Financial Stability Report December, 2021

Issue No. 10

The Financial Stability Report is a publication of The Central Bank of The Bahamas, prepared by The Research Department for issue in August. All correspondence pertaining to the Report should be addressed to:

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PREFACE

As part of its statutory mandate, the Central Bank of The Bahamas is required *"to ensure the stability of the financial system".* This report analyses key financial sector developments and assesses the underlying risks to financial stability in the domestic economy. It considers the financial system's ability to withstand shocks and function well enough to contribute to the healthy performance of the economy.

This Financial Stability Report (FSR) relies on data from the key regulators of the domestic financial system, which include the Central Bank, as the supervisor of banks, credit unions, money transmission business and payment service providers; the Securities Commission, the regulator for the securities industry; and the Insurance Commission, with responsibility for the insurance industry. It summarises the macroeconomic environment, provides an overview of key developments within the financial sector and assesses potential risks to the health of the system.

The first FSR was published in 2013 and the report is currently an annual publication.

EXECUTIVE SUMMARY

Risks within the financial sector remained contained during 2021, as the Central Bank maintained its risk-based approach to financial supervision, although with ongoing adjustments to the Novel Coronavirus (COVID-19) pandemic. As a result, surveillance continued for both domestic and international supervised financial institutions (SFIs), to ensure that financial and business continuity risks posed by the pandemic were mitigated. Due to the effectiveness of vaccines and the reduction of travel restriction in 2021, the international and domestic economy alike began the initial stages of recovery. As such, the negative impact of COVID-19 lessened, despite lingering effects.

In addition, the Bank continued to monitor SFIs' approach to adapting their operations under the restrained conditions of the pandemic, and the identified risk management challenges of the environment. Regulatory attention also sharpened around SFIs preparedness to address operations risks posed by severe hurricanes. Specifically, the Central Bank engaged with the Association of International Banks & Trusts ("AIBT") and the Clearing Banks Association ("CBA") to release two codes of practice around practical guidance for dealing with such disruptions, in July 2021.

There is no immediate risk to financial stability within the banking system, given the commercial banks' high capital buffers and satisfactory provisioning levels. Consolidated stress test results—which evaluate credit, liquidity, and interest rate risks—showed that the domestic systemically important banks (DSIBs) remained resilient. At all levels of shocks, capital remained well above the the Bank's established minimum requirement of 17.00%. Moreover, the banking sector's average capital to risk-weighted assets ratio fluctuated between 26.87% and 32.14%. In addition, the Bank Stability Index (BSI) and the Aggregate Financial Stability Index (AFSI) revealed that the sector's stability was sustained in 2021 and there is no stability concerns.

Meanwhile, supervision of credit unions remained focused on multiple risk-based outcomes around Anti-Money Laundering/Know Your Customer (AML/KYC), corporate governance and credit risk management frameworks, and remediation efforts against on-site examination findings. More specifically, the Central Bank continued to monitor the loan repayment deferrals to eligible and impacted member at the onset of the pandemic, given the sector's very thin capital and liquidity buffers. During the year, credit unions overall profitability declined relative to the prior year, as asset quality and liquidity levels weakened. Nevertheless, capital adequacy levels remained above international benchmarks.

In the insurance sector, performance indicators for both life and non-life insurance providers varied during the year, but remained in-line with international targets. In particular, the dominant life insurance sector, as well as the non-life insurance, profitability recovered in 2021, relative to the prior year pandemic-related downturn. Moreover, the insurance sector remained sound, evidenced by the adequacy of its financial stability ratios.

In terms of payments, electronic instruments became the more prevailing form of payments for goods and services as a result of the pandemic. Thus, the Bank's key objective in payments modernization is to reduce heavy reliance on cash in the domestic market, and in December 2021 consulted with financial institutions and other payment service providers on the way forward in eliminating all domestic cheques. However, with regard to the consideration for new license applications for Payment Service Providers (PSPs) and Money Transmission Businesses (MTBs), the moratorium was extended to September 2022, in an effort to ensure the stable and orderly adjustment of participants in the payments space.

Over the medium-term, the Central Bank is committed to sustained active and diligent surveillance of financial institutions, in order to ensure the stability of the sector. Risk management strategies surrounding anti-money laundering (AML) and counter-financing of terrorists (CFT) will remain top priority. The Bank will also adopt policies that promote effective liquidity management, within the context of a recovery in the domestic economy and improved employment conditions, in order to mitigate the potential impact of higher credit demand on external reserves. In this context, robust liquidity could present accelerated medium-term credit expansion risk that would need to be managed. In April 2021, the credit bureau transitioned to live operations, with the majority of domestic banks and credit unions, in addition to 38 entities identified as having statutory obligation to report to the bureau. This will provide sufficient information to assess borrower's creditworthiness and establish both pricing and supply of credit by risk profiles.

STRUCTURE OF THE REPORT

To the extent that domestic and international economic conditions affect the financial stability these are taken up in Chapter 1 of this report. Chapters 2 to 4 assess stability indicators respectively, in the Banking, Credit Unions and Insurance sectors. This focus is limited to the domestic sector, as due to exchange control regulations a distinct separation is maintained between the balance sheets of the domestic and international sectors. Chapter 5, then presents a summary of the overall assessments and outlook, followed by the conclusion in Chapter 6. In Appendix 1, the overall structure of the financial sector is discussed, with emphasis on banks, credit unions and the insurance sector. Further, being an important aspect of the financial system, capital market developments are summarized in the appendix; although they do not pose any systemic concerns for financial stability.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

The Bahamian economy remains heavily reliant on global economic developments, which impacts the tourism sector. In 2021, the International Monetary Fund (IMF) estimated that the global economy experienced a 6.1% growth, a turnaround from a 3.1% contraction in 2020, when economic activity was largely affected by the Novel Coronavirus (COVID-19) pandemic and the global lockdown to contain the spread. Nevertheless, growth in 2022 is anticipated to moderate to 3.6%, attributed to geopolitical tensions in Eastern Europe, which has resulted in a rise in the cost of energy internationally.

In the United States, the annualized Gross Domestic Product (GDP) expanded by 5.7% in 2021, a reversal from a 3.5% decline in 2020, owing to advancements in private inventory investment, exports, personal consumption expenditures, and non-residential fixed investment. As a consequence of these developments, the jobless rate decreased by 2.7 percentage points to an annual average of 5.4% in 2021. Meanwhile, the annual inflation rate surged to 4.7% from 1.2% in 2020. Against this backdrop, the Federal Reserve maintained the target range for the federal funds rate at 0.00%-0.25%, in an effort to encourage further economic growth.

In other major economies, economic developments revealed positive trends. In Europe, amid the reduction of restrictions related to the spread of COVID-19, in the United Kingdom real GDP grew by an estimated 7.4%, a switch from a 9.9% reduction last year, underpinned by increases in all of the major sectors. Similarly, the euro area's real economic output rose by an annualized rate of 5.3%, vis-à-vis a 6.6% decline in 2020. In Asia, China's real GDP strengthened to an annualized 8.1%, surpassing the 2.3% expansion in 2020. Further, Japan's real output increased to 1.6%, a turnaround from a 4.8% falloff in the previous year.

1.2. Regional Environment

The economic performance improved for most Caribbean economies, as the region recorded a growth in 2021, following a contraction in the prior year. Nevertheless, unemployment rates stayed above pre-COVID levels and inflationary pressures heightened, reflective of soaring commodity prices and pandemic-induced supply-demand imbalances. Meanwhile, the regional financial sector remained stable and highly capitalized, bolstering its resilience to external shocks. Nonetheless, risks to tourism-based economies persisted owing to exposure to volatile conditions within key source markets, while commodity-based economies were adversely impacted by the variability in international prices. For the region, average real GDP rose by 6.3% in 2021, a turnaround from a COVID-19 related 6.0% decrease in 2020 (see Table 2). In particular, Belize and The Bahamas registered real economic growth of 9.8% and 15.6%, following respective reductions of 14.1% and 14.5% in the previous year. Further, Jamaica's economy grew by 4.4%, Eastern Caribbean, by 3.9% and Barbados, by 1.4%, vis-à-vis contractions of 10.2%, 14.0% and 17.6%, respectively, last year. In addition, the falloff in real output in Suriname and Trinidad and Tobago slowed to 3.5% and 1.0%, from 13.5% and 7.8%, respectively. Meanwhile, Guyana's real GDP growth moderated to 19.9% from 43.4% in 2020.

TABLE 1

Selected Indicators for Developed Economies (%)	2015	2016	2017	2018	2019	2020	2021
GDP Growth Rates							
United States	2.9	1.6	2.2	2.9	2.3	(3.5)	5.7
Euro Area	2.1	2.0	2.4	1.8	1.2	(6.6)	5.3
United Kingdom	2.3	1.8	1.8	1.4	1.4	(9.9)	7.4
China	6.9	6.7	6.8	6.6	6.1	2.3	8.1
Japan	1.2	0.6	1.9	0.8	0.7	(4.8)	1.6
Unemployment Rates							
United States	5.3	4.9	4.4	3.9	3.7	8.1	5.4
Euro Area	10.9	10.0	8.6	7.9	7.6	7.9	7.7
United Kingdom	5.4	4.9	4.4	4.1	3.8	4.5	4.5
China	4.1	4.0	3.9	4.0	3.6	3.8	4.0
Japan	3.4	3.6	2.8	2.4	2.4	2.8	2.8
Inflation Rates							
United States	0.1	1.3	2.1	2.4	1.8	1.2	4.7
Euro Area	0.2	0.2	1.5	1.8	1.2	0.3	2.6
United Kingdom	0.0	0.7	2.7	2.5	1.8	0.9	2.6
China	1.4	2.0	1.6	2.1	2.9	2.4	0.9
Japan	0.8	(0.1)	0.5	1.0	0.5	(0.02)	(0.30)

Sources: IMF, International Statistical Bureaus

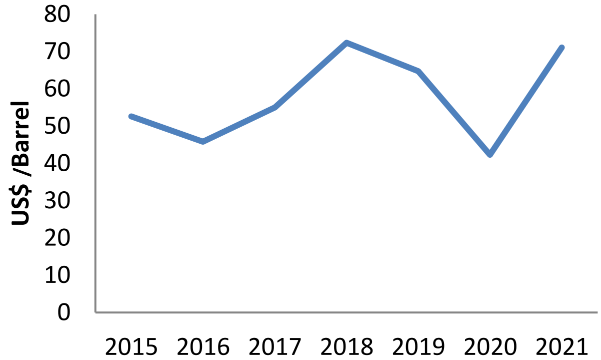
TABLE 2

Selected Caribbean Countries' GDP Growth Rates (%)	2015	2016	2017	2018	2019	2020	2021
Bahamas	1.6	0.1	1.6	2.8	0.7	(14.5)	15.6
Barbados	2.2	2.3	(0.2)	(0.5)	(0.1)	(17.6)	1.4
Belize	3.4	(0.6)	1.4	3.0	0.3	(14.1)	9.8
Eastern Caribbean	2.6	2.7	1.2	3.0	2.8	(14.0)	3.9
Guyana	3.1	3.4	2.1	3.4	4.7	43.4	19.9
Jamaica	0.9	1.5	0.7	1.4	1.0	(10.2)	4.4
Suriname	(3.4)	(5.6)	1.7	2.0	2.3	(13.5)	(3.5)
Trinidad & Tobago	1.9	(6.5)	(2.0)	0.3	0.0	(7.8)	(1.0)
Average	**1.5**	**(0.6)**	**0.6**	**1.8**	**1.5**	**(6.0)**	**6.3**

