: Gross License Fees during 2005 amounted to approximately $10.258 million

Source: Central Bank of The Bahamas

greater regulatory effectiveness, primarily through:

- an examination programme aimed at ensuring that the many banks which had converted from "managed" or shell status had done so effectively;
- publication of new Guidelines, in particular, a comprehensive review of requirements for licensees to combat money laundering (AML) and terrorist financing (CFT);
- continued development of co-operative ties with foreign regulators, with particular emphasis on expediting and simplifying the execution of requests for information from overseas regulators; and
- updating and further development of the staff training programmes.

The Department also continued to perform its core functions of licensing, policy formulation and supervisory monitoring. These activities are outlined below.

Licensing Activity and Physical Presence Policy

During 2005, the number of bank and trust licences fell by 16 to 250 (see Table 14).

The Governor granted 9 new licences and revoked 25 licences, which reflected continuing mergers and rationalizations among existing banks and the closure of a few remaining "managed" banks, which had chosen not to take up a physical presence in The Bahamas[1]. The Governor also suspended and revoked an unrestricted licence, which was placed in liquidation.

Of the 250 licensees, 205 (82%) operated through physical presence as compared to 213 in 2004. A further 42 maintained management arrangements approved by the Central Bank and consistent with good international practice (i.e., they either have restricted licences and/or are branches of banks originating from G10 countries), and three (3) institutions were still in transition to physical presence. For a listing of the banks and trust companies licensed to operate from or within The Bahamas as at end-2005, please refer to the Bank's website.

On-site Examinations

Since 2000, on-site examinations have become an integral part of the Central Bank's

[1] Please see the 2004 Annual Report, page 34 for further details.

supervision of banks and trust companies in The Bahamas. The Department conducted 39 on-site examinations (see Table 15) during 2005, a significant number of which focused on ensuring that banks which had switched from being managed by other licensees had successfully established a physical presence in The Bahamas. Considerable time and resources were also expended on safety and soundness examinations of four domestic licensees, for which the Central Bank is either the home or primary supervisor.

The Department continues to adopt a risk adjusted approach in determining which licensees should be examined, taking into account factors such as the nature of the licensee's business and its previous record on safety and soundness.

The outcome of the physical presence examinations was broadly satisfactory, with most of the subject banks showing a satisfactory transition to the new regime. The Central Bank continued to discuss with licensees areas where improvements were needed, often in the area of corporate governance—ensuring that local staff and Resident Non-Executive Directors played a full role in the operations of licensees. Detailed timetables of required changes were agreed upon with relevant licensees and monitored closely by Central Bank staff. Safety and soundness examinations generally indicated an encouraging improvement in the systems and controls utilized by banks. The Central Bank also kept under close review, the lending portfolios of domestic banks.

TABLE 15: Onsite Examinations Conducted (2003-2005)

	2003	2004	2005
Examinations			
Licensees (physical presence)	33	24	4
Managed Banks	22	0	24[1]
Domestic Licensees	3	2	4
Follow-up /Special focus examinations	6	6	7
Total Examinations	64	32	39

Source: Central Bank of The Bahamas
[1] Represents licensees which were recently converted to physical presence.

The staff worked side by side with foreign supervisors who made a number of onsite inspection visits to The Bahamas, to ensure that the latter's obligations as home supervisor could be met while protecting Bahamian laws regarding confidentiality of depositor information.

The examination team increased in number by one (1) to eight (8) during 2005, and was supported by a series of secondments of permanent staff. These secondments are designed to improve the Department's capacity to undertake examinations in the long-term. The Central Bank plans to increase the proportion of the Department's overall supervisory resources devoted to on-site examinations in the coming year.

Other Domestic Supervisory Actions

The Supervisory Unit of the Department continued to carry out comprehensive analysis and assessments of the ongoing financial positions of active banks and trust companies in 2005. The ability of licensees to operate as going concerns and their compliance with the Bank's requirements regarding liquidity, solvency, risk and management, were investigated and assessed.

The Bank continues its commitment to promote the 'fit and proper' management of its licensees through, inter alia, the Department's review of licensee applications for approval of proposed directors and senior officers and through meetings held with licensees to discuss prudential issues. This is in keeping with the Bank's objective to ensure that persons who control and manage the business of banks or trust companies possess the highest credentials and have the appropriate experience to carry out their responsibilities. During 2005, the appointments of 116 directors and 48 senior officers were approved by the Governor following the Department's review process, and the Department held a total of 122 meetings with licensees relative to prudential matters. The Department continued to monitor instances of attempted fraud or questionable activities brought to its attention by various entities. Through the use of its web-site, the Department provided timely information on suspected fraudulent schemes and unlicensed entities purporting to be banks or trust companies while continuing to update various bodies such as the Attorney General's Office, the Royal Bahamas Police Force, the Postmaster General, the Bahamas Telecommunications Company, the Registrar General and other financial sector regulatory authorities.

During the year, the Inspector of Banks and Trust Companies introduced a quarterly letter to licensees who were advised, among other matters, of developments that affected their operations, new guidelines for consultations and issuance of guidelines and regulations. Licensees have found this an excellent avenue for obtaining information on general issues and for focusing their attention on areas requiring their responses or input.

The Department continued an ambitious work programme to strengthen its prudential regulations and provide clear guidance to licensees, guided by the Bank's Basel Core Principles Self-Assessment and the Module II Assessment of The Bahamas, conducted by the International Monetary Fund in 2002.

New Guidelines

The Bank issued five (5) final guidelines during the year (see Table 16). The guidelines relating to the Prevention of Money Laundering and Countering the Financing of Terrorism (the AML/CFT Guidelines) were the most crucial, as they replaced interim Guidelines issued in April 2004. These Guidelines incorporate both the mandatory minimum requirements of the Financial Transactions Reporting Regulations, 2000 and industry best practices for verifying customer identity and for developing anti-money laundering procedures and measures to prevent terrorist financing. Extensive input from the private sector greatly assisted in the preparation of these guidelines.

The Large Exposure Guidelines, which came into effect in March 2005, outlined the minimum standards and requirements that licensees are expected to follow in relation to controls on large exposures and risk concentrations. Since implementation of these Guidelines, the Department has reiterated the fact that all licensees are covered by them, except those in the restricted licence category or licensed to conduct only trust business.

As required by the Guidelines, licensees have commenced submitting Annual Policy Statements on Large Exposures, which have a deadline of 30th June 2006. The Inspector has given a general waiver on the requirement to pre-notify the Central Bank of any market loan where the aggregate amount placed with that counterparty exceeds 25% of capital, provided certain criteria were met by the licensee.

