THE CENTRAL BANK OF THE BAHAMAS

ANNUAL REPORT
& Statement of Accounts
2012

For the year ended 31 December, 2012

Mission

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

Values

Our commitment to fulfilling our Mission is embodied in our Core Values of:

- Objectivity
- Confidentiality
- Integrity
- Excellence
- Teamwork
- Empowerment
- Initiative

Vision

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

THE CENTRAL BANK OF THE BAHAMAS

March 22, 2013

Dear Prime Minister:

In accordance with Section 32(1) of the Central Bank of The Bahamas Act, 2000, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2012. Included with this Report is the Annual Statement of Accounts of the Bank for the year.

Respectfully yours,

Wendy M. Craigg
Governor

The Rt. Hon. Perry G. Christie
Prime Minister and Minister of Finance
Office of the Prime Minister
Cecil Wallace-Whitfield Centre
West Bay Street
Nassau, N.P., Bahamas

About The Bank

Under the Central Bank of The Bahamas Act, 2000 (the Act), the Bank is mandated to promote and maintain monetary stability and balance of payment conditions, conducive to the orderly development of the economy; in collaboration with other financial institutions, to promote and maintain adequate banking services and high standards of conduct and management therein; and to advise the Minister on any matter of a financial or monetary nature referred by him to the Bank for its advice.

MONETARY POLICY

In its monetary role, a central objective of the Bank is to ensure that adequate support is maintained for the fixed parity of the Bahamian dollar against the United States currency. To do so, the Bank has to maintain adequate foreign reserves against the stock of its demand liabilities to banks and the public, and ensure that the demand for foreign exchange, stimulated principally by domestic credit expansion, does not exceed the pace at which the economy earns foreign currency from real sector activities. In support of this goal, the Bank has statutory responsibility for the prudent management of the country's external reserves.

The Bank's administration of exchange controls is also closely linked to the fixed exchange rate policy objective. Capital controls, which have undergone gradual relaxation in recent years, restrain the movement of capital by residents; however, there are no restrictions on current payments.

FINANCIAL STABILITY

The Bank's supervision regime, through its prudential oversight of regulated entities, is a critical part of the infrastructure to maintain high standards of service, conduct and management in the banking sector. A combination of off-site examinations, on-site inspections, and market intelligence informs the risk-based assessments that are used to monitor the soundness of licensees, and stress testing is undertaken to gauge resilience to key economic and financial shocks.

PAYMENTS

The Bank's involvement in the payments system is also an integral component of its overall mandate to ensure stability of and confidence in the financial system. In performing its oversight function, the Bank seeks to ensure, *inter alia*, that the payments infrastructure functions smoothly, efficiently and fairly in the interest of all participants and users, that it minimizes and controls risks, and that the level of technological, product and services development is adequate and satisfies the needs of the economy.

CURRENCY

The Bank meets the currency needs of the public by arranging for the procurement, storage and issuance of Bahamian banknotes and coins, as well as maintaining the quality of currency in circulation. Banknotes deemed as unfit are withdrawn from circulation and replaced.

PUBLIC DEBT & FUND MANAGEMENT

The Bank provides front, middle and back office services to the Government and its agencies in activities involving debt issuance and administration, and the management of several sinking fund arrangements.

Directors and Senior Officials

At December 31, 2012

DIRECTORS

Mrs. Wendy Craigg - Chairman

Mr. Maxwell Gibson

Mr. L. Edgar Moxey

Archdeacon James Palacious

Mr. Felix Stubbs

SENIOR OFFICIALS

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

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Foreword

The global backdrop for the performance of the Bahamian economy in 2012 was one of weak and uneven output growth, reflecting restraints imposed by fiscal consolidation, household deleveraging, cautious business spending and still sluggish global trade. Notwithstanding, the domestic economy maintained a mildly positive growth momentum of 1.8%, supported by steady gains in tourism, alongside foreign and public sector-led construction investments. However, the narrow nature of the recovery constrained job gains, while price developments were, on balance, stable, despite the volatility in global oil prices. Challenges persisted on the fiscal front, as the overall deficit for FY2011/12 widened, amid weak revenue flows and higher capital spending.

Throughout 2012, the Bank remained focused on ensuring the stability of the financial sector, headlined by the monitoring of commercial banks' key risks, especially credit risk, given the persistence of elevated non-performing loans. This was reinforced with stress testing of banks' resilience to reasonable shocks, and other initiatives aimed at achieving compliance with international best practices for regulation and supervision.

The success of our efforts in these areas was confirmed by the outcomes of The Bahamas' first Financial Sector Assessment Programme (FSAP), which was conducted in July by a 12 member team under the leadership of the International Monetary Fund (IMF). The assessment, which comprised a series of comprehensive reviews of the main components of the financial sector, namely, banking, insurance and securities activities, concluded that there were no immediate threats to financial stability and cited improvements in our supervisory and regulatory oversight arrangements. Since the FSAP, all of the domestic regulators have incorporated the recommendations into their respective work agendas, including specific initiatives aimed at strengthening crisis management and financial safety net frameworks.

In this report, you will be updated on the Bank's progress with various strategic initiatives. In the area of bank supervision, work continued towards achieving full implementation of the risk-based supervisory framework, issuance of new and revised supervisory guidance documents, and planning for the implementation of Basel III. On the legislative front, several significant pieces of legislation were passed, in January, geared towards enhancing oversight of domestic payments, and industry consultations were undertaken in respect of proposed changes to the governing legislation for banks and trust companies.

Work on the credit union transition project is also well advanced. Drafts of a Credit Unions Bill and accompanying regulations are presently under consideration by stakeholders, and training and consultative initiatives have focused on capacity building and the corporate governance framework of the sector. We are also pleased with the progress made towards the implementation of a credit bureau, having now reached the stage where established workgroups, drawn from the major credit providers, have commented on a draft Credit Reporting Bill.

In other areas of our operations, we continue to pursue measures to ensure that the Bank is well positioned and equipped to deliver on its mandate. Apart from streamlining operational processes, we have also enhanced our compensation programme that will help in recruiting and retaining talent, and continue to place emphasis on training and development.