Sources: IMF, International Statistical Bureaus, Regional Central Banks, Bloomberg

Chart 1

Oil Prices (Brent Crude Oil Index)



Source: Bloomberg

1.3. The Domestic Environment

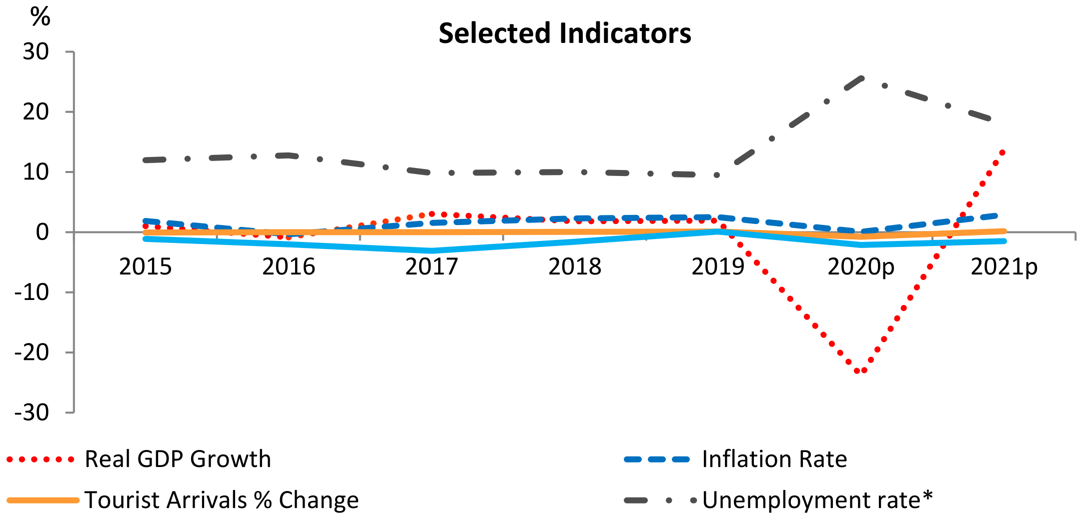
The domestic economy's recovery underpinned improving financial stability conditions in 2022, with a healthier external sector outcome and a calendar-year reduction in the fiscal deficit. Real GDP rebounded by an estimated 13.7%, following a 23.8% contraction in 2020. The outturn was bolstered by gains in tourism arrivals, particularly within the high value added air segment, following a resumption in visitor flow amid the relaxation of globally imposed travel restrictions. Total arrivals rose by 17.1% to 2.1 million, partly reversing a 75.2% retrenchment in 2020 to 1.8 million visitors. Underpinning this development, air arrivals more than doubled to 886,629, vis-à-vis the reduced 418,329 arrivals in the preceding year. In contrast, reflective of the delayed resumption in cruise activity, sea arrivals were still contracted by 11.8% to 1.2 million, albeit a slowdown from the 75.4% decline in 2020. In the swiftly developing private vacation rental market, positive trends were noted, as total room nights sold grew by 62.8%, a switch from the 46.9% decrease registered in the preceding year.

Reflective of the increase in the cost of imported fuel, domestic inflationary pressures rose during 2021. Specifically, the rise in the Retail Price Index (RPI) firmed to 2.9% in 2021, from just 0.04% in the prior year, given average cost increases for most of the index's components.

During the FY2020/2021, the overall fiscal deficit expanded significantly to $1.3 billion from $825.7 million in FY2019/2020, In particular, revenue reduction also coincided with increased outlays related to the COVID-19 pandemic, and to a lesser extent the 2019 major hurricane. While total revenue contracted by $186.6 million (8.9%) to $1,908.8 million, aggregate expenditures grew by $323.1 million (11.1%) to $3,243.6 million. Over the calendar year, however, the deficit moderated to $882.1 million from $1.4 billion in 2020, underpinned by a $695.8 million (41.8%) recovery in revenue collections, which outpaced the $218.1 million (7.2%) increase in total expenditure.

Chart 2

Selected Indicators



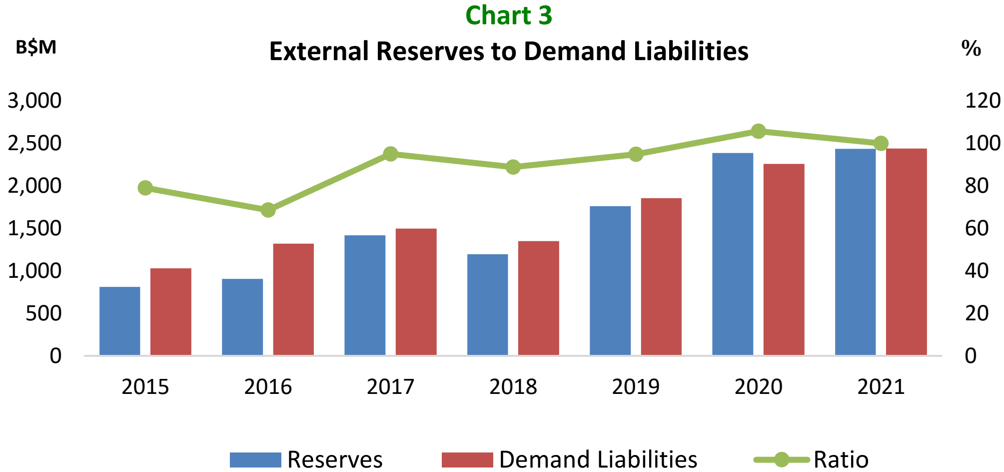
* IMF Article IV estimates for 2021

Source: Central Bank of the Bahamas, Bahamas National Statistical Institute

Domestic monetary trends featured gains in bank liquidity in 2021, as the expansion in the deposit base surpassed the growth in domestic credit. Similarly, external reserves expanded, attributed to the IMF's Special Drawing Rights (SDRs) allocation and reduced private sector net outflows. Bank's credit quality indicators weakened over the review year, as a result of the negative effects stemming from the ongoing COVID-19 pandemic. Further, the weighted average interest rate spread narrowed, with the decline in the average lending rate, contrasting with the rise in the corresponding deposit rate.

Chart 3

External Reserves to Demand Liabilities



Source: Central Bank of The Bahamas

At end-2021, external reserves reached $2.4 billion, making it equivalent to an estimated 36.3 weeks of total merchandise imports, lower than the 56.8 weeks at end-2020. The useable reserves, or balances remaining after statutory provisions for 50.0% of the Central Bank's demand liabilities, grew by $41.0 million (3.3%) to $1,216.2 million. In addition, the improvement in the Central Bank's balance sheet continued in 2021, as the end-of-year external reserves to demand liabilities ratio remained above the 90.0% benchmark, at approximately 100.0%. While lower than the 2020 closing ratio of 105.6%, it still exceeded the 2019 estimate of 95.0%. Contributing to this outcome was the receipt of proceeds from Government external borrowings and Special Drawing Rights (SDRs) from the IMF in the third quarter of the year.

TABLE 3

The Bahamas: Macroeconomic Indicators

	2015	2016	2017	2018	2019	2020	2021
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	6.1	(0.2)	4.4	3.2	3.4	(26.5)	15.6
Real GDP Growth Rate (%)	1.0	(0.9)	3.1	1.8	1.9	(23.8)	13.7
Inflation Rate (Average chg in RPI)	1.9	(0.3)	1.5	2.3	2.5	0.0	2.9
Unemployment Rate (May)*	12.0	12.7	9.9	10.0	9.5	25.6	18.1
Overall Fiscal Balance (B$M)	(252.0)	(467.1)	(622.5)	(337.4)	(238.9)	(1,366.1)	(882.1)
% of GDP	(2.1)	(3.9)	(5.0)	(2.6)	(1.8)	(14.1)	(7.9)
Private Sector Credit (B$000)	6,299.7	6,170.8	5,982.9	5,886.2	5,891.6	5,766.1	5,680.7
Weighted Average Lending Rate (%)	12.3	12.5	11.8	11.3	10.5	10.4	10.0
Weighted Average Deposit Rate (%)	1.4	1.2	1.0	0.8	0.6	0.5	0.5
Treasury Bill Rate (%)	0.9	2.0	1.9	1.7	1.8	1.9	2.9
Gross Int'l Reserves (B$M)	811.9	904.0	1,417.4	1,196.3	1,758.1	2,382.2	2,432.8
Import Cover Ratio (Tot. Merch. (CIF) in week	14.1	16.5	21.9	17.4	28.3	56.8	36.3
Current Balance (B$M)	(1,478.3)	(1,472.7)	(1,652.9)	(1,199.3)	(345.5)	(2,373.4)	(881.5)
as % of GDP	(12.5)	(12.4)	(13.4)	(9.4)	(2.6)	(24.5)	(7.9)
Total Public Sector Debt (B$M)	7,460.0	7,901.1	8,834.0	9,249.5	9,437.2	10,814.0	11,636.2
of which: External	2,175.8	2,373.0	3,233.9	3,171.8	3,123.1	4,478.0	4,760.8
Internal	5,284.2	5,528.1	5,600.1	6,077.7	6,314.1	6,335.9	6,875.4
Total Arrivals ('000s)	6,112.1	6,265.0	6,135.8	6,622.0	7,249.5	1,794.5	2,100.6
Tourist Expenditure (B$M)	2,537.5	2,725.9	2,930.2	3,727.6	4,125.5	967.4	2,321.7
Construction Number of Permits Issued	1,299.0	1,136.0	1,355.0	1,504.0	1,553.0	1,278.0	N/A
Value of Starts (B$M)	119.8	96.2	136.6	118.2	102.9	154.6	N/A
Value of Completion's (B$M)	228.9	193.2	1,493.6	333.8	213.0	200.0	N/A
Average Oil Prices (Brent Crude Oil Index)	52.6	45.8	55.0	72.4	64.7	42.3	71.0

Source: Central Bank of The Bahamas, Bahamas National Statistical Institute, Bloomberg

*2020 and 2021 rates represent forecasts

N/A - Not Available

CHAPTER 2: BANKING SECTOR

The Bahamas' exchange control regime effectively limits banks from undertaking domestic business activities other than through assets funded with domestic liabilities. Therefore, this averts any direct connection or balance sheet flows from direct international to domestic banking operations. As a consequence, this chapter focuses specifically on the stability of the domestic banking sector.