In addition, during 2005, the Central Bank issued several draft Guidelines for industry comments

TABLE 16: Issued Guidelines

	GUIDELINES	Final Issue Date
1	Guidelines for Licensees on the Prevention of Money Laundering and Countering the Financing of Terrorism	19th October 2005
2	Guidelines for the Measurement, Monitoring, and Control of Impaired Assets.	15th April 2005
3	Guidelines for the Management of Capital and the Calculation of Capital Adequacy	15th April 2005
4	Guidelines for the Management of Liquidity Risk	25th March 2005
5	Guidelines for the Management of Large Exposures	25th March 2005

Source: Central Bank of The Bahamas

TABLE 17: Draft Guidelines Released for Industry Consultation

	Document	Date Released	Final Date for Comments
1	Guidelines for Licensees' Electronic Banking Activities	4th April 2005	28th February 2006
2	Guidelines for Chartered Accountants and Chartered Accounting Firms Serving as Auditors of Banks and Trust Companies Licensed by the Central Bank of The Bahamas.	1st April 2005	28th February 2006
3	Guidelines for the Establishment or Acquisition of Overseas Branches, Subsidiaries, and Representative Offices.	19th April 2005	28th February 2006
4	Guidelines for the Management of Country Risk	19th April 2005	28th February 2006
5	Minimum Disclosure Requirements Guidelines	14th June 2004	31st March 2006

Source: Central Bank of The Bahamas

(Table 17).

These Guidelines are expected to become final, after comments have been incorporated, during the first half of 2006. All final and draft Guidelines are published on the Central Bank's web-site.

General Guidelines for Licence Applications

The General Information and Guidelines for Licence Applications were released by the Central Bank in December 2001. The document has been updated by the Policy Unit to reflect changes in the contact information of the Department as well as to clarify certain terms in the Guidelines. Amendments were also made to the Fee Schedule section of the Guidelines to reflect the current fees.

Outsourcing of Functions Within Banks

The Minimum Standards for Outsourcing Material Functions Guidelines were issued in late 2004. Since then, the Bank has received numerous applications from banks for approval of proposed outsourcing arrangements which cover a variety of functions traditionally performed in-house by banks, including treasury management and transaction processing facilities. In reviewing the outsourcing applications, much emphasis is placed on the comprehensiveness of service-level agreements, which are vetted by the Bank's Legal Unit for possible omissions regarding confidentiality of data, supervisory access, and other requirements, as set out in the Minimum Standards.

Towards Implementation of the New Capital Accord

The Central Bank is optimistic about the implementation of Basel II. The Bank Supervision Department fully supports the principles underlying and incorporated in the new Capital Accord (Basel II) and the implementation of Basel II in The Bahamas. However, while there are advantages to the implementation of the New Accord, the Bank anticipates important challenges related to resources and training and the need for enhanced home-host country supervisory co-operation for offshore banking centres like The Bahamas.

Basel I Status

The Bahamas is committed to implementing a capital adequacy regime which is appropriate to the maintenance of a strong international banking centre. This commitment is evidenced by the fact that the Central Bank, under the provisions of the Banks and Trust Companies Regulation Act 2000, mandates capital standards for licensees that are consistent with the Basel Capital Accord.

To date, however, the 1996 amendments to Basel I related to Market Risk and Netting Arrangements have not yet been introduced, partly due to the relatively small number of licensees which would have been obliged to comply with such provisions. The domestic/retail banks will generally be subject to relatively little market risk, given the existence of exchange control requirements and the limited domestic capital market activities of banks. Typically, approximately 25 of the international offshore licensees have more than 10% of their on and off-balance sheet assets in a form subject to market risk. Additionally, the liability driven nature of international/offshore banking in The Bahamas has led to capitalization levels which are considerably higher than the 8% minimum risk asset ratio requirement. This is due mainly to the Central Bank's policy that a portion of a bank's balance sheet should be diversified into high quality, liquid financial instruments which attract low risk weights.

A comprehensive draft Market Risk Guideline has been developed and is being reviewed by the Department for practicality in the Bahamian context. Plans are also underway to secure an appropriate consultant to review the draft Guideline and to assist in training selected staff in the mechanics of market risk assessment. Currently, the Department is conducting a limited impact study to determine the adequacy of applicable prudential returns in producing the necessary data for monitoring purposes. Consultation on the Market Risk Guideline is proposed for late 2006, with introduction of requirements scheduled for mid-2007.

Basel II Status

Regarding Basel II, work has commenced alongside that of the Market Risk project. The necessary legislative provisions to support Supervisory Review as defined under Pillar II, were engrained in the enhanced legislative landscape introduced in 2000, and over the last five years have been promulgated into Regulations and Guidelines. The legal basis for the implementation of Pillars I - III can be found in the Banks and Trust Companies Regulation Act, 2000 (BTCRA), which empowers the Inspector to set capital adequacy standards in line with the Basel Accord and allows also for directives to licensees to augment capital levels, when necessary. Prior to these provisions being enacted, the ability of the Central Bank to require additional capital had been supported by prudential norms. Further, in 2005 the Department released its capital adequacy guidelines to strengthen this practice and to increase transparency.

Regarding Pillar III, a Minimum Disclosure Guideline document is currently in the public domain for comments. These Guidelines will facilitate compliance with Basel II market disclosure provisions. A limited study to determine the potential compliance gap regarding the requirements of the Guidelines is scheduled for March, 2006. It is intended that these Guidelines be finalized and released before year-end 2006.

Basel II - The Road Ahead

The Bahamas is likely to allow its licensees to use a range of approaches as appropriate for their size and complexity, while also taking into account the approach of their parent banks, where applicable. It is expected that, for those stand-alone banking licensees which are solely incorporated in The Bahamas and for which The Bahamas serves as home regulator, the simplified and standardized approach as outlined in the Basel II document (www.bis.org) will be the most suitable in the short term. The Bank intends to fully implement Basel II for all licensees by 2010.

Interaction with Banks' External Auditors

In keeping with the intent to have regular discussions with external auditors, representatives of this fraternity met with the Governor, the Inspector, senior management of the Department and the Bank's Legal Counsel during the year. The role of the external auditors in the implementation of the Guidelines, finalized and released to licensees, in 2004, was an important part of the discussion agenda. The Guidelines discussed included, among others, Guidelines for the Measurement, Monitoring, and Control of Impaired Assets;

Guidelines for the Management of Capital and the Calculation of Capital Adequacy; and Guidelines for the Management of Large Exposures.

Auditors also gave their input on the draft Minimum Disclosure Requirements and the Guidelines on the Prevention & Detection of Money Laundering for Licensees, which was finalized in October, 2005; industry trends, and the Bahamas Institue of Chartered Accountants (BICA)/AML certificate.

Developments related to the Regulatory Framework

An important responsibility of the Department is to ensure that the legal framework for the regulation and supervision of banks and trust companies in The Bahamas remains relevant, current and consistent with international best practices. Consequently, the Policy Unit in consultation with the Legal Unit, actively reviews and amends, where required, regulations, guidelines or governing legal framework for licensees—taking into account both local and international developments. In all cases, financial sector participants, as well as other regulators, are widely consulted on all proposed regulations/guidelines.

In 2005, proposed amendments to the Banks and Trust Companies Regulations Act, 2000 to facilitate, the introduction and regulation of Private Trust Companies were drafted and submitted for industry consultation. Private Trust Companies are intended to act as trustees for trusts organized by a particular family and will be prohibited from offering services to the general public. Significant work has also been completed on draft amendments to provide for the regulation of Money Transmission Businesses.