Our success derives heavily from the skills and commitment of our team and the expertise they bring in the areas of research, supervision, information management, facilities management, human resource management, finance, audit and operations. I therefore, would like to thank them for their cooperation and support, and look forward to their continued commitment in the future.

Governor

2012 at a Glance

- The Bahamian economy grew at a mild pace of 1.8% in 2012, supported by steady gains in tourism output and foreign investment-led construction activity.
- Inflation remained relatively benign, despite the volatility in international oil prices.
- The unemployment rate declined by 1.9 percentage points, year-on-year, to 14.0% at end-November, although staying well above pre-crisis levels.
- Government's overall deficit widened to an estimated 5.6% of GDP in FY2011/12 from 4.7% in the prior period, as the gains in expenditure outstripped increases in tax revenue.
- The National Debt to GDP ratio rose to an estimated 61.2% of GDP in 2012, up from 55.3% in 2011.
- In July, the Bank coordinated the country's first Financial Sector Assessment Programme (FSAP)—the outcomes of which confirmed the stability of the Bahamian financial sector.
- In the banking sector, high levels of loan arrears persisted, dampening private sector credit, with one outcome being the continuation of elevated liquidity levels.
- Oversight of domestic payment systems was enhanced through the enactment of significant pieces of legislation.
- Major progress was achieved on the rollout of the Risk-based Supervision Framework (RBSF).
- The Credit Union Transition Project attained a major milestone, with the preparation of a draft Credit Unions Bill.
- Steps towards the eventual establishment of a domestic credit bureau were advanced with the production of a draft Bill, which is presently under consideration by key stakeholders.

GOVERNANCE AND ACCOUNTABILITY

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

Board of Directors

Under the governance structure established in the Act, the Board of Directors is responsible for the overall policy and general administration of the Bank, covering strategic planning, financial and accounting matters, risk management and other internal policies. The Board comprises the Governor (Chair) and four (4) independent Directors. Members of the Board are appointed by the Governor General.

The Bank wishes to extend its sincere thanks to former Directors, Messrs. Wayne Aranha, Colin Callender, Q.C., and Philip Stubbs, whose tenure ended 30th June, 2012, and to Dr. Ronald Knowles who resigned from the Board, with effect from 6th June 2012, for their contribution to the work of the Bank. We also extend a warm welcome to new Directors Messrs. Maxwell Gibson, L. Edgar Moxey, Felix Stubbs and Archdeacon James Palacious, who were appointed with effect from 1st July, 2012.

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

Among the statutory provisions governing Board appointments, Directors may not hold more than one percent (1%) of the ordinary paid up share capital of, or have a controlling interest in any financial institution, trust company or money transmission business regulated by the Bank.

The Board, which is required by the Act to hold monthly meetings, met on twelve (12) occasions in 2012; three (3) Directors form a quorum. The Act provides for the appointment of two (2) Deputy Governors who may attend Board meetings, but are not entitled to vote. However, where a Deputy Governor, in the absence or disability of the Governor, is chairing the Board meeting, he or she is entitled to vote. Currently, only one Deputy Governor has been appointed.

During its meetings, the Board considered regular reports on monetary and financial developments; monthly financial statements and reports comparing actual financial performance against the approved budget and substantial financial contracts for the procurement of goods and services. A permanent Board agenda item was a discussion of economic and financial conditions, both domestic and external, and their implications for the economy as well as the Bank's operations. The Board was also kept informed of the Bank's activities and decisions through detailed quarterly operational briefings from management.

Audit Committee

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

The Audit Committee is composed of three (3) non-executive Board Members, L. Edgar Moxey (Chairman), Maxwell Gibson and Felix Stubbs. The Heads of Internal Audit and the Accounts Department normally attend the meetings of the Committee. In 2012, the Committee held thirteen (13) meetings, inclusive of three (3) sessions with the external auditors.

Accountability & Transparency

In the conduct of its affairs, the Bank seeks to ensure a high degree of transparency, which facilitates accountability. In accordance with statutory requirements, the Bank prepares a report of its activities during the year, which is submitted to the Minister of Finance within four (4) months after the end of each fiscal year. Copies of this report are laid before Parliament. Monthly balance sheet information is also provided to the Minister and published in the Gazette.

The Bank releases information on domestic economic and financial developments in its Monthly Economic and Financial Development (MEFD) reports, Quarterly Economic Reviews (QER) and Quarterly Statistical Digests (QSD). All of these publications are made available to the public on the Bank's website.

As part of the Bank's arrangements to facilitate and maintain coordination between monetary and fiscal policy, the Governor meets with the Minister, or his designee, on a monthly basis. This also provides an opportunity for keeping the Minister informed of the Bank's performance in meeting its statutory obligations.

During 2012, the Governor and senior officers of the Bank gave official speeches on various topics, including domestic economic conditions and prospects, developments in the regulatory and supervisory space, and updates on other strategic projects.

Strategic Planning

The Board-approved Strategic Plan (2009-2013) establishes the goals, objectives and strategies which continued to define the activities pursued by the Bank in 2012. For this five-year period, the Bank has identified six (6) strategic goals, which are closely aligned with its statutory duties and functional priorities, namely:

Goal 1: Effective Monetary Policy

Goal 2: Safety and Soundness of the Financial System

Goal 3: Effective Contribution to Economic Policy Making

Goal 4: Secure, Efficient and Modern Payment System

Goal 5: Prudent Foreign Exchange Management

Goal 6: Operational Efficiency

Ownership of the Plan is promoted through the Bank's performance management system and individual employee performance targets. Progress with agreed strategic activities was assessed throughout the year, and communicated to the Board. The Bank achieved notable progress on several targets concerned with the safety and soundness of the financial system and monetary policy implementation. Although some adjustments were required to implementation timelines for several projects, due to various exigencies, the Bank still expects to accomplish its specified activities within the life of the Plan.