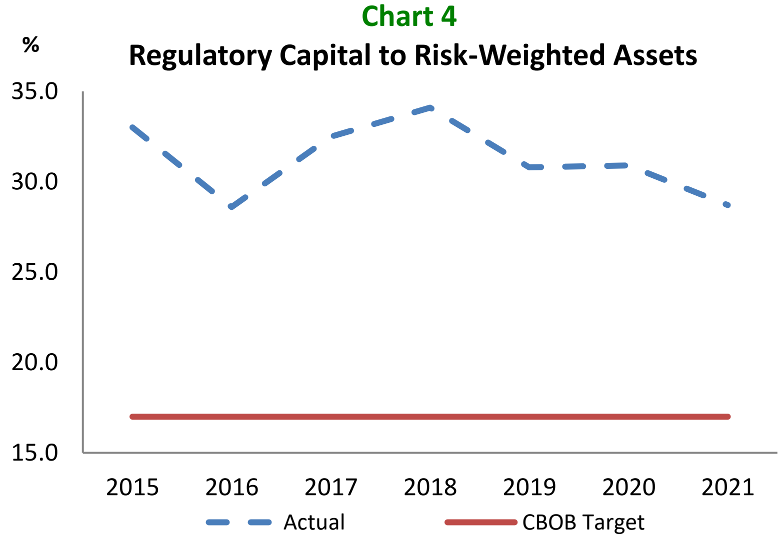
2.1 Asset Trends

Total domestic assets of the banking system increased by 1.0% to $11.0 billion, after a gain of 2.0% in 2020. As a share of the total asset portfolio, loans and advances dominated at 59.3%, followed by securities (19.5%) and claims on the Central Bank, mainly in cash and balances (16.5%). Contributing to the falloff in asset growth was a moderation in the buildup in banks' claims on the Central Bank to 4.6% from 26.4% the year earlier. Meanwhile, the decrease in loans & advances extended to 3.2% from 0.3% in the prior year. In contrast, banks' holdings of securities—the other significant balance sheet item—rose by 8.3% after a reduction of 1.5% in 2020.

2.2 Capital Adequacy

Although domestic banks remained well capitalized in 2021, the ratio of average capital to risk weighted assets was reduced by 2.2 percentage points to 28.7%, at end-December 2021. The system's capital adequacy ratio remained far above the Central Bank's target ratio of 17.0% of risk-weighted assets and the international benchmark of 8.0%.[1]

Chart 4
Regulatory Capital to Risk-Weighted Assets



Source: Central Bank of The Bahamas

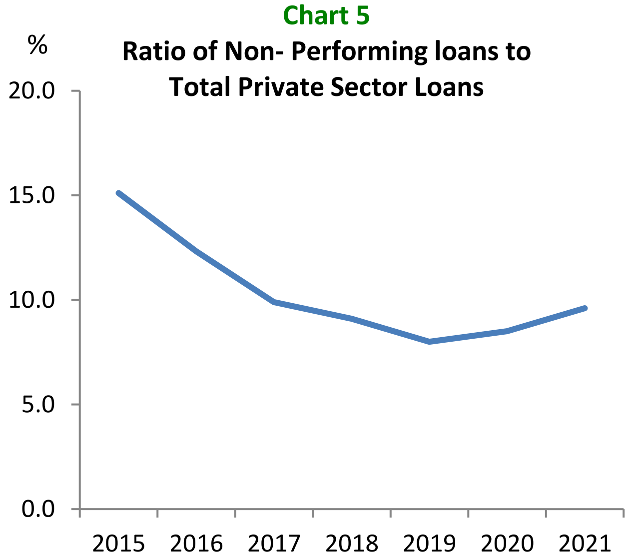
[1] The Central Bank imposes a "trigger" ratio of 14.0%, below which licensees would be required to implement measures to either reduce risk exposures or supplement their capital.

2.3 Asset Quality

Banks' credit quality indicators softened only mildly in 2021, as the onset of the economic recovery allowed institutions to unwind loan payment deferral schemes that were introduced in the first year of the COVID-19 pandemic. In particular, total private sector loan arrears rose at a significantly tempered pace of $6.7 million (0.9%) to $779.8 million, after an $86.7 million (12.6%) deterioration in 2020. This reflected a rise in consumer and commercial delinquencies, which overshadowed the reduction in the mortgage segment. As a result, less marked firming occurred in the ratio of arrears to total private sector loans, by 0.4 percentage points to 14.2%, following an increase of 1.7 percentage points a year earlier.

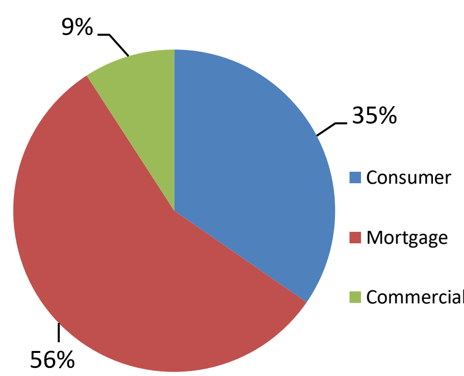
An analysis by average age of delinquencies indicated that non-performing loans rose by 11.2% to $527.9 million, extending the preceding year's 4.5% growth. Leading this development were respective increases in the consumer and commercial components, of 38.0% and 16.4%. In a partial offset, non-performing mortgages reduced by 3.0%. Meanwhile, short-term arrears (31-90 days) fell by 15.6% to $251.8 million, a reversal from a 28.5% growth in 2020. The outcome was largely due to declines in the mortgage and consumer segments, of 19.7% and 17.0%, respectively, while short-term commercial arrears expanded by 37.5%. As a result, the NPL ratio, against total private sector loans rose by 1.2 percentage points, to 9.6%; while the ratio of past due loans to total private sector loans narrowed by 74 basis points to 4.6%.

Chart 5
Ratio of Non- Performing loans to Total Private Sector Loans



Source: Central Bank of The Bahamas

Chart 6
Composition of Private Loan Arrears (2021)



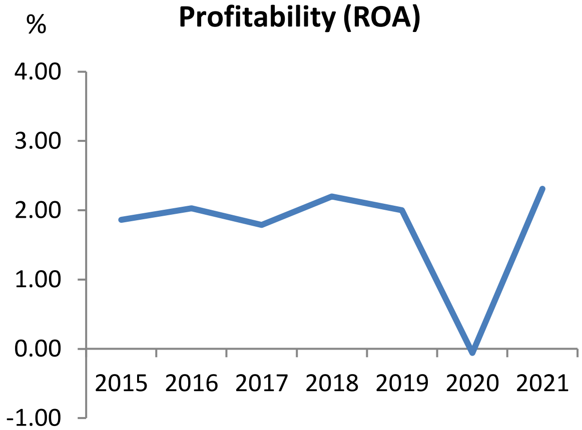
Source: Central Bank of The Bahamas

2.4 Profitability

Domestic banks' profitability rebounded strongly to a net surplus of $254.7 million, vis-à-vis a net loss of $6.7 million in 2020. The turnaround was attributed to contractions in non-staff related operating costs and bad debt provisioning, combined with a growth in other "non-interest" earnings. Correspondingly, the ratios of net income to average monthly assets (ROA), and to equity (ROE) strengthened to 2.3% and 10.9%, respectively, relative to the previous year's negative ratios of 0.1% and 0.3% (see Table 4).

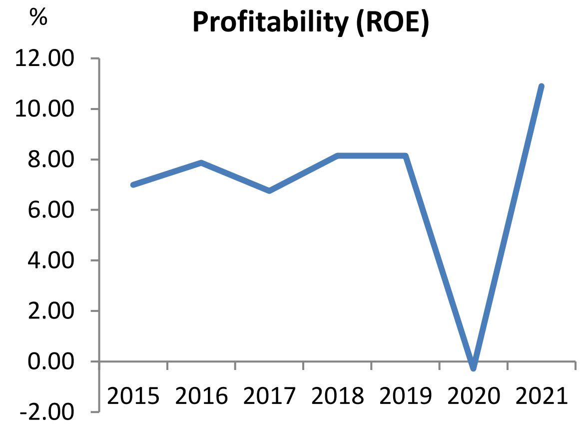
Total provisions for bad debt decreased by $62.5 million (10.9%) to $512.6 million, following charges of $149.3 million (35.1%) in 2020. Consequently, the relevant ratio to average assets narrowed by 70 basis points, to 4.40%. In addition, operating costs reduced by 11.6%, lowering the corresponding ratio by 58 basis points, to 3.55% of average assets, as the declines in non-staff outlays and occupancy costs overshadowed the rise in staff costs. In contrast, depreciation costs grew by 20.6%, elevating the related ratio by 3 basis points, to 0.18% of average assets. Meanwhile, the ratio of net interest income to average assets fell by 18 basis points to 4.6%, due to a 4.0% increase in interest expense, and a 0.7% reduction in interest income. In contrast, the ratio of commission and foreign exchange income to average assets moved higher by 7 basis points, to 0.44%.

Chart 7
Profitability (ROA)



Source: Central Bank of The Bahamas

Chart 8
Profitability (ROE)



Source: Central Bank of The Bahamas

2.5 Liquidity

Banking system liquidity levels remained robust in 2021, partly reflecting increases in Treasury bill holdings and balances with the Central Bank. As a share of total assets, banks' holdings of liquid assets rose by 1.4 percentage points to 33.8%, after widening by 2.3 percentage points in the prior year. Meanwhile, the ratio of liquid assets to short-term liabilities moved higher by a 1.0 percentage point to 46.7%, slowing from a 4.1 percentage point gain in 2020.

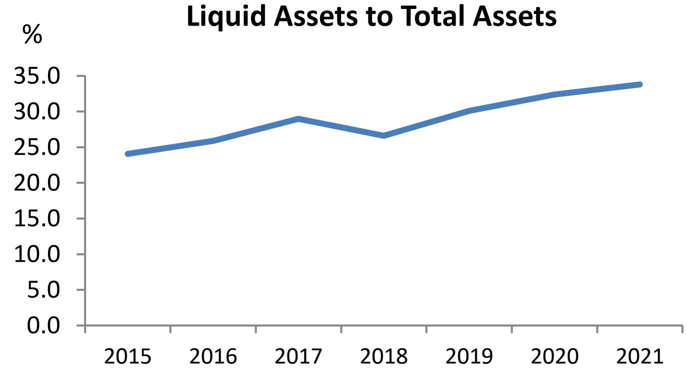
Owing to the buildup in deposit balances and a decrease in outstanding loans, the ratio of deposits to total loans firmed by 7.6 percentage points, to 122.2%, compared with a rise of 0.4 percentage points the year earlier. In particular, the ratio of demand deposits to total deposits rose by 2.5 percentage points to 47.6%; after remaining relatively stable at 45.1% in the previous year (See Table 4).