Non-Executive Directors

Prompted by market demand to clarify the role and expectations of the Central Bank in relation to Non-Executive Directors, the Inspector held two workshops with Resident Non-Executive Directors (RNEDs), on the 29 November and 8 December 2005.

Regulatory Co-operation in The Bahamas

In 2005, the Group of Financial Service Regulators (GFSR)[1] that was formed in 2002, continued to work closely together to ensure greater harmonization of the existing regulatory regime. At the end of May 2005, Mr. Hillary Deveaux, the Acting Head of the Securities Commission of The Bahamas assumed the chairmanship of this body. During 2005, the GFSR met eight (8) times. In addition, there were a number of special focus meetings to discuss the supervision of financial conglomerates with activities falling under the jurisdiction of several or all of the regulatory agencies.

The GFSR published, at end-June 2005, an Information-Sharing Handbook,[2] designed to explain to overseas regulators the procedures required when they approach their Bahamian counterparts with requests for cross-border co-operation. The Central Bank also co-ordinated work by the regulators designed to demonstrate the success of The Bahamas in meeting overseas regulatory requests for co-operation on a timely and effective basis. This contributed to the decision by the Financial Action Task Force (FATF) at the end of October 2005, to remove The Bahamas from its monitoring list.

Regulatory Reform

In June 2005, the Government appointed a Financial Services Regulatory Reform Commission, under the chairmanship of the Minister of State for Finance, Hon. James Smith, to consider options for consolidating the various regulatory agencies. The Commission's membership includes representatives from each of the regulatory institutions, along with Sir William Allen. The areas of review include the legal framework, resources and costs of regulation and operable financial regulatory models that are possible for adapting to the local situation. A draft proposal is due to be presented to the Government before year-end.

CFATF Mutual Evaluation Questionnaire

In 2005, the Policy Unit, in preparation for the Caribbean Financial Action Task Force Evaluation in May 2006, took part in the completion of the CFATF

[1] This group consists of representatives of the Central Bank, the Securities Commission, Registrar of Insurance, Compliance Commission, the Inspector of Financial & Corporate Service Providers and the Department of Co-operatives.
[2] This information is available on the Central Bank's web-site.

Mutual Evaluation Questionnaire. This exercise was carried out in conjunction with other staff members of BSD, the Legal Unit and the Research Department.

Caribbean Technical Working Group on Corporate Governance (CTWG)

The Caribbean Corporate Governance Forum (CCGF) was established in September 2003 to promote good standards of corporate governance in the Caribbean. The Forum established the CTWG to pilot the development of Corporate Governance activities in the Caribbean and to function as the working committee for Corporate Governance in the region. The Central Bank, through its Bank Supervision Policy and Legal Units, continues to follow this initiative.

The Bank Supervision Policy Unit is currently reviewing the Basel Committee on Banking Supervision's latest release on Corporate Governance in banks. Subsequent to this review, changes will be made to the Bank's 2001 Corporate Governance Guidelines, should it be necessary to do so.

International Regulatory Co-operation

Foreign bank regulators continued to conduct, either in person or through agents, on-site examinations of Bahamian licensees owned by banks in these countries. Such examinations are allowed, with strict protection of Bahamian confidentiality laws, for the purposes of consolidated supervision. Banking regulators from Costa Rica, Peru and Switzerland were among those who took advantage of these provisions. During the year, Memoranda of Understanding covering co-operation between the Central Bank and its foreign counterparts were signed with Brazil and Peru. The formalising of these memoranda brings the total signed to five [5]. The Bank also has agreed and signed onto a multilateral memorandum of understanding with CARICOM member Central Banks and the Monetary Authority of the Cayman Islands, the British Virgin Islands' Financial Services Commission, and the Central Bank of the Netherlands Antilles.

During 2005, the Central Bank co-operated with other foreign regulators, receiving and responding to 33 requests from 20 countries (see Table 18). This compares with 28 requests from 19 countries in 2004. In a number of cases, the Central Bank dealt with requests which had originally been received by the Securities Commission; however, because of the latter's narrower powers, these requests were transferred to the Central Bank. Most of the queries came from North American regulators and related to requests for information arising out of investigations of insider trading or market manipulation. A number of Central Bank licensees and others co-operated under the Central Bank's powers as set out in the Central Bank of The Bahamas Act, 2000.

TABLE 18: Requests for Co-operation from Foreign Regulatory Authorities in 2005

Country	No. of Requests	Completed	Outstanding
British Virgin Islands	2	2	
St. Lucia	1	1	
Trinidad & Tobago	3	3	
United States	5	2	3*
Panama	3	3	
Guernsey	2	2	
Canada	4	3	1*
Guyana	1	1	
El Salvador	1	1	
Jersey	1	1	
Italy	1	1	
Barbados	1	1	
Mauritius	1	1	
Netherlands	1	1	
Belize	1	1	
Cayman Islands	1	1	
Ecuador	1	1	
Nigeria	1	1	
Peru	1	1	
Colombia	1	1	

Source: Central Bank of The Bahamas
Note: * In these cases, data have been provided but additional "follow-up" requests were still being processed at year end.

Letters to Home Regulators

As of May, 2005, the Inspector initiated a process of annual communication with the Home Regulators of the Central Bank's licensees. The United States' Federal Reserve Board, French, Swiss, British, Brazilian, and Spanish regulators were among the home regulators which were given an overview of the operations of subsidiaries or branches while being requested to give their comments on the condition of the parent and its operations. The rate of response to requests from home regulators was very positive, and the Bank intends to continue with these annual letters.

Memberships in International and Regional Bodies

The Bank continues to be an active participant in discussions on issues that affect regional and cross-border bank supervision. Such topics of interest in 2005 included international cooperation, AML/CFT issues, and harmonisation of legislative provisions. The Bank Supervision Department currently maintains membership in the following international and regional bodies.

- Association of Banks of the Americas [ASBA] www.asbaweb.org
- Offshore Group of Banking Supervisors [OGBS], and www.ogbs.net
- Caribbean Group of Banking Supervisors [CGBS] www.cgbsnet.org

Several of the Department's staff currently serve as financial experts for the Caribbean Financial Action Task Force mutual evaluations.

Human Resources and Training

The Department's staff complement at end-2005 remained at 52, as new staff replaced persons who had moved on to new endeavors. During the year, a coordinator of training was appointed to focus resources in updating the training program and identifying key areas that required special attention, and significant sums were approved for management and staff training for 2006. The training program will concentrate primarily on several key areas: market risk, advanced credit risk, anti-money laundering monitoring, and advanced risk management. A strong emphasis will remain on in-house training and the availing of courses and seminars offered by other agencies both locally and overseas.

For 2005, the staff benefited from specialized training provided by the Financial Stability Institute, the Caribbean Group of Banking Supervisors, the United States Federal Reserve System, OFSI, CARTAC, and the Association of Supervisors of the Americas.

In October 2005, the Central Bank sponsored a 'Risk Based Supervision Course' for the Department's staff and regional and domestic colleagues, which was facilitated by OSFI. During the year, the Department's senior staff along with the Legal Counsel also organized and held several round table sessions with senior industry staff to discuss the provisions as contained in the 'Guidelines for licensees on the prevention of money laundering and countering the financing of terrorism'.

