



**The Central Bank of The Bahamas
Annual Banking Survey Report
2002**

GROSS ECONOMIC CONTRIBUTION OF BANKS AND TRUST COMPANIES IN THE BAHAMAS, 2002

INTRODUCTION

This article reports on the results of the Central Bank's 2002 survey of the gross economic contribution of banks and trust companies in The Bahamas. Value-added expenditures in the banking sector, along with the contribution from other financial services activities account for an estimated 15 percent of the Gross Domestic Product. After slowed growth in 2001, these activities and the associated employment opportunities decreased during 2002, reflecting sectoral adjustments to the new regulatory environment and weak business opportunities in both the domestic and global economy. Sluggishness in the international setting, characterized by both weak macro-economic fundamentals and turbulent financial markets, have also complicated the adjustments brought on by changes in the regulatory regime, where the competitive dimensions of the reforms have not yet been fully ascertained. An added dimension that has prevented a full assessment of the competitive effects of the regime changes is the degree to which the vigor of multilateral initiatives to encourage the strengthening of supervisory regimes among offshore financial centers have wavered, affecting the speed and the extent to which parallel reforms have taken place in many of The Bahamas' competitor jurisdictions. The evolving character and force of the initiatives also introduced delays in decisions to engage new business in international centres. Despite these short-term uncertainties, the recent changes in the regulatory regime are expected to produce positive long-term results for the sector.

An important new policy that is affecting the banking sector is the Central Bank's requirement that all public banking and trust licensees operating from or within The Bahamas establish a staffed, physical presence within the jurisdiction by June 2004. Unless their operations are managed by a public licensee with a physical presence, restricted operations must also meet this requirement. A significant number of managed licensees have decided not to satisfy this requirement and have had their licenses terminated, causing a marked reduction in the number of

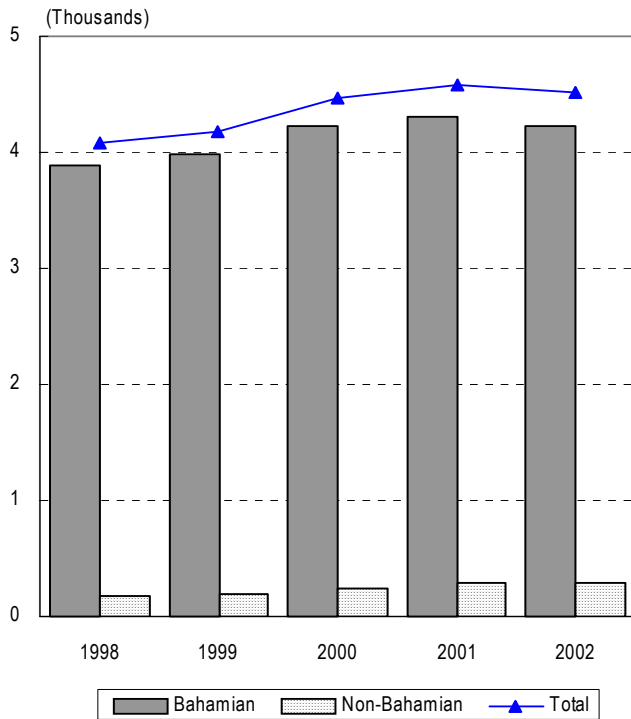
licensed operations for the second consecutive year, to 301 in 2002 from 356 in 2001 and 410 in 2000. Licensed public banking and trust operations fell by 38 to 189 and restricted non-active operations, by 17 to 112. The remaining public licensees consisted of the euro currency operations of 42 foreign branches and 122 Bahamian incorporated institutions which together comprised the international or offshore sector. A further 25 public institutions represent the domestic banking and trust operations, including 9 Authorized Dealers (commercial banks), 1 savings and loans institution and 15 Authorized Agents (trust companies).

While the reduction in licensees had less marked effects on employment, the physical presence count, which affect staffing, also declined, to 203 from 221. Some recovery is expected during 2003, as approximately 43 of the remaining managed operations are in the process of converting to physical presence. Notwithstanding, restructuring activities among domestic banks caused a decline in employment during 2002, while scaled-back capital programmes explained a sizeable decrease in expenditures.