TABLE 4

Key Domestic Banks Financial Stability Indicators (%)	2015	2016	2017	2018	2019	2020	2021
Liquidity Indicators							
Loan to Deposit Ratio	108.6	100.9	95.4	96.4	87.5	87.2	81.8
Deposits to Loan Ratio	92.1	99.1	104.8	103.7	114.3	114.7	122.2
Demand Deposits to Total deposits	32.6	37.2	39.0	40.7	45.2	45.1	47.6
Liquid Assets to Total Assets	24.1	25.9	29.0	26.6	30.1	32.4	33.8
Liquid Assets to Short-Term Liabilities	37.0	37.8	42.7	38.3	41.6	45.7	46.7
Credit Risk Indicators							
NPL to Total Private Sector Loans	15.1	12.3	9.9	9.1	8.0	8.5	9.6
Total Assets Growth rate	1.8	1.6	2.3	(2.4)	7.4	2.0	1.0
Loans & Advances Growth rate	(0.3)	(0.6)	(4.1)	0.9	1.4	(0.3)	(3.2)
Capital Adequacy							
Regulatory capital to risk-weighted assets (avg)	33.3	28.6	32.5	34.1	30.8	30.9	28.7
Trigger Ratio	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Target Ratio	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Profitability Indicators							
ROAA (annualized)	1.9	2.0	1.8	2.3	2.4	-0.1	2.3
ROAE (annualized)	7.0	7.9	6.8	8.8	10.7	-0.3	10.9
Net interest income to average earning assets (annualized)	5.4	5.3	5.1	5.1	5.0	4.8	4.6
Net interest income to gross income	70.5	69.4	69.4	68.5	77.7	108.4	75.5
Non interest expenses to gross income	47.4	48.4	52.1	49.7	58.3	97.1	61.2
Personnel expenses to non interest expenses	46.8	44.0	40.8	41.2	39.0	32.8	38.1
Trading and fee income to total income	3.9	3.2	3.8	3.8	5.4	8.3	7.2
Effective Interest Rate Spread	7.1	7.2	7.1	7.1	7.2	8.0	9.0

Source: Central Bank of The Bahamas

Chart 9
Liquid Assets to Total Assets



Source: Central Bank of The Bahamas

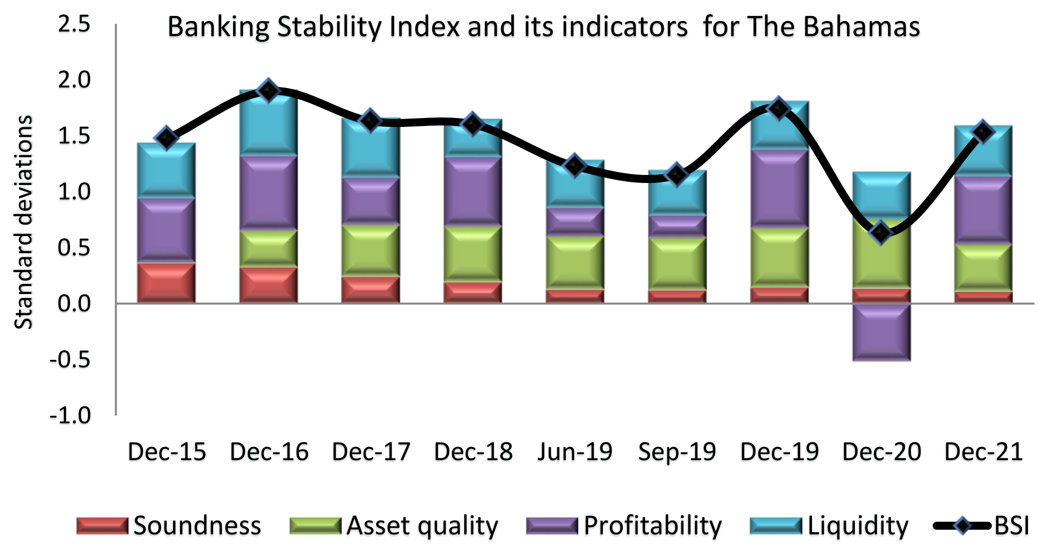
2.6 An Assessment of the Stability of the Banking Sector

2.6.1 The Banking Stability Index

The Banking Stability Index (BSI) is an aggregate indicator of the soundness of the Deposit-Taking Institution (DTI) sector. It was calculated as a normalized weighted average of key performance indicators, namely capital adequacy, asset quality, profitability and liquidity. Each variable was normalized using statistical standardization, which allows for the different variables to be on the same scale. In 2021, the BSI—which measures the soundness of DTIs in The Bahamas—improved, reflective of the gradual pace of recovery in the domestic economy from the pandemic-led slowdown in 2020. The index increased to 1.53 from 0.63 in 2020, an indication that the sector remained relatively sound. Specifically, the normalized profitability indicator strengthened to 0.61, a switch from the previous year's negative 0.52, showing a rise in profitability, as returns on both assets and equity registered gains in 2021, following decreases in the prior year. Further, the liquidity indicator firmed to 0.45 from 0.43 in 2020, as banking sector liquidity remained elevated and risk remained low. However, the normalized asset quality indicator fell to 0.42 from 0.62 in the preceding year. In addition, indicators of respective capital adequacy and interest rate edged down to 0.11 and 0.01, from 0.13 and 0.02 in the prior year. Overall, the BSI stabilized on a standard deviation of 0.9 in December 2021, suggesting that liquidity levels within the sector remained high, as the share of liquid assets to total assets grew.

Chart 10

Banking Stability Index and its indicators for The Bahamas



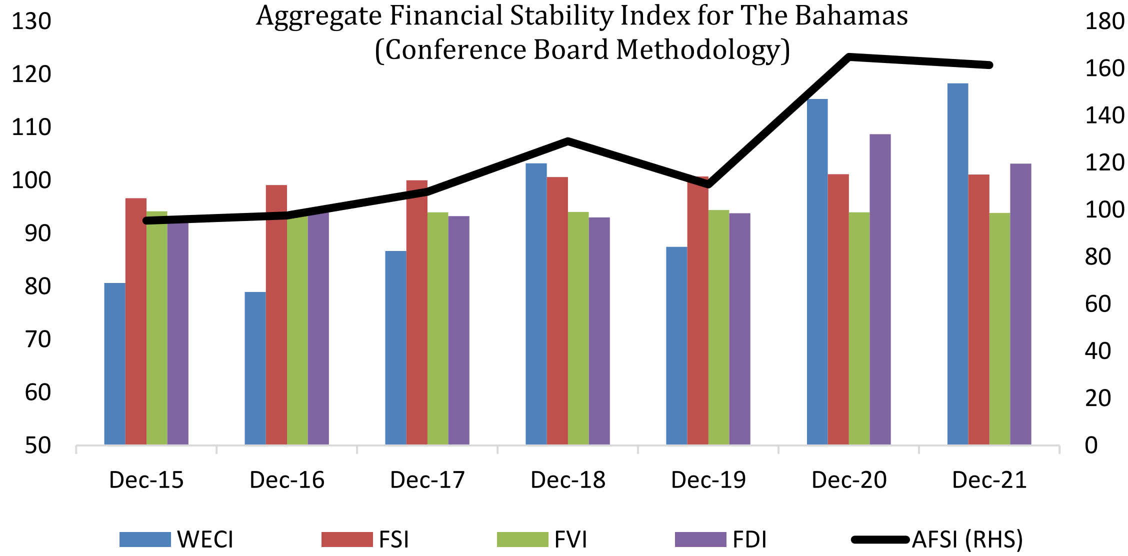
2.6.2. Aggregate Financial Stability Index

The Aggregate Financial Stability Index (AFSI), forms a single measure of financial stability from microeconomic, macroeconomic and international factors. It is comprised of sub-components such as the financial development index, the financial soundness index, the financial vulnerability index and the world economic climate index. A higher AFSI value suggests increased financial sector stability, while a lower value signals a decline in stability.

The overall AFSI index normalised to 122.0 in 2021 from 123.0 in the prior year; an indication that it is reverting to trend following an increase in 2020, that was scaled by below trend level of GDP. An analysis of the components showed that the outturn was largely attributed to reversion on the financial development index to 119.6 from 132.0 in the previous year, underpinned by the recovery in GDP growth. The index meanwhile maintaied improvement relative to 2019. In the meantime, the world economic climate sub-index strengthened to 153.7 from 147.0 in 2020, reflective of the the recovery in the global economy following a COVID-19 pandemic related contraction in the previous year. Further, the financial soundness index was unchanged at 115.1 in 2021 relative to 2020, on account of an uptick in the ratio of liquid assets to total assets. Likewise, the financial vulnerability sub-index stabilized at 98.7 vis-à-vis the previous year, explained by a notable correction in the total fiscal balance to GDP ratio.

Chart 11

Aggregate Financial Stability Index for The Bahamas (Conference Board Methodology)



2.6.3. Stress Testing

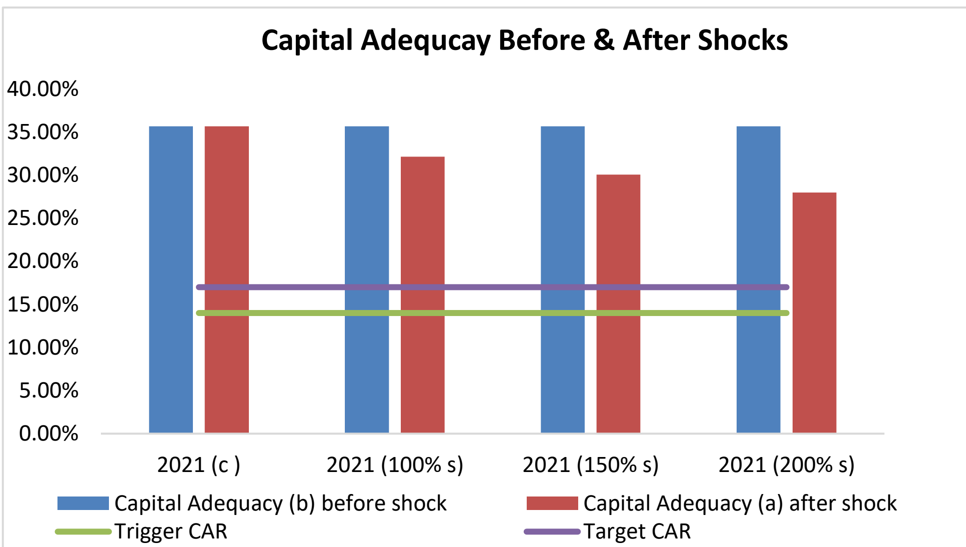
Broad observations from consolidated results are provided relative to credit, liquidity and interest rate risk stress tests. Credit risks scenarios feature prominently in stress tests of the robustness of the banking system. Liquidity and interest rate risks were also monitored on an on-going basis, with the former being subject to more enhanced monitoring, over the past two years, given the potential impact on banks' operations due to the COVID-19 pandemic. Given the high capital and liquidity positions of banks, stress test results have reflected a resilient system. The Bahamian economy via the COVID-19 pandemic, has provided a real-world stress that confirmed the results of the Bank's stress testing.

Credit Risk Stress Tests

The credit risk stress test uses extreme, but plausible, stress scenarios to assess whether the domestic systemically important banks (DSIBs) have sufficient capital or total loss absorbing capacity to withstand various levels of shocks to NPLs, which may be precipitated by a probable economic or financial crisis.