Work Agenda for 2006

In addition to fulfilling its normal supervisory and regulatory tasks, the Department intends to place particular focus on the following issues during 2006:

- Continued regular contact and interaction with the directors and management of each individual licensee, in order to maintain and update the Department's understanding of its business model, risk profile and risk-management processes, and with a view to achieving effective and efficient risk-based supervision.
- Active engagement of industry professionals, inclusive of external auditors, Bahamas Financial Services Board, Bahamas Association of Compliance Officers, and senior officers of licensees.
- Preparatory work towards implementation of the Market Risk component of Basel I, alongside work on areas of Basel II.
- Active participation in the CFATF mutual evaluation.
- Ongoing review and continued updating of the regulatory framework and the Department's supervisory process and procedures to ensure that they remain in line with international and local standards and

developments, including Basel II.

- Focused on-site examinations to confirm implementation of AML/CFT Guidelines.
- Continued participation in the initiatives and activities of international and regional bank-supervisory bodies, such as the CFATF, OGBS, CGBS and ASBA.
- Ongoing monitoring of the status of banks' corporate governance.
- Ongoing combating and investigation of bogus operations.

Deposit Insurance Corporation

The Deposit Insurance Corporation (DIC) is a strategic component of the prudential regulation and supervision of the domestic banking sector, providing coverage to thirteen (13) member institutions in 2005. The DIC insures Bahamian dollar deposits up to a maximum of $50,000 to any single depositor in each member institution. Member institutions do not hold any equity position in the DIC.

The DIC invests in Bahamas Government Registered Stocks (BGRS), which earn interest rates tied to the Nassau Prime Rate. Investments at end-2005 amounted to $3.9 million compared to $1.9 million in 2004. The $6.75 million in startup bonds were repaid in 2004 from the DIC's accumulated premiums.

The DIC assesses member institutions on an annual premium equal to one-twentieth of one percent of the sum of an amount equal to the average of the sum of deposits insured by the DIC as of March 31 and September 30, in the immediately preceding premium year. Based on average total insurable Bahamian dollar bank deposits of $3.7 billion during 2004 as compared to $3.4 billion in 2003, premiums levied and collected in 2005 amounted to $1.8 million compared to $1.7 million in 2004. At end-2005, the accumulated assets of the Fund stood at $4.9 million compared with $2.9 million in 2004.

INFORMATION TECHNOLOGY

During the year, the Information Technology Department audited its communication and infrastructure platforms, with a view to increasing efficiency, reliability and security. The Department upgraded its hubs and cabling equipment and implemented a Disaster Recovery Plan.

In 2005, the Bank made a decision to upgrade its Oracle Application software to the latest level A73 Programme Temporary Fixed time (P&F) 16, which provided web interface functionality. In an effort to streamline the Administration Department's activities, a decision was taken to acquire the Oracle Corporation's Procurement and Subcontract Management & Inventory Management Modules. The Lotus Notes System, which hosts the Bank's HR forms, was optimized and enhanced for greater efficiency, and major enhancements and modifications were made to various application systems in line with user requirements.

LEGAL UNIT

During 2005, the Legal Unit continued to assist the Bank in its review and application of international standards and initiatives and to advise the Bank on the effect of these standards on existing policies and procedures. The Unit, which was expanded by the addition of a Legal Officer, actively participated on the Bank's Policy Advisory Committee which is responsible for formulation and revision of the Bank's procedures and regulations. The Unit also prepared amendments to the Banks and Trust Companies Regulation Act, 2000 relating to the regulation of private trust companies and money transmission businesses.

Over the course of 2005, officers in the Unit participated in regional and international seminars and meetings which focused, among other things, on cross-border information exchange, misuse of corporate vehicles, legal aspects of securitisation for Central Banks, the impact of International treaties and documents on the decisions of National Courts, corporate governance, standards for combating money laundering and terrorist financing, the detection and prevention of serious financial crime, fraud, corruption and bribery.

Combating Money Laundering and Terrorist Financing

The Legal Unit, working together with the Bank Supervision and Research Department assisted

Box 4
The Bahamas Anti-Money Laundering and Combatting Financing of Terrorism Regime

The Bahamas has established international standards for its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime through the enactment of, inter alia, various pieces of legislation which provide the essential infrastructure for a properly functioning AML/CFT regime including:

- **The Proceeds of Crime Act, 2000:** which criminalizes money laundering related to drug trafficking and other serious offences. It provides for the search, seizure and confiscation of the proceeds of drug trafficking or any relevant offence as described in the Schedule of the Act, and for the registration and enforcement of foreign confiscation orders.
- **The Dangerous Drugs Act, 2000:** which incorporates the relevant provisions of the Vienna Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances. The Bahamas signed this Convention in 1988. The Act substantially re-enacts the provisions of the repealed Dangerous Drugs Act and makes new provisions for the forfeiture of personal property used while committing offences.
- **The Financial Intelligence Unit Act, 2000:** which established the Financial Intelligence Unit (FIU). The FIU is responsible for inter alia receiving, analyzing, obtaining and disseminating information which relates to or may relate to offences under the Proceeds of Crime Act, 2000.
- **The Financial Transactions Reporting Act, 2000 (FTRA) and the Financial Transactions Reporting Regulations, 2000 (FTRR):** which set out comprehensive customer due diligence (CDD) requirements for financial institutions and provide that CDD is to be carried out using a risk based approach. The FTRA and FTRR further set out requirements for, inter alia, verification of customer identity, record keeping and reporting of suspicious transactions by financial institutions. In October 2005 the Bank issued comprehensive Guidelines on the Prevention of Money Laundering and Combating the Financing of Terrorism for its licensees. The Central Bank. assesses its licensees' AML/CFT policies and procedures against these Guidelines during onsite examinations.
- **The Anti-Terrorism Act, 2004:** which defines and criminalizes the offence of terrorism and the financing of terrorism. The Act applies to actions, persons and property both inside and outside The Bahamas. The Anti-Terrorism Act also contains provisions for the freezing, forfeiture and disposal of funds used to facilitate terrorism.
- **The Financial and Corporate Service Providers Act, 2000:** which provides for the licensing and regulation of financial and corporate service providers dealing with, inter alia, registration, management and administration of international business companies (IBCs) and Exempted Limited Partnerships. Licensed corporate service providers must follow proper due diligence procedures in customer identity verification; maintain adequate records on the beneficial owners of IBC's; and the names and addresses of partners in Exempted Limited Partnerships. The Inspector of Financial and Corporate Service Providers is charged with responsibility to carry out on-site and off-site examinations to ensure statutory compliance with this Act and the Financial Transactions Reporting Act, 2000 by corporate service providers.

the Bank in the revision of its Anti-Money Laundering Guidelines. In October 2005, the Bank issued Guidelines on the Prevention of Money Laundering and Countering the Financing of Terrorism for its licensees. The Guidelines took into account the FATF's revised 40 Recommendations and the Special Recommendations for Combating the Financing of Terrorism. The Guidelines also incorporated both the mandatory minimum requirements of The Bahamas' amended anti-money laundering legislation and industry best practices. Box 4 provides an overview of The Bahamas' AML/CFT regime.