Bank Management

The Governor, Deputy Governor and Department/Unit Heads are integrally involved in the governance of the Bank's operations, meeting at least weekly, or as frequently as matters dictate, to discuss strategic activities and ongoing work programmes. During 2012, emphasis was maintained on ensuring the appropriateness of the Bank's operational policies and procedures, finalizing BCP arrangements, and addressing human resources and skill requirements to satisfy the Bank's ongoing needs.

Decision making on matters pertaining to the Bank's critical functions and overall operational practices and procedures is supported by several strategic internal committees, either directly chaired by the Governor or under delegated authority to other Bank officers. These are:

- the **Executive Committee**, which meets weekly, to consider the management and day-to-day operations of the Bank;
- the **Monetary Policy Committee**, which meets monthly, to discuss economic and monetary developments and decide on issues relating to the formulation of monetary policy;
- the **Investment Committee**, which meets weekly, and maintains oversight and manage-

BOX 1: Strategic Focus for 2013

IMPROVE OPERATIONAL FRAMEWORK FOR MONETARY POLICY

- Continue work on creating quarterly economic forecasts, using the financial programming model.
- Develop and expand payment system oversight functions of the Bank to cover e-money products, and conclude arrangements for the introduction of a domestic payments switch arrangement and other retail payment services.
- Progress consultations with key stakeholders on market-based auction mechanism for Government bonds, and other initiatives aimed at introducing efficiency in Government securities market.
- Advance proposed changes to the Central Bank Act, to ensure the Bank's ability to meet its mandate in a more dynamic financial environment.
- Introduce a robust web portal to facilitate online reporting by stakeholders.
- Compile balance of payments according to revised IMF methodology.

STRENGTHEN REGULATORY AND SUPERVISORY FRAMEWORKS

- Conclude implementation of Risk Based Supervisory Framework (RBSF), and achieve full integration with onsite examinations.
- Enhance capital rules to conform with Basel II and Basel III requirements.
- Continue review of legislation, regulations and guidelines to maintain compliance with evolving international standards.
- Continue monitoring of credit risks, through regular meetings with commercial banks and the stress testing exercise.

ENHANCE FINANCIAL STABILITY ARRANGEMENTS

- With assistance from other regulators, develop national financial crisis management plan, to include an evaluation of deposit insurance arrangements.
- Enact credit reporting bill and select an appropriate credit bureau operator who would assist with consumer education initiatives.
- Produce an inaugural semi-annual Financial Stability report for The Bahamas.
- Assume supervisory and regulatory responsibility for credit unions.

IMPROVE OPERATIONAL EFFICIENCY

- Review Exchange Control arrangements with a view to achieving further operational efficiencies and providing opportunities for greater liberalization.
- Complete build out of business continuity plan, to include the secondary site and other resiliency arrangements.
- Continue to leverage automation in work processes, to achieve greater efficiency.

ment of the external reserves and provides input into other Bank-related investment decisions;

- the **Policy Advisory Committee**, which meets monthly, to consider supervisory and regulatory policy initiatives;
- the **Selection and Appointment Committee**, which meets as necessary, to undertake final screening and make appointment recommendations in respect of candidates applying for position vacancies; and
- the **Pension Administrative Committee**, which meets quarterly, and considers matters relating to the administration of the Bank's defined benefit pension plan.

RISK MANAGEMENT

In carrying out its responsibilities, the Bank faces a range of financial, business and enterprise risks, which it seeks to manage carefully, so as to limit any impact on the Bank's ability to fulfil its mandate. The Bank's risk management framework assigns primary responsibility for identifying, assessing, controlling and mitigating risk to the management of each operational area; and the Board as well as the Audit Committee also contribute to the risk management process.

Among the key mechanisms used to control operational risks are: effective budgetary controls; separation of duties; the creation of policies, standard operating procedures and internal controls; extensive monitoring, reconciliation and reporting systems; a sound procurement framework; ongoing training; an internal audit function that continues to play a crucial role in monitoring operational risks, and an institutionalized framework for strategic planning. To further embed a risk management culture within the Bank, steps are underway to complete the build out, in 2013, of a comprehensive risk-based control self-assessment process for all operational activities.

Given the heavy reliance on technology in operational activities, an important element of the Bank's enterprise risk management strategy involves a routine evaluation of data security and information management processes to ensure their appropriateness and robustness. As part of the annual audit exercise, the Bank undertakes a system and process assurance review of key applications and software to ensure, *inter alia,* accuracy in processing of data and logical access controls. To further mitigate risks, specific process enhancements were implemented for various treasury back office operations, to achieve straight-through processing objectives, and other operational activities were automated and proper controls implemented.

The Bank has in place a number of controls to mitigate fraud, inclusive of a clear decision making hierarchy, well defined limits for staff involvement in financial decisions/transactions, controls on users' computer access and independent functions. Along with the Fraud Control Policy, staff training in fraud awareness, and arrangements by which suspicious behaviour can be reported anonymously, provide a framework for maintaining staff understanding of their responsibilities in this area. The Bank's employee Code of Conduct also outlines the high standard of integrity and propriety that is expected of staff in carrying out their duties.

During 2012, efforts were ongoing to strengthen the Bank's readiness and response capabilities to address potential business disruptions. Having agreed on the IT Disaster Recovery strategy, the Bank acquired and implemented the various systems, and steps are underway to complete the remaining elements of the Business Continuity Plan (BCP) in early 2013.

In other risk mitigation strategies, the Bank continues to review its operational processes, incorporate best practices, and put in place well-defined policy frameworks. Along these lines, succession planning and talent management remained key elements of the Bank's risk management framework. In its Succession Plan, the Bank has identified various critical positions, and a talent pool of staff from which it may draw to fill vacancies in some of those areas. In 2013, the objective is to ensure that developmental plans, and that other human resource initiatives support operational resiliency.

INTERNAL AUDIT

Internal Audit (IA) is integral to the Bank's internal control framework, providing independent, objective evaluation and assurance activities, and reporting on the effectiveness of internal controls, risk management and governance activities. It is through these efforts that IA works to assist the Bank in achieving greater operational effectiveness and efficiency.