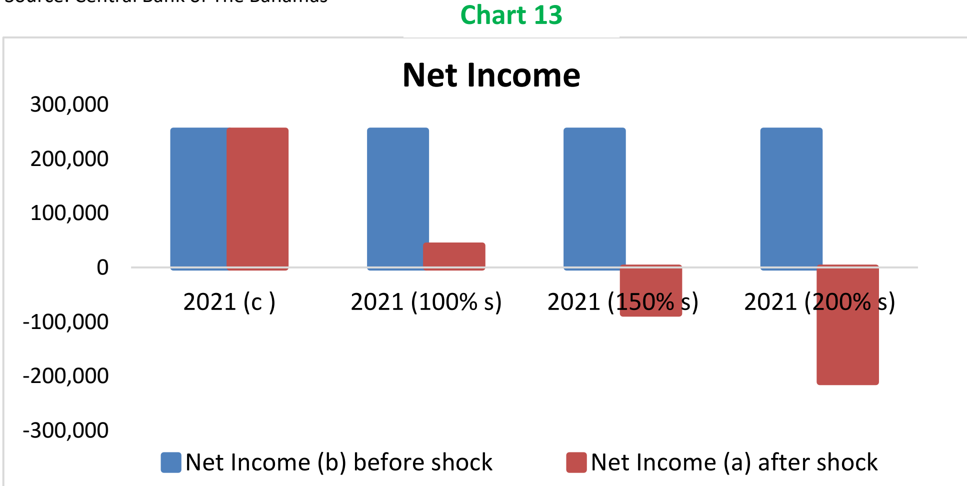
There are no immediate financial stability concerns, given the commercial banks' high capital buffers and satisfactory provisioning levels. The credit stress scenarios examined shocks to NPLs of 100%, 150% and 200% and the consequent impact of these on the statement of income and ultimately capital. The consolidated results, which produced simulated declines in banks' capital levels of up to 7.95%, consistently yielded no capital injection requirement. At all levels of shocks, capital remained well above the established trigger and target ratios of 14.0% and 17.0%. In particular, the banking sector's average capital to risk-weighted assets ratio fluctuated between 26.87% and 32.14% (see Chart 12).

Chart 12



Source: Central Bank of The Bahamas

Chart 13



Source: Central Bank of The Bahamas

Interest and Liquidity Shocks

Stress test results continued to show that commercial banks are less vulnerable to interest rate risk in their banking books, given the infrequent movement in the Bahamian dollar Prime lending rate and the continued robust levels of eligible capital, among other reasons.

Relative to liquidity risk, stress test results continued to indicate that banks' risk to near-term depletion of liquidity was negligible. This conclusion is underpinned by the high level of liquidity across the banking system, supported by bank's continued cautious posture to lending, and the limited investment opportunities locally for banks to deploy their excess liquidity.

CHAPTER 3: CREDIT UNIONS

Credit unions retained their status as the second largest deposit taking and loan granting institutions, following commercial banks. In this regard, the sector remains under the supervision of the Central Bank, where a risk-based approach has been implemented, inclusive of anti-money laundering/know your customer (AML/KYC), corporate governance and credit risk management. The sector operated with capital buffers below that of banks, and more concentrated exposures in some cases to the tourism industry. However, the average liquidity ratio continued to surpass the minimum statutory thresholds. In the interim, the sector received heightened protection from enrolment in the Deposit Insurance Scheme, and remained under improved prudential oversight.

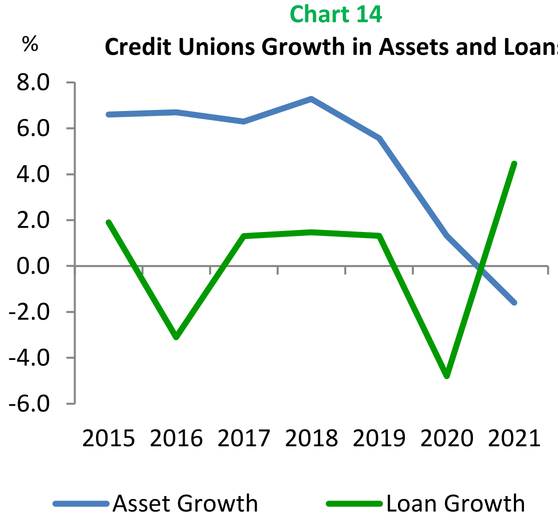
3.1. Assets and Liabilities

Total assets within credit unions declined by 1.6% ($7.7 million) to $474.6 million in 2021, a reversal from the 1.3% growth in the preceding year. In the underlying developments, deposits with the league increased by 2.5% ($2.4 million) to $96.1 million, although lower than the 4.2% gain in the prior year. Similarly, loans to members, which comprised a dominant 49.7% of total assets, rose by 4.5% ($10.1 million) to $236.0 million, vis-à-vis a 4.8% falloff in the previous year. Disaggregated by loan portfolio, consumer purchases continue to be the primary form of credit at 61.8%, followed by mortgages at 37.3%, with SME development (0.5%) and other lines of credit (0.4%), accounting for the remainder.

Credit union total deposits also fell by 1.9% ($7.8 million) to $409.1 million, contrasting with a 1.4% gain in 2020, largely attributed to term deposits, which accounted for 30.7% of the aggregate, reducing by 8.1% ($11.0 million) to $125.8 million. In contrast, savings deposits—at 61.2% of the total—grew by 2.5% ($6.0 million) to $250.5 million, extending the 6.1% expansion in the prior year.

Chart 14

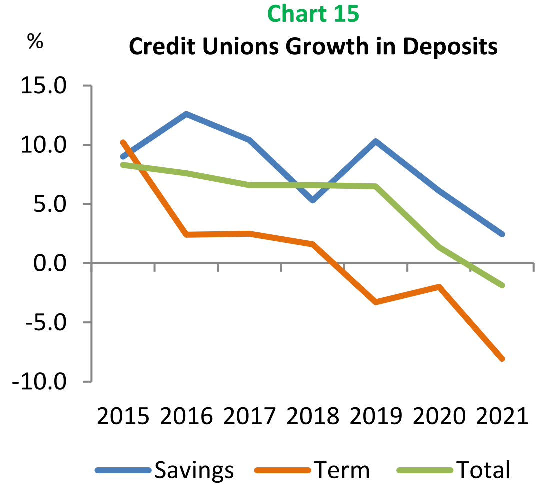
Credit Unions Growth in Assets and Loans



Source: Central Bank of The Bahamas

Chart 15

Credit Unions Growth in Deposits



Source: Central Bank of The Bahamas

TABLE 5					
Selected Financials for Credit Unions (B$M)					
	2014	**2015**	**2019**	**2020**	**2021**
Total Assets	347.7	370.6	476.0	482.3	474.6
Total Gross Loans	230.9	235.3	237.3	225.9	236.0
Total Deposits	291.6	315.9	411.3	416.9	409.1
Liquid Assets	86.8	101.6	195.9	209.5	197.1
Savings	146.4	159.6	230.4	244.5	250.5
Term Deposits	122.8	135.3	139.6	136.8	125.8
Total Members' Equity	40.7	42.4	52.1	55.6	55.6
Non-Earning Assets	25.2	25.0	50.2	39.9	36.8
Allowance	11.8	14.1	8.0	7.2	8.2
Short-Term (ST) Payables	1.4	1.0	1.0	1.1	1.2
Capital & Surplus	20.5	19.0	16.4	16.0	14.3
Provisions	1.1	2.3	3.4	3.7	2.6
Net Income	2.8	1.3	1.9	3.8	2.3
Institutional Capital	14.3	11.9	7.8	7.2	5.2
# of Credit Unions	7	9	10	10	10
Financial Ratios (%)					
Equity-to-Asset Ratio	11.7	11.5	10.9	11.5	11.7
Return on Assets	0.8	0.3	0.4	0.8	0.5
Return on Equity	7.0	3.0	3.7	6.9	4.2
Provisions to Loans	0.5	1.0	1.4	1.6	1.1
Total Gross Loans to Total Assets	66.4	63.5	49.9	46.8	49.7
Liquid Assets to Total Assets	25.0	27.4	41.2	43.4	41.5
Non-Earning Assets/Total Assets	7.2	6.7	10.5	8.3	7.8
(Liquid Assets-ST Payables)/Total Deposit	29.3	31.9	47.4	50.0	47.9

Source: Department of Cooperative Development & Central Bank of The Bahamas

3.2. Capital Adequacy

In 2021, credit unions' capital ratio continued to exceed the 10.0% international PEARLS benchmark, at 11.7%, despite elevated negative exposure due to declining asset quality. The aggregate capital & surplus resources—held to cover unexpected losses—reduced by 10.3% ($1.7 million) to $14.3 million, extending the 2.6% falloff a year earlier. Within this context, the relevant ratio of total equity[2] to total assets (the gearing ratio) firmed to 11.7% from 11.5% in 2020.

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

Chart 16

Creidt Unions Capital Adequacy

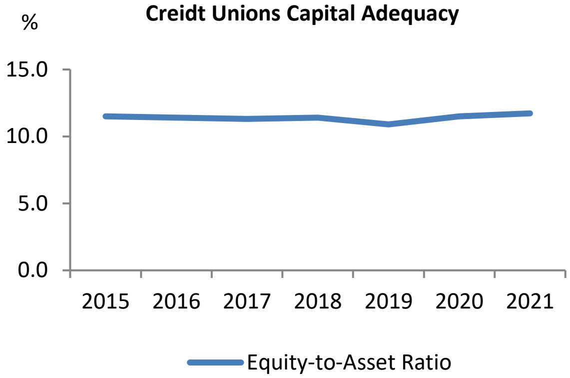
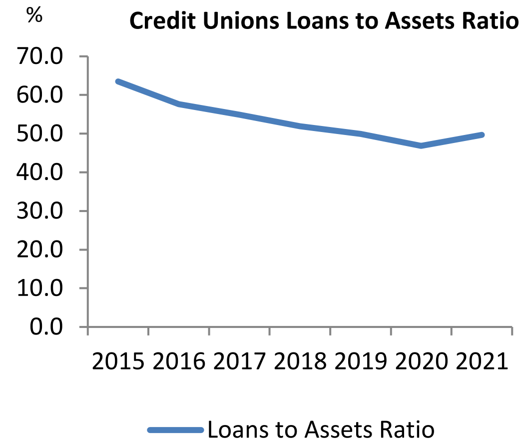


Chart 17

Credit Unions Loans to Assets Ratio



Source: Central Bank of The Bahamas

3.3. Asset Quality

Credit unions' total impaired loans[3] increased by 18.6% ($6.2 million) to approximately $39.3 million in 2021, extending the 17.3% growth in the preceding year. Correspondingly, the ratio of delinquencies to total loans firmed to 17.2% from 15.2% in 2020. By the average age of delinquency, non-performing loans (NPLs)—which accounted for 75.3% of total delinquencies—advanced by 23.0% ($5.6 million) to $29.5 million, extending the 4.3% increase a year earlier. In addition, short-term delinquencies (31-90 days) rose by 7.3% ($0.6 million) to $9.8 million, albeit lower than the 31.8% expansion in the previous year.