Staff of the Bank's Legal Unit together with staff from the Financial Intelligence Unit and the Compliance Commission represented the Caribbean Financial Action Task Force (CFATF) at the Financial Action Task Force's (FATF) typology meetings in Brazil in November 2005. The typology meeting focused on the misuse of corporate vehicles and trade-based money laundering. Staff of the Legal Unit also participated in The Bahamas' delegation at the CFATF Plenary XXII and Ministerial session held in Jamaica in October 2005.

INTERNAL AUDIT UNIT

During 2005, the Internal Audit Unit continued its efforts to ensure that key operational areas, including currency, external reserves management and correspondent Banks' Accounts reconciliations, were monitored on a continuous basis.

The Dormant Accounts review was a key audit completed during 2005. This audit involved a comprehensive review of the dormant accounts under the Bank's supervision for a period of some 15 years (including receipts of dormant accounts, and payment of claims). The Unit also assisted in the migration of the dormant accounts administration to a more functional database and reporting system developed within MIMICS. Other key audits undertaken included a review of the accounts payables process, which led to the Internal Audit Unit conducting a number of control self-assessment workshops, and a review of the internal controls over the Real Time Gross Settlement (RTGS) system.

Members of the Unit represented the Bank at the 8th Meeting of Central Bank Internal Auditors that was held in Rio de Janeiro, Brazil in August 2005 and the Directors of Central Bank Internal Auditors II Meeting, held in Jamaica in April 2005. The Internal Audit staff also participated in local training sponsored by the Institute of Internal Auditors.

ADMINISTRATION DEPARTMENT

In 2005, the Administration Department continued its oversight of several major capital projects, including the air conditioning upgrade in the Old Wing of the Bank, which was initiated in 2004 and substantially completed in December 2005. The Department also closely monitored the installation of a new 600 kw generator, the acquisition of a 5,000 gallon underground fuel tank and a new fresh water pumping system and the reconfiguration of the Bank's parking lot in an effort to create additional spaces for staff.

The Department continued to lend logistical support to major local and international conferences held under the auspices of the Bank, namely the ARCCBISS Conference in July, All Risk Management Seminar in October and the CCMS Conference in November.

ADMINISTRATION

THE BOARD

On 31 May 2005, Governor Julian Francis demitted office and was succeeded by Deputy Governor, Wendy Craigg, who assumed the Chair of the Board of Directors. Dr. Pandora Johnson, Vice President of Research, Planning and Development at the College of The Bahamas and Mr. Carleton Williams, MBE, a retired businessman, continued their membership on the Board. The Board extends appreciation to Governor Francis for his outstanding leadership.

OVERSEAS MEETINGS AND CONFERENCES

In July and December, Governor Craigg attended Central Bank Governors Meetings, held in Trinidad and Tobago and Belize, respectively, and in September, she attended the IMF/World Bank Annual Meetings held in Washington, D.C.

The Bank was also represented by other members of its Management Team and non-management employees at meetings and conferences overseas.

STAFF TRAINING, DEVELOPMENT AND RELATIONS

During the year, the Bank continued automation of Human Resources document processing within the Lotus Notes workflow environment, with the migration of staff loans to the system. Enhancements were also made to effect improvements in the annual performance review process. In December, after a brief delay, the Bank re-engaged consultants for the Organization and Compensation Review Exercise.

To enhance the safety and security of Bank facilities, employees and visitors, electronic identification (ID) and card access systems were introduced by the Bank.

The Bank again committed significant resources to employee training and development as was demonstrated by its sponsorship of over 204 attendances at local and international seminars, courses and meetings. Enrolments in international training programmes totalled 94 and, in addition to domestic and overseas training programmes, employees of the Bank participated in 13 in-house training and development workshops and seminars, inclusive of the Annual Induction Training Course. Staff enrolment in self-initiated continuing education programmes was consistent throughout the year. Presently, 46 employees are benefiting from tuition and text-book subsidies under the Staff Training Incentive Programme. Moreover, four employees are currently enrolled in full-time programmes at The College of The Bahamas, McGill University and the American University, under the Bank's in-service awards programme.

At the 2005 Long Service Awards Presentation Ceremony, the Bank recognized seven (7) employees for thirty years of service, three (3) employees for twenty years of service and five (5) employees for ten years of service.

STAFF COMPLEMENT

As at 31 December 2005, the staff complement stood at 233, which included 204 permanent and 29 contractual employees. Thirteen (13) employees resigned during the year, five (5) retired and one (1) was terminated. New recruits totalled thirteen (13).

PUBLIC RELATIONS

The 22nd Annual Art Competition and Exhibition was successfully hosted in November with the usual support from local High Schools and the College of The Bahamas. As anticipated, several entries were received from the Family Island schools.

ACKNOWLEDGEMENT

The Board of Directors extends its sincere appreciation to all employees for their continued dedication and service during the past year.

MANAGEMENT'S REPORT

The Central Bank of The Bahamas' Financial Statements for the year ended December 31, 2005, along with comparative figures for 2004, are shown on pages 45 to 68.

Total assets of the Bank declined by $87.5 million (10.3%), mainly on account of a $89.0 million (13.3%) reduction in external assets to $578.8 million. The latter comprised a $165.7 million (53.3%) reduction in foreign currency deposits, which completely offset the increase in marketable securities of $77.0 million (22.5%). Fixed assets grew by $1.2 million (9.4%).

The Bank's total liabilities declined by $87.5 million (10.3%), led by a $94.5 million (12.8%) contraction in demand liabilities. In particular, deposits by commercial banks decreased by $97.4 million (25.4%), and deposits by the Bahamas Government and its agencies, by $41.5 million (43.6%). Some offset was provided by the $45.9 million (18.7%) hike in total currency in circulation.

Higher yields on foreign assets combined with growth in average reserve holdings supported a $10.1 million (40.2%) rise in operating income to $35.2 million. Expenses grew by $2.8 million (11.6%) to $27.0 million, resulting in an overall increase in profits from operations of $7.3 million (778.7%) to $8.3 million.

The Central Bank of The Bahamas

FINANCIAL STATEMENTS

31 December 2005

BDO Mann Judd
P O Box N 10144
Nassau, Bahamas

Pannell Kerr Forster
P O Box N 8335
Nassau, Bahamas

REPORT OF THE AUDITORS TO THE DIRECTORS OF
THE CENTRAL BANK OF THE BAHAMAS

We have audited the accompanying balance sheet of the Central Bank of The Bahamas as at 31 December 2005 and the related statements of profit, changes in capital and reserves and cash flows for the year then ended. These financial statements are the responsibility of the management of the Central Bank of The Bahamas. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly in all material respects, the financial position of the Central Bank of The Bahamas as at 31 December 2005 and the results of its operations, changes in capital and reserves, and cash flows for the year then ended, in accordance with International Financial Reporting Standards, and in all material respects, comply with the Central Bank of The Bahamas Act, 2000.