EMPLOYMENT TRENDS

After increasing steadily at an annualized rate of 3.9% in the five years through 2001, banking sector employment decreased by 63 (1.4%) to 4,523 persons in 2002. All of the reduction occurred in the local workforce, where the number of Bahamians fell by 73 (1.7%) to 4,227, in comparison to a gain of 77 (1.8%) to 4,300 in 2001 and average annual job growth of 107 (3.4%) in the five-years ending 2001. The transition to physical presence among managed international banks and trust companies provided marginal job gains at senior levels, with expatriates employment rising by 10 (3.5%) to 296 in 2002, augmenting the 49 positions added in 2001. As a result, the share of jobs held by non-Bahamians rose slightly, to 6.5% from 6.2% in 2001, with a corresponding marginal decrease in the share of Bahamians.

Employment



2001 trend reflected moderated growth from the average five year advance of 8.5% up through this period.

Higher staff expenses, on a reduced workforce, caused the average annual compensation per employee to increase by 6.4% to \$44,851 in 2002, in comparison to a less robust gain of 2.8% in 2001 when bonus packages were scaled back, and an average 4.5% increase per annum for the period 1997 - 2001. Average compensation for Bahamians rose by 7.5% to \$41,600, but was a lesser 4.8% at \$40,556 when adjusted for the impact of the separation packages. This still bettered the average annual gain of 3.6% during 1997-2001. Conversely, the average pay for expatriates decreased by 3.1% to \$91,263 owing to a further reduction in the bonus component.

Emphasis on training was heightened during the year, as direct expenditures partially recovered to \$2.9 million vis-à-vis the 2001 decrease to \$2.2 million and a 5-year high of \$3.1 million in 2000. Employees capitalized on the two and four-year tertiary level programs at local institutions and diploma courses offered by the Bahamas Institute of Financial Services.

EXPENDITURES

A marked reduction in capital spending, after three years of above average outlays, combined with decreases in administrative expenses and government fees, underpinned a contraction in the expenditure contribution of banks during 2002. Total outlays fell by \$31.7 million (7.4%) to \$396.4 million in contrast to a 4.7% increase in 2001 and the last five years' annual uptrend of 9.6% since 1997.

In this context, operating costs represented a higher share of gross outlays (95.1%) compared to 2001 (88.6%) and for the average five years through 2001 (90.7%). These outlays nevertheless, decreased marginally by \$2.4 million (0.6%) to \$377.0 million, reversing the 4.5% increase of 2001, and the average annual rise of 8.3% in the five years through 2001. Salary expenses were higher by 5.0% at \$202.9 million in 2002, mainly reflecting job separation costs associated with the reduced staffing levels. This contrasted with the previous year's growth of 5.7%, when staffing was increased to satisfy regulatory compliance functions, although the

Other administrative costs of the banking sector, inclusive of fees for professional services and utilities, contracted by 7.0% to \$155.7 million, overturning the 2001 increase of 4.8% and contrasting with the five years' average yearly gain of 9.0% through 2001. With a further reduction in the number of licencees, total fees paid to the Government decreased by 5.9% to \$15.5 million, after a reduction of 5.2% in 2001. Inclusive of 2002, the Government's total fees collected from the sector since 1997 amounted to \$93.3 million.

Banks and trust companies' capital outlays declined to \$19.4 million in 2002 from a record high of \$48.7 million in 2001, and above average spending in each of the two previous years of \$31.2 million and \$45.7 million, respectively. In this regard, the combined expenditure on new premises and renovations decreased to \$5.8 million from \$26.1 million; land purchases, to \$0.2 million from \$2.1 million and other fixed assets, to \$13.1 million from \$20.5 million.