The operations of IA are guided by a Board-approved Internal Audit Charter, which formalizes the mission, authority and responsibilities of this function within the Bank. IA's activities are based on a risk-driven Audit Plan, which is approved by the Audit Committee. To maintain independence, the Head of IA reports functionally to the Audit Committee and administratively to the Governor.

In 2012, IA conducted reviews of the Bank's processes in the Accounts, Banking, Bank Supervision, Exchange Control, Administration, and Human Resources Departments. Recommendations made were accepted for implementation by the various departments to achieve enhancements in the control environment. In complementary activities, IA provided input to various working committees of the Bank, geared towards promoting robust internal controls and governance and risk mitigation arrangements.

BOX 2: Monetary Policy in 2012

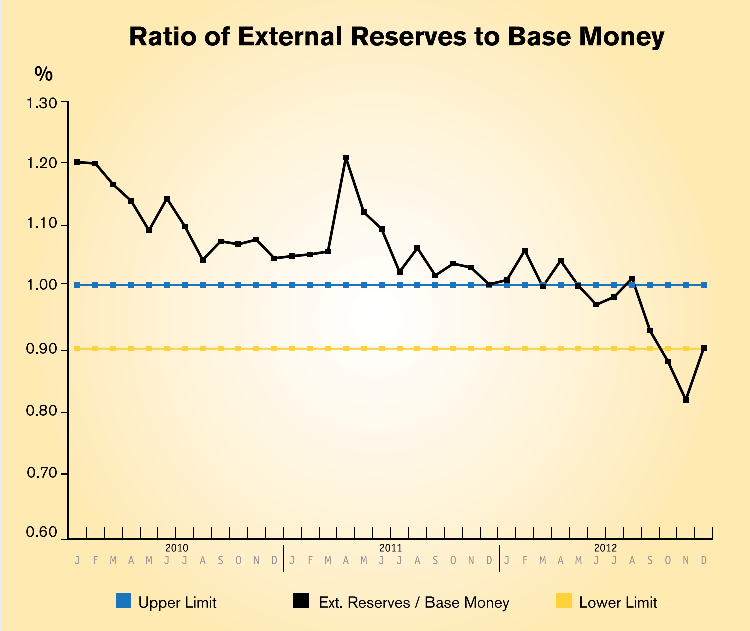
During 2012, the Central Bank's Monetary Policy Committee (MPC), chaired by the Governor and comprising several Department Heads and technicians, continued to monitor and analyze developments in the domestic and international environment, to ensure the appropriateness of domestic policy measures in maintaining financial stability and the adequacy of balance of payments conditions to support the fixed exchange rate regime. The MPC met on twelve (12) occasions, and its reports were summarized in a public release five (5) days subsequent to the meetings.

MPC proceedings in 2012 were framed by several key trends in the domestic real and financial sectors, namely:

- Mild growth in tourism and other real sector activity, and the narrowness of the economic recovery, with no significant improvement in employment conditions.
- The fairly tempered level of foreign currency inflows set against ongoing demands for foreign exchange, especially for oil payments, and the corresponding downward pressure on external reserves.
- Persistence of elevated loan arrears in the banking sector, as business conditions remained challenging and consumers continued to deleverage from a sizeable debt overhang.
- Sluggishness in private sector demand, banks' more stringent borrowing requirements and the high debt profile of the consumer constrained growth in private sector credit.
- Elevated levels of bank liquidity, which kept interest rates low.

Against this backdrop, the MPC closely monitored the evolution of external reserves, which fluctuated between 100%-105% of base money in the first five (5) months of the year, to exceed the upper bound of the Bank's target range of 90%-100%. This outturn reflected modest tourism sector earnings, construction-related foreign investment inflows and foreign currency proceeds from extraordinary tax receipts related to the sale of a large-scale tourism resort. In the latter six (6) months, however, the ratio receded to average between 90-100%, due to profit repatriations by some banks and sizeable outflows for fuel purchases. After reaching a low of 81% of demand liabilities in November, the ratio recovered to approximately 90% at end-2012, being supported by the proceeds of the Government's $180 million external loan in mid-December.

The MPC's deliberations included ongoing reviews of economic conditions in the US economy, which showed a faltering trajectory, and evaluation of the possible implications of this for the sustainability of the tourism recovery. Oil prices, which exhibited volatility, were also closely followed, as well as the developments in the euro debt crisis and its adverse implications for global growth.



Close monitoring of banks' credit portfolios continued throughout 2012, to evaluate any risks to the Bank's overall financial stability objective. In doing so, the Committee considered the monthly updates on commercial banks' loan provisioning activities, reports and findings emanating from the Bank Supervision Department quarterly credit meetings with banks, as well as data on banks' loan restructuring activities and write-offs. In the members' view, the ongoing strength of banks' capital mitigated any concerns in this area.

As part of its analytical initiatives, the Committee undertook an analysis of liquidity conditions, and acknowledged that the high levels persisted because of the weakness in private sector demand. The considered view was that the situation was not expected to change in the near-term, given the weakness in the real sector which required more favourable external factors to achieve a firmer upturn. As a consequence of the credit conditions and the external reserve position, the MPC did not pursue any change in the monetary policy stance.

CURRENCY AND BANKING SERVICES

The Bank provides a range of banking and registry services to participants in the financial and public sectors—related to currency issuance, public debt operations and limited transactional banking services for government agencies.

Currency Operations

The Bank is responsible for ensuring that adequate supplies of high quality Bahamian currency (banknotes and coins) are available to the general public, and for protecting the public's confidence in the currency. The Bank, therefore, takes special care in the design, selection of substrate, minting and printing of currency. To maintain a high quality of banknotes in circulation, the Bank subjects all issues to authentication and sorting into quality categories, leading to the withdrawal of unfit and issuance of new banknotes.