BDO Mann Judd

Pannell Kerr Forster

Chartered Accountants
Nassau Bahamas
12 April, 2006

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 DECEMBER 2005

(Expressed in Bahamian Dollars)

	Notes	2005 $	2004 $
ASSETS			
FIXED ASSETS	4	14,051,923	12,839,331
EXTERNAL ASSETS	5		
Foreign currency deposits		145,398,558	311,069,071
Marketable securities issued or guaranteed by foreign governments	6	419,134,652	342,149,332
Accrued interest receivable on foreign currency		5,305,732	4,852,240
International Monetary Fund	7		
Bahamas reserve tranche		8,948,165	9,722,870
Special drawing rights		9,333	29,684
		578,796,440	667,823,197
OTHER ASSETS			
Bahamas Mortgage Corporation bonds	8	300,000	300,000
Advances to the Bahamas Government	9	76,987,608	71,018,608
Bahamas Government registered stocks	10	72,694,600	78,516,600
Loans to Bahamas Government agency	11	7,300,000	7,575,000
The Bridge Authority bonds	12	743,300	688,000
Accrued interest, receivables and other accounts		12,946,788	12,582,601
		170,972,296	170,680,809
		$763,820,659	$851,343,337

The notes on pages 53 to 68 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 DECEMBER 2005

(Expressed in Bahamian Dollars)

	Notes	2005 $	2004 $
LIABILITIES, CAPITAL AND RESERVES			
DEMAND LIABILITIES			
Notes in circulation		286,291,928	241,240,744
Coins in circulation		14,892,693	14,039,578
Deposits by commercial banks	13	286,229,823	383,675,086
Deposits by The Bahamas Government and Bahamas Government agencies		53,792,324	95,319,083
Deposits by international agencies	14	782,706	755,624
Accrued interest, payables and other accounts		2,851,915	3,314,052
Provision for payment into the Consolidated Fund	16	—	1,000,000
		644,841,389	739,344,167
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	15	14,621,388	15,887,264
CAPITAL AND RESERVES			
Authorised and fully paid capital		3,000,000	3,000,000
Exchange equalisation account	16	154,046	(237,893)
Contingency reserve	16	750,000	750,000
Other reserves	16	13,758,811	13,758,811
General reserves	16	86,695,025	78,840,988
		104,357,882	96,111,906
		$763,820,659	$851,343,337

The statements were approved by the board of directors and authorised for issue on 5 April, 2006, and are signed on its behalf by:

Governor

Director

The notes on pages 53 to 68 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF PROFIT

FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 $	2004 $
INCOME	17	35,249,180	25,135,708
EXPENSES	18	27,003,204	24,197,272
NET PROFIT FOR THE YEAR		$8,245,976	$938,436

The notes on pages 53 to 68 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CHANGES IN CAPITAL AND RESERVES

FOR THE YEAR ENDED 31 DECEMBER 2005

	Authorized and fully paid capital	Exchange equalisation account	Contingency reserve	Other reserves	General reserves	Total
	$	**$**	**$**	**$**	**$**	**$**
Balance at 1 January 2004	3,000,000	1,043	750,000	13,758,811	77,663,616	95,173,470
Net profit for the year	—	—	—	—	938,436	938,436
Transfer of unrealised exchange losses	—	(238,936)	—	—	238,936	—
Balance at 31 December 2004	3,000,000	(237,893)	750,000	13,758,811	78,840,988	96,111,906
Net profit for the year	—	—	—	—	8,245,976	8,245,976
Transfer of unrealised exchange gains	—	391,939	—	—	(391,939)	—
Balance at 31 December 2005	$3,000,000	$154,046	$750,000	$13,758,811	$86,695,025	$104,357,882

The notes on pages 53 to 68 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005

	2005 $	2004 $
CASH FLOWS FROM OPERATING ACTIVITIES:		
Profit for the year	8,245,976	938,436
Adjustment for items not involving the movement of cash:		
Amortisation of premiums on marketable securities	6,014,680	2,710,918
Depreciation	1,675,362	1,350,030
Gain on sale of fixed assets	(31,567)	–
Interest income	(32,721,196)	(23,829,552)
Interest expense	389,461	251,496
Net cash used in operating activities before changes in operating assets and liabilities	(16,427,284)	(18,578,672)
(Increase)/decrease in operating assets:		
International Monetary Fund - Special Drawing Rights	(470,820)	231,844
Receivables and other accounts	(768,962)	(892,931)
(Decrease)/increase in operating liabilities:		
Notes in circulation	45,051,184	14,531,978
Coins in circulation	853,115	840,570
Deposits by commercial banks	(97,445,263)	139,175,952
Deposits by The Bahamas Government and Bahamas Government agencies	(41,526,759)	67,345,269
Deposits by international agencies	27,082	(211,543)
Payables and other accounts	(462,137)	(1,095,496)
Net cash (used)/provided by operating activities	(111,169,844)	201,346,971

The notes on pages 53 to 68 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005

	2005 $	2004 $
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities	(110,000,000)	(90,000,000)
Proceeds from maturities of marketable securities	27,000,000	32,500,000
Purchases of fixed assets	(2,907,842)	(1,955,885)
Proceeds from sale of fixed assets	51,455	2,845
Advances to Bahamas Government	(5,969,000)	—
Purchase of The Bridge Authority bonds	(53,300)	(91,000)
Purchases of Bahamas Government registered stocks	(112,244,300)	(59,026,200)
Proceeds from sales and maturities of Bahamas Government registered stocks	118,066,300	24,291,200
Loans to Bahamas Government Agency	—	(1,500,000)
Repayments of loan by Bahamas Government agency	275,000	275,000
Interest received	32,659,316	21,782,284
Net cash used by investing activities	(53,124,371)	(73,721,756)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment to the Consolidated Fund	(1,000,000)	—
Interest paid	(389,461)	(251,496)
Net cash used by financing activities	(1,389,461)	(251,496)
Net (decrease)/increase in cash and cash equivalents	(165,683,676)	127,373,719
Cash and cash equivalents at beginning of the year	311,130,951	183,757,232
Cash and cash equivalents at end of the year	$145,447,275	$311,130,951
Cash and cash equivalents are comprised of the following:		
Foreign currency deposits	145,398,558	311,069,071
Cash on hand (included in accrued interest, receivables and other accounts)	48,717	61,880
	$145,447,275	$311,130,951

The notes on pages 53 to 68 form an integral part of these financial statements.

1. INCORPORATION AND ACTIVITIES

The Central Bank of The Bahamas (the Bank) was established under the Central Bank of The Bahamas Act Chapter 321, 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, credit and balance of payments conditions conducive to the orderly development of the Bahamian economy.

2. BASIS OF PREPARATION

The accompanying financial statements have been prepared on a going concern basis and in accordance with International Financial Reporting Standards (IFRS). The financials have also been prepared under the historical cost convention, as modified by marketable securities. The preparation of the financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the year. Actual results can differ from those estimates.

3. ACCOUNTING POLICIES

Significant accounting policies used in the preparation of these financial statements are noted below.