TABLE B. GROSS ECONOMIC CONTRIBUTION OF BANKS AND TRUST COMPANIES

Period	1997	1998	1999	2000	2001p	2002p	1997	1998	1999	2000	2001p	2002p
	DOMESTIC						INTERNATIONAL					
A. TOTAL EMPLOYMENT	3,050	3,178	3,203	3,274	3,341	3,284	892	902	978	1,186	1,245	1,239
Bahamians	2,999	3,123	3,155	3,232	3,299	3,240	764	772	836	991	1,001	987
Non-Bahamians	51	55	48	42	42	44	128	130	142	195	244	252
	(B\$ Millions)											
B. TOTAL OPERATIONAL COSTS	185.1	180.5	203.2	216.4	227.7	227.3	90.4	95.3	111.0	146.8	151.7	149.7
(1+2+3+4)												
1. Salaries	100.1	105.8	113.0	119.9	121.5	128.8	39.4	41.7	47.8	63.0	71.7	74.1
2. Government Fees	7.2	4.6	6.5	6.2	6.6	6.3	8.0	9.6	7.9	11.2	9.9	9.2
i) Licence	1.7	2.1	3.0	3.0	3.0	3.1	5.9	5.8	5.2	5.7	5.0	4.2
ii) Company Registration	0.3	0.3	0.6	0.3	1.1	0.7	0.3	0.3	0.4	0.7	1.4	2.1
iii) Work Permits	0.4	0.4	0.5	0.4	0.5	0.4	0.7	0.7	0.8	1.8	1.8	1.9
iv) Other Government Fees	4.8	1.8	2.4	2.5	2.0	2.2	1.1	2.8	1.5	3.0	1.7	1.0
3. Staff Training	1.4	1.6	1.5	1.7	1.2	1.3	0.7	0.9	1.2	1.5	1.0	1.6
4. Other Administrative Costs	76.4	68.5	82.2	88.6	98.4	90.9	42.3	43.1	54.1	71.1	69.1	64.9
C. CAPITAL EXPENDITURE 1/	12.9	9.3	15.9	14.2	25.3	13.2	8.2	8.2	15.2	31.4	23.3	6.2
D. TOTAL EXPENDITURE (B+C)	198.0	189.8	219.1	230.6	253.0	240.5	98.6	103.5	126.2	178.2	175.0	155.9
E. AVERAGE SALARY (B\$'000)	32,808	33,296	35,270	36,619	36,381	39,217	44,180	46,255	48,874	53,134	57,603	59,785

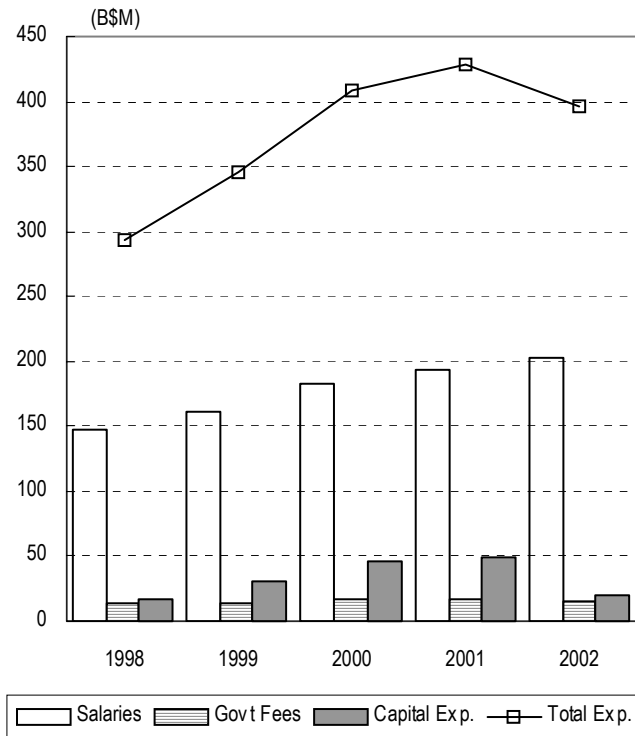
Source: The Central Bank of The Bahamas

1/ (includes construction, renovation expenses and other fixed assets)

DOMESTIC VS. INTERNATIONAL

An analysis by domestic and international operations provides additional useful insights into the banking sector's contribution to the economy. By comparison, domestic operations are of the retail, labour intensive nature, as compared to the more high-end, skills dependent private banking and assets management functions of the international sector. It is important to note however, that many domestic licencees also have significant international or non-resident operations.

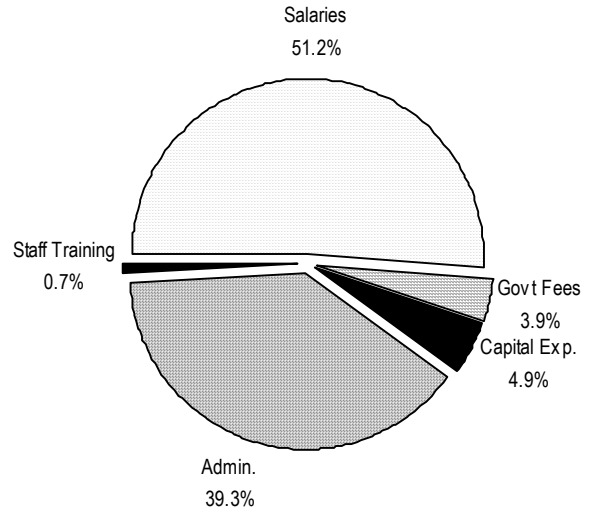
Expenditure



Total employment among domestic banks fell by 57 (1.7%) to 3,284 during 2002, representing a stable 72.6% of all positions within the sector. Developments were largely influenced by the pairing down of the operations of one institution with an international focus, and reduced staffing at a number of retail operations. The downsizing exercises nevertheless, only affected jobs held by Bahamians, which decreased by 59 to 3,240, while expatriate jobs rose by 2 to 44. Correspondingly, the share of jobs in the local sector held by Bahamians was slightly re-