The Bank maintains thirteen (13) denominations in active circulation, which include eight (8) banknotes: $0.50, $1, $3, $5, $10, $20, $50, and $100 and five (5) coins: $0.01¢, $0.05¢, $0.10¢, $0.15¢ and $0.25¢. At end-2012, while the 1¢ coin accounted for the highest quantity of coins in circulation, at 80.01%, it represented only 24.1% of the corresponding value. The $100 denomination was the highest value of banknotes in circulation, at 40.2%, and a lower 4.0% of quantity. Cash remains an important means of undertaking transactions. The total quantity and value of Bahamas currency in circulation increased by 5.1% and 6.2%, respectively, compared to the 2011 levels.

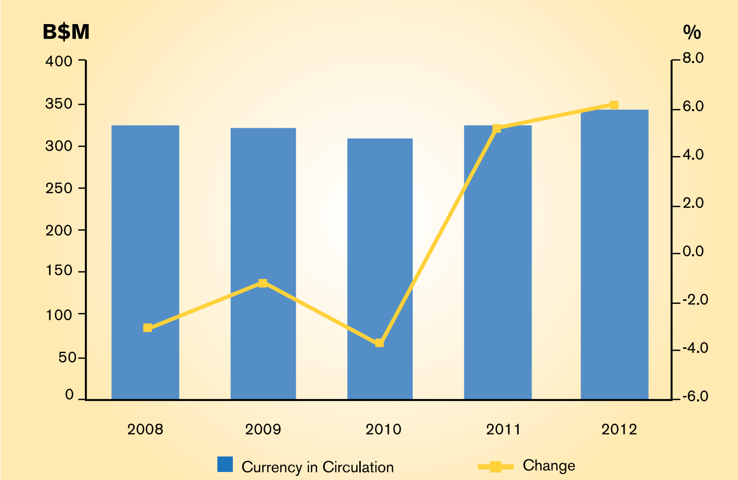
Throughout 2012, the Bank undertook reviews of the currency issuance process, and collaborated with commercial banks and cash transit companies to ensure optimal banknote processing, handling and distribution. In August 2012, the Bank resumed its annual meeting of cash services heads, focusing on measures that could be taken to improve logistical and operational efficiencies between the Bank and its stakeholders.

In currency printing activities, the Bank issued its first reprint of CRISP $50 banknote, previously released in 2006, and awarded its tender for the first reprint of the CRISP $1 banknote, initially released in 2008. Additionally, the Bank awarded its first-ever tender for an annually dated coin, in this case its one cent circulation coin, which is expected to be released in 2014.

Prevention and detection of counterfeiting continues to be accorded high priority. Bank staff facilitated annual counterfeit detection seminars, both in Nassau and Freeport, and on request from local business establishments and government agencies. The objective of these seminars is to provide retailers and cash handlers with the education and materials to improve public awareness and confidence in Bahamas banknotes. The Bank maintained a close relationship with banknote printing companies to update internal knowledge of new typologies in the area of counterfeiting as well as new banknote security features, and currency professionals participated in a number of local and international training programmes.

The Bank's numismatic programme, which has been in existence since 1973, has in excess of one hundred circulation coin proof and non-proof sets series depicting authentic Bahamian images and commemorating significant milestones in Bahamian history. In an effort to revitalize the programme, the Bank hosted its production and distribution stakeholders to a numismatic workshop, facilitated by the Royal Canadian Mint in October, 2012. Participants discussed the current state of the programme and forward-looking ideas and strategies to restart the programme. Several outcomes of this workshop are now under consideration for implementation by the Bank, inclusive of the preparation of a numismatic coin catalogue.

Currency In Circulation



Relations with Banks

In accordance with section 19 of the Act, domestic commercial banks are required to maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since implementation in 1974, the reserve ratio has remained at 5.0%, with a minimum of 80% to be held in deposit balances at the Bank. Consistent with the decline in Bahamian dollar deposits, required reserves fell by 0.8% to $249.2 million, compared with growth of 2.4% in 2011. Institutions also maintained balances to facilitate cheque clearing arrangements.

Relations with Public Sector

The Bank provides registry services for various public sector institutions, including the registration of new debt issues, ongoing maintenance of ownership records, distribution of interest payments, and redemption of securities at maturity. Additionally, the Bank acts as Registrar on behalf of the Public Treasury and coordinates the issuance and redemption of Treasury bills and Bahamas Government Registered Stocks (long-term bonds). In the absence of an active secondary market for these securities, the Bank has performed market maker activities, on a discretionary basis.

For 2012, the value of outstanding Treasury bills increased by $47.5 million to $349.1 million at end-December. The average tender rate (on rollover maturities) was lowered by 197 basis points to 99.9571%, which corresponded to a 788 basis point increase in the average discount rate to 0.1716%. Despite the increasing rate of discount, Treasury bill rediscounts (early redemptions) totalled $147.6 million, in contrast with a modest $20 million in 2011. During the year, further steps were taken towards improving the processes and systems that support these operations.

The value of Government bonds outstanding rose by $278.7 million to $2,872.3 million, reflecting four (4) new issues, totalling $335.6 million, and maturities of $57.0 million. Government securities currently have a maximum maturity of twenty-five (25) years, bearing simple interest rates ranging from 4.00% to 6.625% per annum, and paid semi-annually.

Bonds arranged and administered by the Bank for public institutions include the Bridge Authority Bonds, the Clifton Heritage Bonds and Education Loan Authority Bonds. The Bank also acts as Registrar for the redemption and transfer of these bonds. During 2012, the value of Bridge Authority Bonds, Clifton Heritage Authority Bonds and Education Loan Authority Bonds outstanding was unchanged, at $28.0 million, $24.0 million and $67.0 million, respectively. Balances in the sinking funds managed by the Bank, to retire external debt, on behalf of the Government and the Bahamas Electricity Corporation totalled $35.6 million and $35.1 million, respectively, at end-2012.

PAYMENT SYSTEMS

During the year, the Bank continued to develop and ensure the comprehensiveness of its monitoring and oversight regime for payment systems, while also sustaining efforts towards enhancing the efficiency of the payments infrastructure. In this regard, several pieces of payments legislation were enacted, discussions commenced with various stakeholders on the national advisory framework for promoting the development of domestic payments services, and the Bank continued to monitor trends in key sector operations.