Revenue recognition

Revenues are recognised under the accruals concept.

Foreign currencies

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 balance sheet date are converted at the closing rate of exchange prevailing at the balance sheet date.

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

3. ACCOUNTING POLICIES (cont)

Fixed assets

Fixed assets are recorded at cost less accumulated depreciation. Depreciation is provided in equal annual installments so as to write off the cost of assets, other than land, over their estimated useful lives. The following rates are used:

Buildings & renovation	2% - 20% p.a.
Office equipment	20% - 33% p.a.
Computer software	33% - 50% p.a.
Office furniture & fittings	20% p.a.
Other fixed assets	20% - 33% p.a.

Marketable securities issued or guaranteed by foreign governments

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

Bahamas Mortgage Corporation bonds

Bahamas Mortgage Corporation bonds are classified as available-for-sale investments and are stated at fair value.

Advances to the Bahamas Government

The advances are classified as loans and receivables originated by the enterprise and not held for trading. These loans, which are payable on demand, are stated at cost. These loans are subject to review for impairment.

Bahamas Government registered stocks

Bahamas Government registered stocks are classified as available-for-sale investments and are stated at fair value.

Loans to Bahamas Government Agency

The loans are classified as loans and receivables originated by the enterprise and not held for trading. These loans, which have a fixed maturity period, are measured at amortised cost, using the effective interest rate method. These loans are subject to review for impairment.

3. ACCOUNTING POLICIES (cont)

The Bridge Authority bonds

The Bridge Authority bonds are classified as available-for-sale investments and are stated at fair value.

Numismatic coins

Numismatic coins, which are specially minted or packaged as collectors' items and which 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 profit.

Retirement benefit costs

The Bank operates a defined benefit contributory pension plan covering substantially all full-time employees. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet 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 amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for the unrecognised actuarial gains and losses and unrecognised 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 unrecognised actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

Fiduciary items

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

4. FIXED ASSETS

	Land	Buildings & renovations	Office equipment	Computer software	Office Furniture & fittings	Other fixed assets	Total
	$	$	$	$	$	$	$
COST							
1 January 2005	2,452,938	11,549,614	5,857,794	5,956,599	2,850,992	486,870	29,154,807
Additions	—	152,841	2,403,156	93,607	155,733	102,505	2,907,842
Disposals	—	—	(20,000)	—	—	(196,819)	(216,819)
31 December 2005	2,452,938	11,702,455	8,240,950	6,050,206	3,006,725	392,556	31,845,830
DEPRECIATION							
1 January 2005	—	3,593,583	4,852,938	5,060,453	2,409,000	399,502	16,315,476
Charge for the year	—	266,483	316,317	862,355	193,292	36,915	1,675,362
Disposals	—	—	(20,000)	—	—	(176,931)	(196,931)
31 December 2005	—	3,860,066	5,149,255	5,922,808	2,602,292	259,486	17,793,907
NET BOOK VALUE							
31 December 2005	$2,452,938	$7,842,389	$3,091,695	$127,398	$404,433	$133,070	$14,051,923
31 December 2004	$2,452,938	$7,956,031	$1,004,856	$896,146	$441,992	$87,368	$12,839,331

Management has reviewed the fixed assets and concluded that none of them are impaired.

5. EXTERNAL ASSETS

External assets comprise of those assets defined as such 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 the year end, external assets represented approximately 89.07% (2004: 90.33%) of such liabilities.

6. 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 31 December 2005, marketable securities held by the Bank, which mature after 5 years, constituted 12.24% (2004: 3.24%) of the Bank's external assets.

	2005 **$**	**2004** **$**
Within 60 days	5,014,240	2,049,038
60 days to 1 year	45,470,340	25,724,933
1 to 5 years	297,785,442	292,749,043
After 5 years	70,864,630	21,626,318
	$419,134,652	$342,149,332

Market value of these securities at the balance sheet date was $417,634,652 (2004: $340,649,332). These securities bear interest at rates varying between 2.62% and 5.00% (2004: 2.62% and 7.50%)

7. INTERNATIONAL MONETARY FUND

Bahamas Reserve 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:

	2005		2004	
	SDR (millions)	$	SDR (millions)	$
Quota	130.3	186,233,923	130.3	202,357,454
Subscription payments in promissory notes	(119.4)	(170,667,244)	(119.2)	(185,121,392)
Subscription payments in currency	(4.6)	(6,618,514)	(4.8)	(7,513,192)
Reserve tranche	SDR6.3million	$8,948,165	SDR6.3million	$9,722,870

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 $51,393,581 (2004: $72,746,915). Consequently, this amount is regarded as a contingent liability and is not recognised in the Bank's balance sheet.

Special Drawing Rights

This amount represents SDR holdings with the IMF, is repayable on demand and bears interest at rates varying from 2.22% to 3.03% (2004: 1.57% to 2.24%).

8. BAHAMAS MORTGAGE CORPORATION BONDS

These bonds bear interest at a rate of 2.00% (2004: 2.00%) per annum below the Prime rate and mature as noted below:

	2005	2004
Between 2-3 years	$300,000	$300,000

9. ADVANCES TO THE 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 10% of either the annual average ordinary revenue of the Government over the three preceding years for which the accounts have been laid before Parliament or the estimated ordinary revenue of the Government for the year, whichever is the less.

At the balance sheet date, advances to the Government approximated 10% (2004: 9.22%) of the lesser of such revenues. Of those advances $34,000,000 (2004: $34,000,000) bear interest at a rate of 1.09% (2004: 1.09%) and $5,969,000 (2004: Nil) bear interest at a rate of 0.08% (2004: Nil). The remaining advances were interest free during both 2005 and 2004. The advances are repayable on demand.

10. BAHAMAS GOVERNMENT REGISTERED STOCKS

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 balance sheet date, Bahamas Government Registered Stocks held by the Bank which mature beyond five years after their date of issue was approximately 11.19% (2004: 10.62%) of such liabilities.

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 such securities maturing beyond 20 years at either 31 December 2005 or 2004.

10. BAHAMAS GOVERNMENT REGISTERED STOCKS (cont)

Bahamas Government Registered Stocks bear interest at rates ranging between 5.60% and 6.75% (2004: 6.12% and 9.50%) and mature as noted below:

	2005 $	2004 $
60 days to 1 year	—	16,000
1 to 5 years	100	600
More than 5 years	72,694,500	78,500,000
	$72,694,600	$78,516,600

11. LOANS TO BAHAMAS GOVERNMENT AGENCY

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

The advances bear interest at 2.00% (2004: 2.00%) and mature as noted below:

	2005 $	2004 $
More than 5 years	$7,300,000	$7,575,000

12. THE BRIDGE AUTHORITY BONDS

These bonds bear interest at rates ranging from 1.00% to 1.50% (2004: 1.00% to 1.50%) per annum over the Prime rate, and mature as noted below:

	2005	2004
More than 5 years	$743,300	$688,000

13. DEPOSITS BY COMMERCIAL BANKS

Deposits by commercial banks consist of current account balances deposited as statutory reserves in accordance with Section 19 of the Act.