duced to 98.7%, although there was some preservation of the overall trend, which shifted the employment share gradually higher in favour of locals, relative to the 1997 share of 98.3%.

Expenditure Components (% of Total)



Offshore sector employment was less markedly reduced, by 6 (0.5%) to 1,239, with Bahamian jobs lowered by 14 (1.4%) to 987, and offsetting the 2001 gain of 10 (1.0%). Conversely, expatriate positions rose by 8 (3.3%) to 252. As a result, the ratio of Bahamians to non-Bahamians in the international banking sector softened to 4:1 from the previous five years' average of 5:1.

During 2002, total expenditures among local operations contracted by 4.9% to \$240.5 million, marked by a 47.7% decrease in capital outlays to \$13.2 million. However, the 2.4% increase in staff costs dampened the total falloff in operating costs, at 0.2% to \$227.3 million. While training outlays were restored to their 2000 levels, reduced outlays were registered for administrative costs (7.7%) and Government fees (3.9%). Nonetheless, in line with total employment shares, domestic operations continued to account for the bulk of expenditures. The share increased slightly to 60.7% in 2002, as these amounts fell by a smaller fraction than the corresponding outlays in the international sector, but was less than the five-year average ratio of 61.5% through 2001.

In the international sector, total expenditure declined further by 10.9% to \$155.9 million, also led by a downturn in investments outlays to \$6.2 million from \$23.3 million in 2001. Although less marked, operating costs fell by 1.3% to \$149.7 million in comparison to gains of 3.3% in 2001 and average annual growth of 13.8% in the five years through 2001. Despite the noted reduction in the number of public licensees, staff outlays were augmented by 3.3%, albeit, fees paid to Government decreased correspondingly by 7.5% and other administration costs declined by 6.1%.

Once job separation effects were excluded, average salary differences, which favour international banking, were maintained during 2002. Unadjusted, average pay in the domestic sector rose by 7.8% to \$39,217. Excluding the separation packages, the increase was 3.9% to \$37,812 per annum, still contrasting with an average compensation gain of 3.9% to \$59,785 for those engaged in the international sector. These compared with respective average annual pay increases of 2.6% and 6.9% in the corresponding sectors during the five years through 2001. Using the adjusted estimate, the average premium on salaries for international operations relative to those in the domestic sector was approximately stable at 58.1%.

REGULATORY AND SUPERVISORY ACTIVITIES

In the context of these developments, efforts continued unabated at strengthening supervisory processes with the banking sector. Into its second year, the Central Bank's onsite examination of banks and trust companies resulted in another 102 inspections carried out during 2002 as compared to 115 in 2001. These included 9 follow-up examinations, 91 first time inspections of international operations and 2 examinations of domestic retail institutions. In addition to prudential issues related to the safety and soundness of financial institutions, examinations assessed the adequacy of anti-money laundering and "know-your-customer (KYC)" compliance and control systems mandated by the 2000 package of legislation. The offsite examinations, which are a counterpart to these inspections, continued to assess the ongoing financial positions of active licensees, employing audited financial statements and other statutory reports. As an adjunct to the process, prudential discussions were held with the senior management of 148 licensees, concentrating, among other issues, on peer-wise comparisons of

licensees' performance as well as on business plans, risk management systems and procedures and capital adequacy. The Central Bank also continued to vet and approve the appointment of directors and senior officers of licensees.

In addition to the continued phasing out of managed operations, work intensified during 2002 on the issuance of Central Bank guidelines affecting the operations of banks and trust companies in The Bahamas. These included comprehensive guidelines for the licence application process and enhanced fit and proper requirements, including diligence procedures for the approval of directors and senior executives of licensees; procedures for reviewing license applications and for assessing the fitness and propriety of applicants. The Central Bank also issued a number of managed licensee guidelines, addressing the transitioning of such entities to full physical presence, and requirements that such entities would have to satisfy, either as branches or restricted operations, to remain as managed licensees.