Payments Oversight & Market Developments

The year 2012 marked a significant turning point for the Bank, in the context of its mandate to promote and ensure the establishment and oversight of a sound, secure and efficient payment system. In support of this objective, a compendium of legislation and accompanying regulations was passed and came into force, in June, namely:

- Payment Systems Act, 2012
- Payment Systems (Oversight) Regulations, 2012
- Payment Systems (National Payments Committee) Byelaws, 2012
- Companies (Amendment) Bill, 2012
- Bills of Exchange (Amendment) Bill, 2012
- Bankruptcy (Amendment) Bill, 2012

In its oversight activities, the Bank, through the Payments Unit, carried out both on and offsite monitoring of systemically important payment systems (SIPS). The Bank also updated its Memorandum of Understanding with the Bahamas Automated Clearing House (BACH), the owners of the ACH, which is used for small value transactions (those under $150,000). Quarterly meetings were held with the BACH to review daily clearing and settlement activities of the service providers, and the status of its own information security arrangements. The Unit also formally established oversight and monitoring arrangements for the operations of the Bank-owned Bahamas Inter-Bank Settlement System (BISS), which delivers real time settlement for large value payments. A monthly report on payment system developments was among the permanent items on the Bank's MPC agenda.

As provided for under the new legislation, the Bank will, during 2013, extend its oversight activities to entities operating in the retail payments space that offer multi-purpose stored-value facilities (electronic money issuers) and other payment instruments. The Bank intends to issue regulations to specifically address the capital requirements of these entities

Under the Byelaws, the Bank initiated steps towards the establishment of the National Payments Committee (NPC), the national advisory body to the Bank on the evolution of payment systems, instruments and procedures. In late December, 2012, the Bank convened an introductory meeting of key stakeholders to apprise them of the purpose of the NPC and obtain input on the areas of priority for discussion at the inaugural meeting, planned for January, 2013.

In keeping with its responsibility for oversight of payment systems, the Bank continued to work closely with the Clearing Banks and the BACH to ensure the efficient functioning of existing services. To address demands of participants, two (2) additional direct credit settlement sessions were added to the existing five (5), including one which allowed employers to make salary payments before banking hours.

The Bank remains supportive of the greater use of electronic modes of payment over paper-based systems, as a means of enhancing its efficiency, use and effectiveness. In this vein, the Bank and the Clearing Banks Association (CBA) continued to advance efforts towards the introduction of Customer Initiated Transactions (CIEs), which are methods of making interbank payments (and transfers) electronically, and include transactions conducted via the Internet, ATMs and the telephone. This new service, which is planned for implementation during 2013, is expected to further reduce the need for cash payments, as it would enable customers to make online payments to any account, at any bank.

A parallel initiative is the proposed introduction of a national ATM switch, which will allow customers to have greater access to their funds and support the widespread use of e-commerce, with a desirable reduction in the use of cash and cheques as a means of payment. Options are currently being explored and the goal is to decide on a way forward in early 2013.

Retail Payment Services

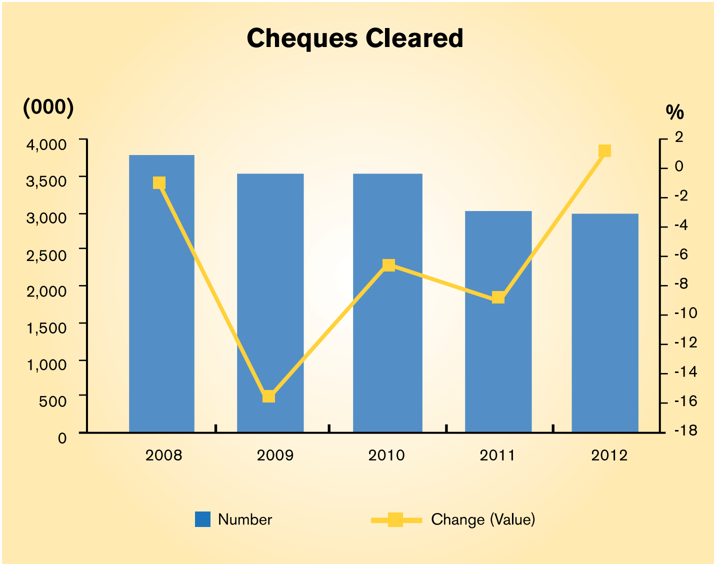
Although most payment transactions are still conducted using both cash and cheques, anecdotal evidence suggests sustained gains in electronic commerce, with the number of electronic payments (e-payments) and mobile payments (m-payments) up over 2012, albeit from a narrow base.

Cheques

Cheques remained the dominant means of non-cash payments in 2012; however, a steady diminution was observed over the past three (3) years, reflecting the increasing preference for direct electronic payments and a higher ceiling for the value of cheques being cleared. The volume of cheques (x9), net of returns, processed by BACH, decreased by 1.9%, to 2,968,908, compared with a more marginal drop of 0.2% in 2011. Reflecting an increase in the average value of cheques cleared, the gain in value was lower at 1.0% to $6.2 billion, from 5.1% in 2011.

Automated Teller Machines (ATMs)

At end-2012, there was a total of two hundred and seventeen (217) ATMs/ABMs installed throughout The Bahamas. The twenty-five (25) ATMs that were configured to dispense both



local currency and US Dollars, were generally located in prominent tourist areas, including hotels and the downtown locations of commercial banks. Preliminary estimates indicate double digit gains in both the number and value of ATM transactions, of 15.0% and 10.2%, respectively.

Debit Cards

The increased use of debit cards for routine transactions reflects their benefits to consumers in terms of convenience and security, as they reduce the need for cash. In 2012, there were four (4) internationally branded locally issued debit cards in the market. Debit card transactions grew in number by 22.2% to 4.6 million, with the corresponding value higher by 16.1% at nearly $3.3 million.