As a result of the rise in loan delinquencies, the collateral value of impaired facilities grew by 13.2% ($2.6 million) from the recorded $19.8 million in 2020. Further, the value of uncollateralized exposures rose by 26.7% ($3.6 million) to $16.9 million. Meanwhile, credit unions' total provisions for loan losses increased by 13.3% ($1.0 million) to $8.2 million, following a 9.8% reduction a year earlier. Consequently, the ratio of provisions to total gross loans grew by 27 basis points to 3.5%, while the coverage ratio for short-term arrears remained unchanged at 35.0% and for NPLs, at 100%.

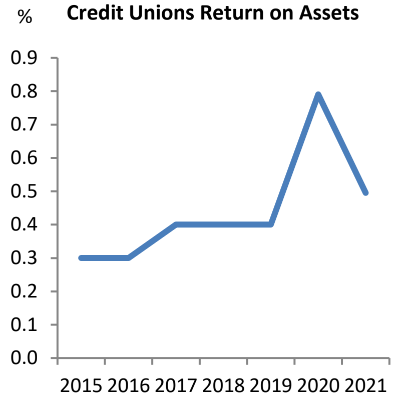
The value of non-earning assets—inclusive of land, buildings, vehicles, furniture and cash—decreased by 7.8% ($3.1 million) to $36.8 million, a moderation from the 20.4% contraction last year. As a result, the relevant ratio of non-earning assets to total assets declined by 6.3 percentage points to 7.8%, exceeding the 2.2 percentage points falloff in 2020.

[3] An impaired loan is defined as one in which the full amount of principal or interest due is not collected on time, according to the contractual terms of the loan agreement.

3.4. Profitability

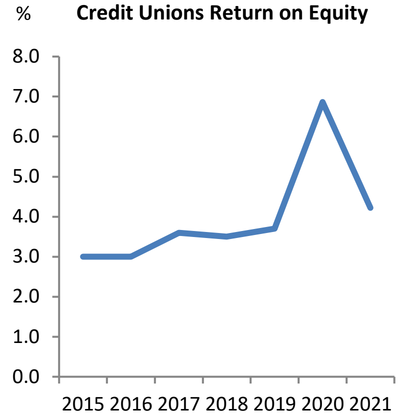
During 2021, credit unions' overall profit declined to $2.3 million, marking a 38.4% contraction relative the previous year, as the return on assets ratio decreased by 30 basis points to 0.5%, while the return on equity ratio fell by 2.6 percentage points to 4.2%.

Chart 18
Credit Unions Return on Assets



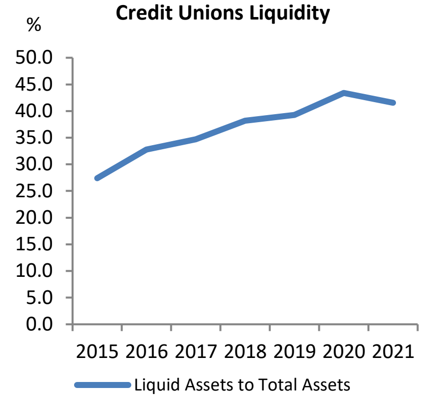
Source: Central Bank of The Bahamas

Chart 19
Credit Unions Return on Equity



Source: Central Bank of The Bahamas

Chart 20
Credit Unions Liquidity



Source: Central Bank of The Bahamas

3.5. Liquidity

Credit unions' liquidity weakened over the year, reflective of a reduction in liquid investments (33.2%), combined with a falloff in cash balances (10.8%), which overshadowed the 5.2% rise in financial investments. Consequently, the ratio of liquid assets to total assets moved lower by 1.9 percentage points to 41.5%, relative to 43.4% in the preceding year. Conversely, the alternative indicator—the ratio of liquid assets net of short-term payables to total deposits—fell by 2.1 percentage points to 47.9% at end-2021. Nevertheless, both ratios exceeded the minimum prudential standard of 15.0%, which indicates that credit unions maintained healthy levels of liquidity.

CHAPTER 4: THE INSURANCE SECTOR

The insurance industry remains an integral part of the financial sector, providing much needed stability in the face of heightened vulnerabilities due to the effects of climate change. During the review year, the sector continued to disburse residual reinsurance inflows from Hurricane Dorian and adjust business operations in the ongoing COVID-19 environment. The domestic insurance sector remained conservative, with its focus on long-term stable investments, such as Government bonds, with minimal concerns regarding the sector's stability.

Information from the Insurance Commission of The Bahamas (ICB) showed that in 2021 the number of companies remained unchanged at 30. These consisted of 12 life and health insurers, offering whole life, term life, as well as universal life, and 18 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—4 life insurers and 6 non-life insurers—which represented a combined market share of approximately 92.6% of total gross premiums written, and the majority of insurance coverage, as at end-December 2021.

The external insurance sector, which is registered under the External Insurance Act,[4] mainly provides self-insurance coverage for non-resident entities in other countries. In 2021, it comprised of 170 entities, of which 20 were insurance companies and 150 were captive cells. Therefore, external insurers' main impact on the domestic economy was through employment and the fees charged by local service providers. As their operations do not impact the local financial sector, the domestic insurance sector will be the major focus of this analysis.

According to key performance indicators, the domestic insurance sector were subdued in 2021. The penetration ratio (total gross premiums to GDP[5]), declined by 0.4 percentage points to 8.2% over last year. Specifically, the dominant life insurance segment registered a profit, albeit lower than profits earned a year prior. Similarly, the non-life sector also recorded an operating profit, although reduced compared to gains accumulated in 2020. In this environment, the sector remained financially sound, as revealed by the adequacy of its financial stability ratios.

4.1 Life Insurance

The life insurers held 72.6% of aggregate assets, and 54.0% of total gross premiums, comprising the dominant segment of the market. Based on provisional data, life insurers' total assets increased by 2.2% ($34.1 million) to $1.6 billion, owing largely to the dominant investments category—at 73.2% of total assets—which grew by 2.9% ($32.4 million) to $1.1 billion.

An analysis of investments revealed a rise in other "miscellaneous" investments to $48.1 million from $15.7 million, along with expanded interest in corporate securities (10.3%), mutual funds (7.2%), corporate equities

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[5] Based on Bahamas National Statistical Institute GDP figures.

listed (4.4%) and investment property (3.5%). Moreover, muted gains were recorded in mortgages (0.9%) and policy loans (0.7%). However, investments in preference shares declined by 27.0% to $12.8 million, while non-listed corporate equities and government securities reduced by 4.0% and by 1.5%, respectively.

Further, total assets registered a growth in receivables (44.5%), re-insurance recoveries (58.5%) and fixed assets (6.3%). In contrast, cash & deposits—the most liquid asset category—contracted by $56.4 million (27.7%) to $146.9 million. Similarly, declines were noted in intangibles (62.3%), and other assets (5.9%).

In terms of funding, life insurers' total liabilities grew by 3.8% ($39.7 million) to $1.1 billion, attributed to a 13.9% rise in 'other liabilities' to $157.9 million and a 2.3% increase in technical reserves to $915.0 million—which finance policyholders' claims and future benefits. Further, aggregate equity levels reduced by 1.1% to $489.8 million, owing mainly to a 4.7% falloff in retained earnings, which overshadowed gains in share capital (12.9%) and "miscellaneous" reserves (3.5%).

In terms of earnings, the net income of domestic insurers decreased to $35.4 million from $58.6 million in the previous year. Contributing to this outturn, total expenses grew by $71.4 million (17.9%) to $470.0 million, outpacing revenue gains. As a result, the respective return on equity (ROE) and return on assets (ROA) ratios weakened to 7.2% and 2.3%, respectively, from 11.8% and 3.8% a year earlier. Likewise, the expense ratio narrowed by 90 basis points to 33.5%. Conversely, the investment yield ratio rose by 1.5 percentage points to 5.2%, as investment income expanded.

Financial soundness indicators for the life insurance industry registered mixed performances in 2021, although remaining above international benchmarks. As a measure of the liquidity of insurance companies, the real estate plus unquoted equities and receivables to total assets ratio, firmed by 3.8 percentage points to 18.2%, while the real estate-to-total assets ratio was unchanged at 5.9%. However, the value of equities as a proportion of total assets—which are considered relatively higher risk—declined to 3.0% from 3.3% in 2020.

Table 6

Life Insurance: Financial Soundness Indicators (%)

	2015	2016	2017	2018	2019	2020	2021p
Capital Adequacy							
Capital/Total Assets	29.5	29.3	30.0	30.1	29.2	32.4	31.3
Capital/Technical Reserves	48.9	48.0	49.1	49.1	48.9	55.4	53.5
Net Premium/Capital	104.2	99.5	88.7	90.5	95.3	81.0	86.6
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	14.8	17.4	14.8	15.4	15.8	14.4	18.2
Equities/Total Assets	6.3	6.0	5.8	5.3	3.9	3.3	3.0
Real Estates/Total Assets	6.8	6.5	5.7	5.9	6.1	5.9	5.9
Earnings & Profitability							
Expense Ratio (expense/net premium)	29.6	29.5	28.5	30.4	34.1	34.4	33.5
Investment Yield (investment income/investment assets)	6.3	5.6	5.2	5.2	8.1	3.7	5.2
Return on Equity (ROE)	11.6	10.8	9.3	7.3	7.0	11.8	7.2
Return on Assets (ROA)	3.4	3.2	2.8	2.2	2.1	3.8	2.3

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

p = provisional

In terms of capital ratios, the net premium-to-capital ratio rose by 5.6 percentage points to 86.6%. In contrast, the capital to total assets ratio narrowed by 1.1 percentage points to 31.3%, and the capital-to-technical reserves ratio declined by 1.9 percentage points to 53.5%, although remaining above the international benchmark of 7.0%-10.0% (see Table 6).

4.2. Non-Life Insurance

Non-life insurance operations registered a decline in assets to $590.1 million from $682.3 million in 2020, as re-insurance recoveries reverted to trend, decreasing to $87.9 million from $178.3 million a year earlier, which had included hurricane claims settlements for policyholders who were affected by the major storm in 2019. Further, cash and deposits—which represented 21.8% of the total—reduced by $21.0 million (14.0%) to $128.9 million. In addition, reductions were noted for intangibles (34.4%), other assets (15.5%) and fixed assets (0.6%). In contrast, receivables—which constituted 39.1% of total assets—grew by $16.7 million (7.8%) to $230.5 million vis-à-vis the prior year. Investments also rose by $4.0 million (3.5%) to $117.7 million, attributed to a rise in corporate equities, non-listed securities, Government securities and mutual funds, which outstripped declines in holdings of preference shares, other "miscellaneous" and property investments.

The sector's total liabilities contracted by $109.7 million (23.7%) to $352.7 million in 2021, in response to a significant contraction in technical reserves, by $99.0 million (32.8%) to $202.6 million and "other" liabilities, by $10.7 million (6.6%) to $150.2 million. In this context, balance sheet equity rose by $17.5 million (8.0%) to $237.4 million, on account of an increase in "other" reserves (14.4%), retained earnings (7.4%) and share capital (1.5%).