The development of supervisory policies and guidelines has also been subject to an increased level of consultations with the industry. Draft prudential guidelines and regulations being circulated for public review and comments at the end of 2002 had as their focus a variety of issues, including large exposures limits, liquidity requirements and foreign currency limits.

As regard cross-border supervision, the Central Bank has also intensified its cooperation with foreign supervisory authorities during 2002. Consolidated supervision of the branch operations of banks licensed in other jurisdictions is an important new feature in the Banks and Trust Companies Regulation Act, 2000, as is greater scope for the Bank to provide assistance to request for information from such agencies. Under such provisions, foreign supervisory authorities were permitted to carry out at least four inspections of Bahamas-based branch operations in 2002, utilizing terms established in earlier Memorandum of Understandings (MOUs), which the Bank concluded with such agencies. During 2002, the Bank executed MOUs along similar lines with additional foreign supervisory authorities. The Bank also either initiated investigations into or provided assistance on information requests in 41 cases originating from supervisory authorities in some 19 countries.

The uniform application of anti-money laundering measures across all financial sector activities meanwhile, provided scope for closer cooperation among the various domestic regulatory and supervisory agencies. In October 2002, a MOU was executed between the Central Bank, the Securities Commission, the Registrar of Insurance, the Registrar General's Department and the Corporate and Financial Services Unit within the Ministry of Financial Services and Investment, formally providing for information sharing, inter-regulatory cooperation and the harmonization of regulatory policies and practices. Under the terms of the MOU, the regulators have already started joint on-site examinations of licensees that are supervised by more than one agency.

As regard other structural changes in the local sector, regulatory approval was granted by the Central Bank and other regional supervisory authorities (except the British Virgin Island) to effect the combination of the Caribbean operations of Barclays Bank Plc and CIBC (West Indies) Holdings Limited. The newly created institution, FirstCaribbean International Bank, is headquartered in Barbados, where the local supervisory and regulatory responsibilities also rest. The domestic sector was also impacted by the closure announcement by Lloyds Bank and Trust (Bahamas) Limited in October 2002, with plans to transfer operations to its North American office.

OTHER DEVELOPMENTS IN THE FINANCIAL SECTOR

The Central Bank also surveyed the economic contribution of other financial sector activities during 2002, including credit unions, the insurance sector, mutual funds administrators and corporate services providers.

Some 20 credit unions operated locally during 2002, compared to 19 in 2001, with an increased asset base of \$132.0 million relative to \$120.4 million in the previous year. During 2002, credit unions provided employment for approximately 96 Bahamians, with estimated expenditures in the local economy of \$5.6 million. The salary component represented 36.3% of total outlays, followed by capital expenditures (34.7%) and administrative fees (21.1%). However, fees paid to Government averaged slightly less than 1.0% of the total. The average salary among credit union employees was estimated at \$12,146.

In the insurance sector, the number of registered companies, brokers and agents increased by 3 to 147 during 2002, reflecting growth in domestic operations, as the number of external insurers remained at 27. Based on the latest available information for 2001, the asset base of domestic insurers was in excess of \$680 million. Although less complete information is available on the sector's contribution, the 2002 survey results covering 13 of the larger domestic operations, which represented nearly 700 employees, indicated an average salary around \$37,000 per annum, with the estimated compensation for Bahamians closer to \$36,000. Some 98.1% of the workforce were Bahamians. For the entities surveyed, salaries represented 56.0% of the total expenditures; administrative expenses, 30.0% and license fees, work permit and other fees paid to Government, approximately 8.0%. Capital outlays were less than 2% of the 2002 expenditures; albeit, similar to the banking sector, insurance companies also expended above average amounts in the last five years on renovations and the construction of new premises.

Statistics compiled by the Securities Commission indicated a modest increase in the number of active mutual funds under management, to 706 during 2002, with a slight increase in assets to \$97.3 billion. Less comprehensive data is available on the industry's contribution to the economy, since such operations are managed by a combination of mutual fund administrators licensed by the Securities Commission as well and banks and trust companies licensed by the Central Bank. Based on responses received from 9 out of 18 fund administrators surveyed, average annual compensation appears much higher than in insurance and domestic banking, consistent with the international focus of the sector—approximating \$48,000 for Bahamians and in excess of \$100,000 for non-residents. It is estimated by the Securities Commission that the Government collects nearly \$1.0 million annually from the licensing and registration of mutual funds.