Credit Cards

Card issuance continues to be dominated by the internationally branded Visa, MasterCard and American Express cards, either issued or supported by local commercial banks. There is also one indigenous credit card that maintained its niche in the market. Trends in credit card usage over the past few years have mirrored the ongoing debt deleveraging by consumers, in response to more challenging economic and employment prospects. During 2012, both the number of credit cards and corresponding debt outstanding contracted. The number of cards fell by 7,193 (5.6%) to 120,779, in contrast to an 8.4% expansion in 2011. This outturn mainly reflected a 4,766 (4.8%) drop to 93,653 for cards with limits under $5000, which accounted for the bulk (77.5%) of the total. Similarly, the value of credit card debt declined by $8.2 million (3.2%) to $243.7 million, due to declines in the under $5,000 and $5,000 - $10,000 categories, of $18.7 million (15.1%) and $12.5 million (16.8%), to $105.2 million and $61.9 million, respectively. In contrast, cards with balances in excess of $10,000 firmed by $23.1 million (43.1%) to $76.6 million.

National Automated Clearing House Association (Nacha) Payments

Nacha sets the globally accepted standard by which the BACH manages the development, administration, and governance of the ACH network in The Bahamas. In 2012, BACH processed a total of 1.49 million Nacha direct debit transactions (predominantly payroll payments) valued at $947.6 million—representing increases over 2011 of 23% and 56%, respectively.

Internet Banking

Domestic commercial banks offer a number of internet banking services to both personal and business customers. All institutions, with the exception of one bank, provided internet banking as an option to customers in 2012. Services include: account viewing, transfers between personal bank accounts and third party accounts, credit card and bill payments, drafts and wire transfers, cheque reordering, and the purchase of foreign currency. Generally, banks offer free monthly internet banking services, with minimal per transaction fees applied for the most common customer transactions.

FOREIGN RESERVES MANAGEMENT

The Bahamas' official foreign exchange reserves stood at $810.2 million at end-2012, and comprised foreign government securities, deposits in foreign banks, Special Drawing Rights, and the Reserve Position (Reserve Tranche) in the IMF.

Foreign reserves are managed by the Bank's Investment Committee (IC), within the parameters established by the Act and a Board-approved Investment Policy and Guidelines. Preservation of capital and liquidity management are the primary objectives of reserve management, followed by the optimizing of returns within the constraints of the former two principles.

By investing in high quality, investment grade assets, the Bank is able to adequately manage portfolio volatility (risk) and achieve its preservation of capital objective. The Bank also ensures, by the use of weekly forecasts, that it maintains sufficient liquidity to support the country's commitments for foreign currency payments in the international market.

During 2012, the IC continued with its weekly meetings, supplemented by several ad hoc sessions, to consider investment decisions, review counterparties credit ratings, and to discuss, *inter alia*, current market trends and developments that could impact foreign currency reserves.

Near year-end, liquidity requirements were supported by a short-term repurchase agreement (repo), and the Bank also took the opportunity to convert a large portion of its SDRs to useable currency. Following the Government's foreign currency borrowing, the Bank was able to unwind the repo.

EXCHANGE CONTROL ARRANGEMENTS

During 2012, the Bank continued to administer exchange controls, in the context of the delegated arrangements with commercial banks for current payments, and restrictions maintained on resident capital outflows—consistent with the existing exchange rate regime.

Initiatives were further progressed towards making these arrangements more efficient, by leveraging modern tools for information storage, retrieval and archival, and automating the collection of data from stakeholders. By end-2012, the Bank substantially completed the scanning and validation of back file records, and successfully launched the electronic version of the foreign currency client account reporting, used primarily by attorneys.

In the context of the liberalized measures pursued over the past five years, the Bank facilitated overseas portfolio investments effected under the non-sponsored Bahamian Depository Receipt (BDR) programme for broker-dealers, the offshore portfolio investment programme of the National Insurance Board (NIB), and the Investment Currency Market (ICM). Activity under the BDR programme continued to be limited, with only two (2) BISX broker dealers participating, and utilizing $15.3 million ($12.7 million in 2011) of the $25 million allocated for 2012. The NIB, however, fully utilized its annual allotment of $25.0 million. At end-2012, overseas capital investments (excluding capital gains/losses) under the BDR programme totalled $64.0 million and the NIB's portfolio reached $84.4 million.

Foreign currency sales to residents for outward investments, via the ICM, continued to attract a 12.5% premium (the bid rate) for outward investments. Purchases, which represent the divestment of ICM investments, were executed at 10.0% (the offer rate). For 2012, the value of capital investments through the ICM was lower at $7.4 million from $12.1 million in 2011, which was dominated by demand from a single institutional investor. In contrast, ICM purchases were a modest $8,090.

At year-end, Authorized Dealers and Agents, important stakeholders in the administration of exchange controls, stood at eight (8) and eleven (11), respectively.

ECONOMIC ANALYSIS, STATISTICS AND RESEARCH

The Bank, through its regular publications, research studies and surveys produced by the Research Department, fulfils a very important public objective, by making available timely and comprehensive economic and financial information on domestic and international developments.

The outcomes of the Bank's annual survey on the domestic contribution of the financial sector and the two (2) Business Confidence surveys provide the public with useful feedback on the respective performance of the financial sector and business firms' economic and financial conditions, and expectations for the near-term.

The Bank's Research staff provided key technical support to the deliberations of the MPC, through various monthly economic and policy briefs. As part of its ongoing research efforts, the staff also prepared and presented a total of five (5) research papers at three (3) internal Roundtable forums. Topics included the domestic loan arrears situation, developments with the country's sovereign credit ratings, and liquidity management practices in the Caribbean. A paper entitled '*An Analysis of Bank Liquidity in The Bahamas*' was also presented at the Caribbean Centre for Money and Finance's (CCMF) conference, which was held in Suriname during the month of November. As part of its ongoing outreach programme, Research staff delivered a number of presentations to high school students on the role and functions of the Bank, and participated in the Department of Statistics' '*World Statistics Day*' events.