With regard to earnings, non-life insurance companies posted an estimated net gain of $14.1 million in 2021, albeit lower than last year's net gain of $17.2 million. Underlying this outturn, total income grew by $9.7 million (8.9%) to $118.6 million. However, total expenses expanded to $104.5 million (13.9%) from $91.6 million in 2020.

Financial soundness indicators were mixed for the non-life insurance sector in 2021. A breakdown by asset composition showed that, capital to total assets increased by 8.0 percentage points to 40.2%, while the equities to total assets ratio firmed by 1.1 percentage points to 6.3%. Further, the investment yield ratio recovered to 1.7%, following a loss of 0.6% in the previous year, while the expense ratio narrowed by 10 basis points to 73.7%. During the year, the risk retention ratio[6] reduced by 1.7 percentage points to 26.5%. Conversely, the loss ratio—which measures whether net claims paid-out exceed net premiums collected—deteriorated, moving higher to 19.6% from 12.6% the preceding year. Likewise, the ratio of capital to technical reserves decreased to 85.3% from 137.1% in 2020, as proceeds from Hurricane Dorian tapered. Similarly, the technical reserves to net premiums ratio normalized to 180.9% from 284.0% in the previous year.

[6] This ratio examines the relationship between net premiums written and gross premiums written.

In this environment, the respective ROA and ROE ratios narrowed to 2.4% and 5.9%, from 2.5% and 7.8% in the prior year. However, the sector continued to hold adequate reserves to mitigate against the risk of adverse shocks.

Table 7

Non-Life Insurance: Financial Soundness Indicators (%)

	2015	2016	2017	2018	2019	2020	2021p
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	52.5	72.7	67.5	59.4	82.6	59.7	56.8
Reinsurance and Technical Reserves							
Risk Retention Ratio (net premiums /total gross premiums)	31.8	32.2	30.8	30.2	27.6	28.2	26.5
Technical Reserves/Net Claims	693.6	1110.5	1332.1	1241.3	902.0	2259.2	921.5
Technical Reserves/Net Premiums	210.0	618.2	443.3	288.2	555.8	284.0	180.9
Earnings & Profitability							
Expense Ratio (expense/net premium)	62.8	66.3	66.4	71.0	71.2	73.8	73.7
Loss Ratio (net claims/net premium)	30.3	55.7	33.3	23.2	61.6	12.6	19.6
Investment Yield (investment income/investment assets)	7.0	9.6	9.4	1.7	3.6	-0.6	1.7
Investment income/net premium	7.0	10.0	9.2	1.6	5.3	-0.7	1.8
Return on Equity (ROE)	8.9	-3.8	8.2	7.5	-14.2	7.8	5.9
Return on Assets (ROA)	4.0	-0.8	2.3	2.7	-1.4	2.5	2.4

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

p= provisional

CHAPTER 5: ASSESSMENT OF RISKS

Financial risks within The Bahamas remained within manageable limits, notwithstanding the COVID-19 global pandemic with no immediate or medium-term threat to the stability of the sector. During 2021, the Central Bank continued to monitor supervised financial institutions' (SFIs) approach to adapting their operations under the restraints of the Emergency Orders and the identified risk management challenges of the environment. The Central Bank maintained its focus on more effective supervisory interventions and refining of administrative processes.

During 2021, firms sustained their hybrid work arrangements to comply with health and safety measures, while also encouraging client facing staff to become vaccinated, although no official vaccine mandate existed for The Bahamas. In the advent of heightened cybersecurity and fraud risk, banks accelerated their digital initiatives and rolled out a number of educational campaigns for their clients to safeguard themselves from cybercrimes. Likewise, firms also invested in financial technology (Fintech) initiatives to support their operations and clients.

Towards strengthening the crisis management framework, the Central Bank, with the assistance of the International Monetary Fund (IMF) developed an action plan to operationalize the recovery and resolution framework that became effective under the new Banks and Trust Companies Regulation Act 2020. This proposes a general approach for SFIs to develop a recovery plan, which would further modernize the recovery and resolution framework for banks and credit unions in The Bahamas, in line with international best practices. Under this action plan, Recovery Planning guidelines for public licensees were drafted. As a result, banks were encouraged to produce their recovery plans. For banks unable to produce recovery plans, the Central Bank maintained its prudential monitoring through monthly asset quality assessments and other indicators, as well as prudential meetings with the executive management of financial institutions.

The Central Bank continued to discharge its supervisory mandate with a view to safeguarding the stability and integrity of the financial sector. This effort was enhanced by progress on the AML/CFT supervision, and the second round of reporting was concluded for the annual AML data returns, which assist the Bank in identifying trends and emerging risks within the industry. Meanwhile, new and updated assessments were conducted for money transmission businesses and payment services institutions. On credit risk management practices, the Central Bank released revised Credit Risk Guidelines, which will replace and expand upon the Impaired Assets Guidance featured in the IFRS 9 updates, asset classifications guidance and further clarifications on the total debt service ratio.

Among domestic systemically important banks (DSIBs) the focus remained on ensuring that SFIs instituted effective strategies to reduce the level of non-performing loans (NPLs), in tandem with the conclusion of loan deferral payment programs. The Central Bank will sustain this emphasis over the medium-term, alongside increased oversight of credit unions, which operate significantly smaller capital buffers than banks. In the meantime, the credit bureau's presence enhances risk management.

At end-April 2021, the credit bureau transitioned to live operations as the majority of domestic banks began reporting to the bureau. In addition to banks and credit unions, at least 38 entities were identified as having a statutory obligation to report information to the credit bureau. In this way, the credit bureau reduces information asymmetries and improves the management of credit risk, thereby strengthening the outlook for financial stability. Therefore, lending institutions will have sufficient information to better assess the creditworthiness of borrowers and to establish, both pricing and supply of credit risk profiles.

These initiatives, will serve to further enhance and strengthen the supervisory regime in place to ensure the continued stability of the financial sector.

CHAPTER 6: CONCLUSION

The Bahamas' domestic financial system remains sound and stable, in terms of the current assessment and the outlook, albeit with risk that must be managed and reduced. Therefore, the Central Bank will continue to pursue policies and reforms aimed at mitigating any potential risks to supervised financial institutions and strengthening of the regulatory environment. Against this backdrop, the Bank will sustain efforts to complete the risk-based supervisory framework (Basel III) for banks and trust companies, along with advancing credit unions risk and governance systems. These measures entail an emphasis on increased buffers against risk, over the course of the business cycle for domestic systemically important banks (D-SIBs) and maturity mismatches. Overall, the Central Bank will continue to strengthen the regulatory framework for its SFIs. Further, the collaborative stance across all regulators will be maintained in an effort to support the resilience of the financial sector.

APPENDICES

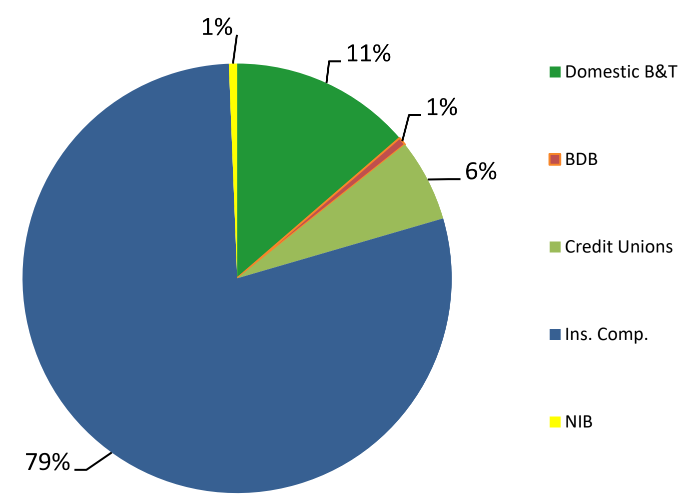
Appendix 1

Structure of the Bahamian Financial System –Selected Highlights

The Bahamas' financial system comprises operations under three key regulators, whose mandate is to ensure a stable financial system. These are the Central Bank, which supervises the banks & trust companies, credit unions, money transmission businesses (MTBs) and payment services firms; the Securities Commission of The Bahamas, with responsibility for investment funds, non-deposit taking lenders, investment fund administrators and capital markets; and the Insurance Commission of The Bahamas, for insurance companies. Only the domestic side of these supervised operations matter for financial stability, and current systemic operations are mostly confined to banks, credit unions and the payments system infrastructure.

Chart 1

Domestic Banks & Non-banks (Dec-21)



At end-2021, there were 214 banks and trust companies (see: Table 1, Appendix), which employed approximately 3,834 persons, with the largest single concentration in the 21 local domestic banks and trust companies[7] (3,243 persons). Other entities within the sector included 5 money transmission businesses (MTBs), 3 payment service providers, 10 local credit unions, 58 insurance companies, 246 financial & corporate service providers and 45 investment fund administrators. Within these operations, 9 of the banks and trust corporations operate either fully or in part within the domestic space, as well as 31 insurance companies. In addition, the Government controlled public sector financial entities include: the Bahamas Development Bank (BDB), the National Insurance Board (NIB) and the Bahamas Mortgage Corporation

[7] There were 9 commercial banks in this total, representing the majority of the domestic assets.

(BMC)[8]. The Bahamas International Securities Exchange (BISX) is also an important component of the domestic financial sector; but with relatively small trading volumes and the absence of complex derivatives or other sophisticated instruments.

TABLE 1
Structure of the Financial System

	2015r	2016	2017	2018	2019	2020	2021
Banks & Trusts							
International	233	232	225	211	199	195	193
Domestic	16	16	17	20	22	22	21
Total	**249**	**248**	**242**	**231**	**221**	**217**	**214**
Non-Bank Financial Institutions							
Investment Funds	885	859	783	748	742	712	682
Credit Unions	9	10	10	10	10	10	10
Insurance companies	148	142	144	151	160	159	158
Domestic Companies & Agents	116	112	115	118	127	127	127
External Insurers	32	30	29	33	33	32	31

r - revised

Source: Central Bank of The Bahamas

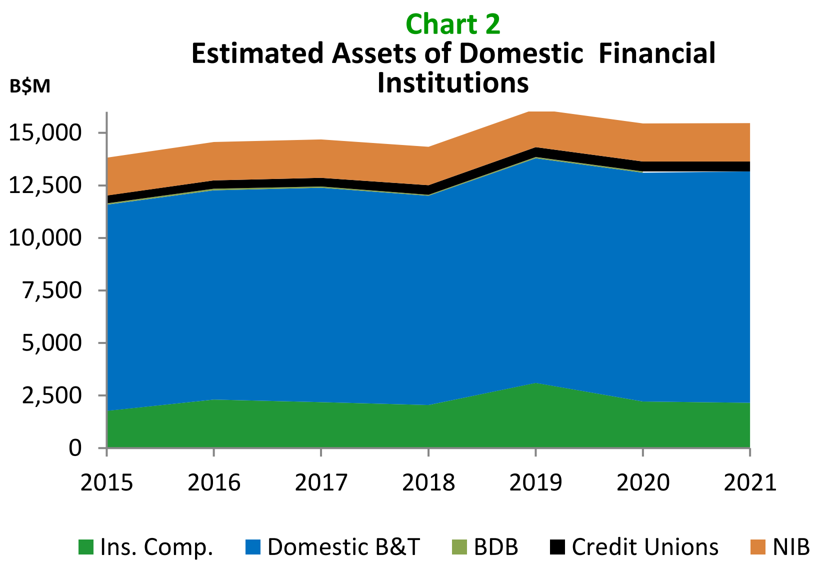
Banking Sector

At end-2021, the banking sector's balance sheet was valued at $150.2 billion, of which international exposures dominated, accounting for $129.0 billion (85.9%) of the total. Domestic licensees (9 commercial banks and 12 mostly trust entities) held the remaining $21.2 billion (14.1%) of assets—which grew by 8.2% in 2021—divided between domestic ($11.0 billion) and foreign ($10.2 billion) assets. Deposits served as banks' most significant source of funds, while the majority share of domestic assets (51.1%) consisted of credit to the private sector in the form of commercial, consumer and residential mortgages. In addition, holdings of Government and public sector debt securities accounted for respective shares of 16.9% and 2.1%. The majority of the sector's assets—in excess of two-thirds—were concentrated in the 3 largest banks.