The present level of the statutory reserves applicable to commercial banks is 5.00% of the total Bahamian dollar deposit liabilities, of which at least 4.00% 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.

14. 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 and the Commission of the European Development Fund. These deposits are interest free and are repayable on demand.

15. INTERNATIONAL MONETARY FUND ALLOCATION OF SPECIAL DRAWING RIGHTS

In accordance with a resolution of The Board of Governors of the IMF, effective 11 December 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. The Special Drawing Rights allocation bore interest during the year at rates varying between 2.22% and 3.03% (2004: 1.57% and 2.24%) and is repayable on demand.

16. RESERVES

a **Exchange equalisation account** - Under the terms of Sections 32(2)(a) and 32(2)(b) of the Act, this account represents the net unrealised profits or losses arising from the revaluation of foreign currency assets and liabilities of the Bank at the balance sheet date.

b **Contingency reserve** - This reserve is maintained in accordance with the provisions of Section 7(1) of the Act.

c **Other reserves** - In accordance with the provisions of Section 7(1) of the Act, the Bank has determined that there will be no transfer from other reserves to general reserves. In 2004 an amount of $Nil was transferred from other reserves to general reserves.

d **General reserves** - Section 7(2) of the Act requires that at the end of any year where the amount in the general reserves exceed twice the authorised 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 reserves at the year end amounted to $86,695,025 (2004: $78,840,988) equivalent to 13.44% (2004: 10.68%) of demand liabilities prior to a provision of $Nil (2004: $Nil) to be paid into the Consolidated Fund.

17. INCOME

	2005	**2004**
	$	**$**
Interest income	32,721,196	23,829,552
Other operating income	2,527,984	1,306,156
	$35,249,180	$25,135,708

18. EXPENSES

	2005 $	2004 $
General & administrative expenses	12,892,737	12,045,425
Staff costs	11,432,394	10,550,321
Depreciation expense	1,675,362	1,350,030
Loss on bank loans	613,250	—
Interest expense	389,461	251,496
	$27,003,204	$24,197,272

19. 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 representing 100% of the paid-up portion of the capital of The Deposit Insurance Corporation. This Corporation was established to manage The Deposit Insurance Fund, which was established to protect funds deposited 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 Deposit Insurance Corporation 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 Deposit Insurance Corporation will be recoverable, and consequently the Bank has made a full provision against this investment.

20. COMMITMENTS

The Bank is committed to rent office space under an operating lease. The Bank is committed to the following future payments under the lease agreement:

Years	$
2006	434,154
2007	434,154
2008	434,154
2009	86,352
2010	21,996

21. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities.

EXTERNAL ASSETS	**2005**	**2004**
	%	%
Geographic Region		
North America	96.76	87.62
Europe	0.44	9.96
Other	2.80	2.42
Industry		
Financial Sector	100.00	100.00

OTHER ASSETS	**2005**	**2004**
	%	%
Geographic Region		
Bahamas	100.00	100.00
Industry		
Government Sector	100.00	100.00

DEMAND LIABILITIES	**2005**	**2004**
	%	%
Geographic Region		
Bahamas	99.88	99.84
Other	0.12	0.16
Industry		
Financial Sector	100.00	100.00

OTHER LIABILITIES	**2005**	**2004**
	%	%
Geographic Region		
International Agencies	100.00	100.00
Industry		
Financial Sector	100.00	100.00

22. RELATED-PARTY TRANSACTIONS

The following transactions were carried out with related parties:

a Key management compensation:	2005
	$
Salaries and other short-term employee benefits	1,017,462
Termination benefits	198,871
	$1,216,333

b Loans to key management of the bank:	2005
	$
Beginning of the year	971,883
Loans advanced during the year	30,000
Loans repayment received	(127,306)
End of year	$874,577

23. CONTINGENT LIABILITIES

The Bank is party to a number of asserted and unasserted claims in the normal course of business, including a number from a former licensee, which are at varying stages of the judicial process. The Bank is vigorously defending all such claims and is of the opinion that the outcome, which cannot presently be determined, will not adversely affect its operations.

24. OFF BALANCE SHEET ITEMS

The Bank has off balance sheet items totalling $34,235,008 (2004: $38,584,791). These items, which are held in a fiduciary capacity, comprise of offsetting assets consisting of bank accounts, and liabilities consisting of dormant retail customer accounts of $34,235,008 (2004: $32,908,959) and a sinking fund of $Nil (2004: $5,675,832).

24. OFF BALANCE SHEET ITEMS (cont)

Certain dormant retail customer accounts, which are received in foreign currencies, are invested in the same currency. These currencies are converted to Bahamian Dollars at the rate of exchange prevailing at the date of accepting their funds, and listed as a memorandum account in the trial balance. Foreign currency deposits are repaid, by liquidating investments in the same currency, which does not involve currency conversion.

25. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Directors consider that, with the exception of marketable securities issued or guaranteed by foreign Governments, all of the Bank's financial assets and liabilities are carried at amounts approximating fair value. The market value of those marketable securities is as stated in note 6.

26. MATURITIES OF FINANCIAL INSTRUMENTS

Except as otherwise stated in notes 6 to 15, the Bank's significant financial assets and liabilities mature within one year of the balance sheet date.

27. INTEREST RATE RISK

Except as otherwise stated in notes 6 to 15, the Bank's financial assets and liabilities do not carry any exposure to interest rate risk.

28. CREDIT RISK

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.

29. DEFINED BENEFIT CONTRIBUTORY PENSION PLAN

The Bank operates a defined benefit contributory pension plan for the majority of its employees.

The amount recognised as an asset in the Balance Sheet in respect of the Bank's defined benefit contributory pension plan is as follows:

	2005 $	2004 $
Present value of funded obligations	(26,465,605)	(27,556,688)
Fair value of plan assets	32,094,290	30,540,884
	5,628,685	2,984,196
Unrecognised actuarial gains	(2,818,111)	(39,118)
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	$2,810,574	$2,945,078

The expense recognised in the statement of profit in respect of the Bank's defined benefit pension plan is as follows:

	2005 $	2004 $
Current service cost	1,047,008	999,778
Interest cost	1,725,546	1,585,581
Expected return on plan assets	(2,122,890)	(1,995,345)
	$649,664	$590,014

29. DEFINED BENEFIT CONTRIBUTORY PENSION PLAN (cont'd)

Movements in the net asset recorded in the balance sheet are as follows:

	2005 $	2004 $
Net asset at beginning of the year	2,945,078	3,002,034
Net expense recognised in the statement of profit	(649,664)	(590,014)
Employer contributions	515,160	533,058
Net asset at end of the year	$2,810,574	$2,945,078

Principal actuarial assumptions used at the balance sheet date are as follows:

	2005	2004
Discount rate	6.25%	6.25%
Expected return on plan assets	7.00%	7.00%
Expected rate of salary increase at 18	9.00%	9.00%
Expected rate of salary increase at 59	2.00%	2.00%
Average expected remaining working lives of employees (years)	19.00	20.00

The actual return on plan assets during the year was $1,981,172 (2004: $1,974,895).

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