Responses from 20 corporate service providers, handling mainly IBC business, indicate that Government fees approximate about \$500 per entity in 2002, with most ranging between \$300 - \$700 per annum. Although a precise estimate on the number of funds was not available, indications are that incorporation and registration activities rebounded during 2002, as fees collected

by the Government recovered by nearly 50% to \$18.0 million during Fiscal Year 2001/02. Fee collection was also more than 10.0% higher during the first three quarters of FY2002/03.

Domestic capital market developments during 2002 were underscored by continued weakness in the level of trading activities which further impeded the operating results of the Bahamas International Securities Exchange (BISX). The expected launch of international products, expected to generate most of the operating revenues, particularly mutual funds listing, did not occur as originally anticipated, while ability to attract international business stalled in the face of the changing regulatory landscape, which nearly coincided with the opening of the Exchange. BISX's operations have therefore relied exclusively on domestic securities listings and trading. Corresponding to similar weakness in the local over-the-counter market, the volume of local shares traded on BISX fell by 30.6% to 2.748 million, with a reduced estimated value of \$13.6 million, compared to \$23.7 million in 2001. Reflecting this market valuation loss, the BISX All Share Price Index declined by 13.0% during 2002. The number of publicly traded companies in The Bahamas remained at 23, although BISX-listed entities decreased by one to 16, following the voluntary delisting of RND Holdings Limited in August 2002.

Amid challenges, efforts to formulate a more financially viable development strategy for the Exchange intensified during 2002. A BISX Joint Capital Market Development Working Group, including the Central Bank, was formed in February 2002 to develop a long-term financing proposal for the Exchange. This work concluded in August with the presentation to the Government of a set of recommendations on financial support for BISX, submitted by the Central Bank and BISX's board of directors. In November, the Government subsequently appointed a select Committee, to advise it on a final support strategy for the Exchange.

CONCLUSION

The competitive dimensions of supplying international financial services have risen to the forefront in

recent years, and The Bahamas has responded by increasing the level of resources dedicated to the promotion of the sector, and through ongoing regulatory enhancements. The securities industry and the insurance sector are currently at the centre of such initiatives. Industry comments have already been received on a third draft of a new insurance sector bill, which is expected to be considered by Parliament before the fall of 2003. Among other things, the legislation is expected to address increased reporting and prudential requirements for insurance companies, and update the requirements for the provision of insurance in the domestic sector, including brokerage services. As regard the securities industry, the replacement to the Mutual Funds Act 1995, The Investments Fund Act, was approved by Parliament in May 2003 and is expected to come into force well before the end of 2003. Apart from supervisory considerations, the Act is noteworthy for its recognition of the potential for growth in business opportunities for the international sector, beyond the more limited range of mutual funds, and is in keeping with the diverse character of investment vehicles available in international financial markets.

Aside from product enhancements along the above lines, more convergence is foreshadowed in the supervisory processes being applied to the various sub-sectors of The Bahamas' financial services industry, capitalizing on the cooperative structures that have been created among local supervisory agencies. In addition to gains in the quality of prudential oversight, the flow of data on the performance of the sector is expected to improve, providing more timely input to policy formulation. Having strengthened the regulatory framework of the jurisdiction, The Bahamas is better poised to take advantage of long-term growth opportunities in the supply of these services with more assured confidence from its international supervisory peers and the clientele base. Such inroads should ensure a sustained and expanded contribution of financial services within the economy.

Table C: Other Selected Financial Sector Statistics

	Unit	2000	2001	2002
Mutual Funds				
Licensed Mutual Funds	Number	757	673	706
<i>Assets Under Management</i>	<i>B\$ Billions</i>	95.02	94.47	97.34
Insurance Companies and Agents				
Total Insurer and Agents	Number	144	147	149
Domestic Companies and Agents	Number	117	120	122
<i>Total Domestic Assets</i>	<i>B\$ Millions</i>	620.4	682.6	n/a
External Insurers	Number	27	27	27
Credit Unions				
Number of Unions	Number	18	19	20
<i>Total Assets</i>	<i>B\$ Million</i>	110.9	120.4	132.0
Bahamas International Securities Exchange (BISX)				
Listed Companies	Number	15	17	16
Shares Traded	Millions	3.72	3.96	2.75
Market Capitalization	B\$ Billion	1.74	1.68	1.31

Sources:

The Central Bank of The Bahamas, Bahamas International Securities Exchange (BISX),
The Securities Commission of The Bahamas and The Registrar of Insurance Companies.