Fiduciary assets under the care of trust companies were estimated at $153.8 billion in 2021 and were almost exclusively held by international financial firms.

State Owned Enterprises

Major state-owned enterprises in the financial system include: the National Insurance Board (NIB or The Board), the Bahamas Mortgage Corporation (BMC) and the Bahamas Development Bank (BDB). NIB is considered systemically important for financial institutions' liquidity management practices. Meanwhile an uptick in unemployment claims led to significant drawdowns in deposit holdings over the past two years, as a result of ongoing COVID-19 pandemic. Meanwhile, neither BDB nor BMC attract deposit funding for their lending operations and they do not represent a systemically important source of credit expansion. BDB—which provides financing for small and medium-sized enterprises—reported a 7.1% decline in its assets base, to $35.3 million in 2021, as falloffs in deposit balances due from commercial banks and assets held with other local financial, overshadowed the growth in outstanding loans. During the review year, at BMC, mortgages outstanding rose by 12.0%, to $187.2 million.



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

Credit Unions

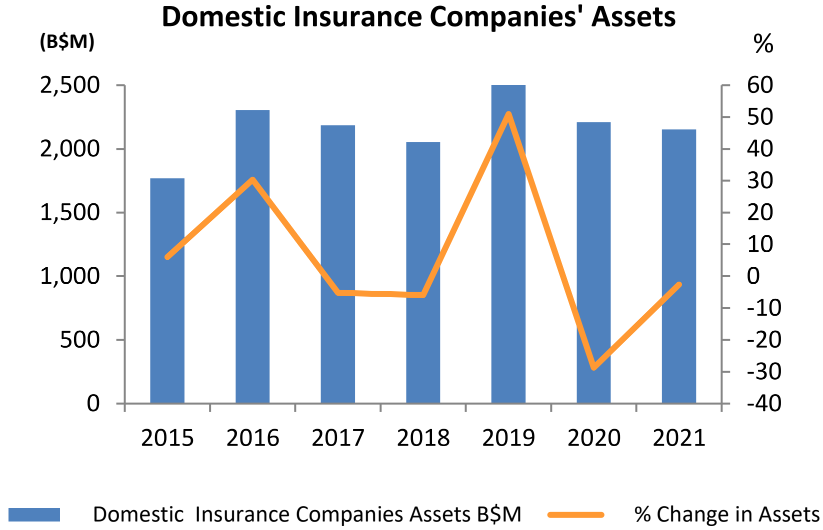
Aside from commercial banks, credit unions are the only other deposit taking and loan granting institutions, with an asset base of $474.6 million in December, 2021. At end-2021, the total membership of these cooperatives stood at an estimated 47,231 individuals. In 2021, the number of active credit unions—inclusive of the Co-operative League—was unchanged at 10. The market continued to be dominated by one institution, which represented approximately 45.9% of the sector's total assets, while smaller entities comprised more modest market shares, ranging from 0.3% to 14.2%.

Insurance Companies

The Insurance Commission of The Bahamas (ICB) reported that operators within the sector consisted of 12 life and health insurers, offering whole life, term life and universal life; and 18 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—5 life insurers and 6 non-life insurers—which represent a combined market share of approximately 92.6% of total gross premiums written and the majority of insurance coverage as at December,

2021. The external insurance sector, which is registered under the External Insurance Act[9], mainly provides self-insurance coverage for non-resident entities in other countries. In 2021, it comprised 39 entities, of which 22 were insurance companies and 17 were captive cells. The total asset base of the sector was relatively stable, remaining at $2.2 billion at the end of the year.

Chart 3
Domestic Insurance Companies' Assets



Source: Insurance Commision of The Bahamas

Capital Markets

The domestic capital market forms a small but, vital part of the financial landscape of the country. The Bahamas International Securities Exchange (BISX) lists and enables the trading of securities of local public companies, and Government's domestic bonds.

While there are currently no financial stability concerns associated with the domestic capital market, performance indicators for the local equity market trended upward during the year, underpinned by the measured pace of recovery in economic performance. The BISX All-Share Price Index increased by 6.5% to 2228.24 points, a reversal from the 6.2% downturn in the preceding year (see Chart 4). Further, the volume of shares traded on BISX more than doubled to 12.0 million, following a 37.2% decline in 2020. Correspondingly, the total value of shares traded grew to $108.4 million, a turnaround from the 34.8% contraction a year earlier.

In 2021, the index's market capitalization rose by 5.9% to $9.3 billion, albeit lower than the 58.4% expansion in the preceding year, which occurred as a result of the listing of Bahamas Registered Stock (BRS) on the Exchange. In addition, the number of companies listed remained unchanged at 47 (see Chart 5). The number of securities listed on the Exchange, excluding public debt instruments remained unchanged at 37, comprising of 20 common shares, 8 preference shares and 9 debt tranches. However, the number of BRS increased by 21 to 231, extending the total number of debt tranches to 240, as the number of publicly traded

[9] See website: http://www.ibc.gov.bs/home

securities on the exchange totalled 268. The five largest companies listed on the Exchange accounted for a dominant 86.3% of total market capitalization; up from 81.4% in 2020.

Chart 4
BISX All Share Index

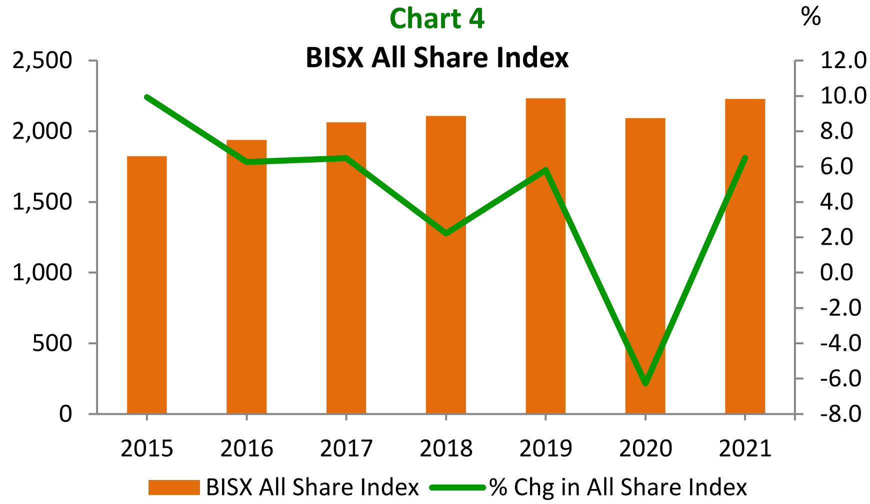
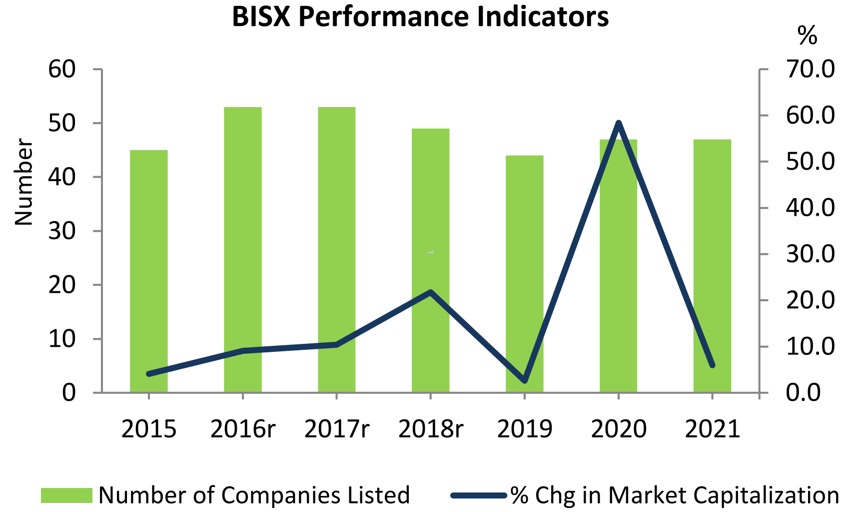


Chart 5
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Payments System

In terms of the payment settlements infrastructure, the Real Time Gross Settlement System (RTGS) is owned and operated by the Central Bank and processes large value transactions (in excess of $150,000). Lower value transactions, however, are channeled through the Bahamas Automated Clearing House Association (BACH), which is owned by the clearing banks. During the review year, the total value of transactions processed through the RTGS decreased by 20.8% to $36.0 billion, from $45.5 billion in 2020. Similarly, retail payments processed through the BACH declined by 6.8% to $4.2 billion, in comparison to $4.6 billion a year earlier.

With regard to other electronic-based payment instruments, the value of debit card transactions grew by 14.3% to $2.0 billion in 2021. However, credit card usage contracted by 11.5% to $217.1 million during the review year. For ATM transactions, the volume rose by 1.8% to 8.1 million, but, the associated value reduced by 7.0% to $1.9 billion. The falloff in electronic payments usage over the review period reflected the residual effects of the COVID-19 pandemic, as globally imposed travel restrictions over most of the year delayed the reemployment of tourism sector employees to the latter months of 2021. As individuals return to work and businesses fully reopen, significant improvements are anticipated for the payments landscape.

Appendix 2

The Banking Stability Index

The Banking Stability Index (BSI) is an aggregate indicator of the soundness of the Deposit-Taking Institution sector. It was calculated as a normalized weighted average of key performance indicators, namely capital adequacy, asset quality, profitability and liquidity. Each variable was normalized using statistical standardization, which allows for the different variables to be on the same scale. The normalized range of values are from 0.0 to 1.0. An increase in the index value shows greater stability. The BSI is measured in standard deviations from the 4-year average.

The Aggregate Financial Stability Index

The Aggregate Financial Stability Index (AFSI) was calculated using four indicators (sub-indices): world climate index, financial development index, financial vulnerability index and financial soundness index. The methodology consists of weighted averages used across the sub-indices, along with the normalization of each indicator for comparability among the variables. The AFSI is therefore the summation of the product of the normalized sub-indices and their associated weights.

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