Efforts were ongoing to enhance the quality and coverage of statistical forms, databases and published data tables, as well as the Bank's economic forecasting model, which forms the basis for assessments of the economy. In the area of debt and cash management, the Bank, within the context of The Bahamas' Debt and Cash Management Committee (DCMC), benefited from an IMF technical assistance mission during the year. Recommendations emanating from this assessment exercise are being considered for implementation, with the objective of developing a medium-term strategy for public sector debt sustainability in The Bahamas.

In recognition of its role in the Bahamian economy, the Bank engages on a regular basis with multilateral organizations (e.g. the IMF, the Bank for International Settlements, and the Caribbean Development Bank) and other external agencies–facilitating requests for financial and economic data.

LEGISLATIVE DEVELOPMENTS

The Bank continued to make use of in-house legal resources to advance its legislative agenda. During 2012, progress was achieved on a number of legal and policy matters, culminating with the entry into force of the compendium of payments system legislation, and amended regulations affecting banks' large exposure and liquidity risk management, and with respect to private trust companies.

With technical assistance from the IMF, the Bank focused on a review of the Central Bank Act for consistency with international best practices for central banking legislation and to ensure the adequacy of its toolkit to operate in a more dynamic financial environment. It is anticipated that a draft Central Bank of The Bahamas Bill, reflecting the outcomes of this exercise, will be advanced for legislative enactment during 2013.

Regulatory/Legislative Initiatives

In 2013, the Bank intends to draft capital adequacy regulations for electronic money providers, and amendments to the Banks and Trust Companies Regulation Act to:

- enhance the framework for the administration of dormant accounts;
- clearly define the scope of consolidated supervision;
- provide a supervisory and regulatory framework for the regulation of Executive Entities and
- include provisions relating to liquidity requirements for bank licensees as a consequence of revisions to the Central Bank of The Bahamas Act.

Also on the agenda is a review of the legislative arrangements under the Banks and Trust Companies Regulation Act (BTCRA) and the Protection of Depositors Act and Byelaws, which seek to strengthen the Bank's resolution and crisis management toolkit. Following on from the technical assistance provided by the IMF, the Bank intends to review the proposed enhancements to the legal framework for the payments system with regard to the transfer of securities, and settlement and finality of payments.

As part of the legislative roll-out process, the Bank continued to engage stakeholders in consultative sessions, which included industry presentations.

PRUDENTIAL SUPERVISION AND REGULATION

The pace and scale of regulatory reforms, as well as the scope and intensity of supervision, have substantively increased since the global financial crisis. Over the past five (5) years, international bodies and groupings, like the Basel Committee on Banking Supervision (BCBS), the Financial Stability Board (FSB), global banking industry associations, and the G-20 political leadership, have examined the lessons learnt from the crisis. The focus has been on closing the gaps in risk management, early identification of emerging risks and macro-prudential indicators, intensity and effectiveness of supervision and, more importantly, measures to prevent a recurrence of a systemic crisis.

Under the auspices of the BCBS, the Core Principles for Effective Bank Supervision were further enhanced, in September 2012. These principles are important as they continue to guide the supervisory frameworks and practices in member countries, including The Bahamas. More importantly, they represent the standards against which individual jurisdictions are assessed for the robustness of their supervisory practices, for example, as in the recently concluded FSAP conducted by the IMF for The Bahamas. The revised set of twenty-nine (29) Core Principles has been reorganized and now highlight the difference between what supervisors do and supervisory expectations of banks, emphasizing the importance of good corporate governance and risk management, as well as compliance with supervisory standards. The Core Principles comprehensively address supervisory powers and responsibilities, focus on effective risk-based supervision, and stress the need for early intervention and timely supervisory actions.

The broad Basel programme is positioned to improve the banking sector's ability to absorb shocks arising from financial and economic stress, improve risk management and governance, and raise the level of transparency and disclosures. The programme comprises two (2) approaches, i.e., bank-level ("micro prudential") regulation, that assesses the resilience of individual banking institutions to periods of stress, and system-wide ("macro prudential") risks that can build up across the banking sector.

The outcomes of these initiatives have a far-reaching impact and hold the national banking supervisors and the banking industry to higher standards with reference to:

- quality, adequacy and consistency of risk-based regulatory capital;
- expectations underlying corporate governance and compensation practices;
- risk management, particularly credit risk management and underwriting practices;
- deployment of stress testing to measure credit, market, liquidity and operational risks;
- liquidity management;
- transparency and disclosure on capital, risk profile and off-balance sheet exposures;
- crisis preparedness, management and resolution;
- deposit insurance regimes and safety-nets;
- consistency and harmonization of supervisory practices;
- categorization of banks that are systemically important, both globally as well as in the domestic markets, and holding these banks to higher supervisory standards; and
- information sharing and cooperation between the home-host supervisors.

A major milestone for the Bank in 2013, will be the implementation of Basel III, as it represents comprehensive reforms to strengthen the existing framework for regulation, supervision and risk management of the banking sector. Basel III builds on the foundation of the International Convergence of Capital Measurement and Capital Standards of 2004 ("Basel II") and subsequent enhancements to the global regulatory framework for capital and liquidity (Basel II, Basel 2.5). In practice, while adhering to the spirit and the letter of the standards, these reforms will be implemented with due recognition to national priorities, resources and applicable discretions, in the context of our banking industry, and risk characteristics, and other factors, such as home-host and regional cooperation and information sharing.

In addition to these international prudential or safety and soundness reforms, a major initiative completed under the stewardship of the Financial Action Task Force (FATF) will also have a major impact on The Bahamas, given the nature and the scale of the international banking and wealth management industry. The FATF announced key changes to its recommendations that, notably, include:

Risk-based approach: It is expected that all countries would need to clearly understand the money laundering and terrorist financing risks which affect them, and adapt their anti-money laundering/countering the financing of terrorism (AML/CFT) system to the nature of these risks by applying enhanced measures where the risks are higher, with the option of simplified measures where the risks are lower. The risk-based approach will enable countries and financial intermediaries to target their resources more effectively.

Transparency: Lack of transparency about the ownership and control of legal persons and legal arrangements, or about the parties to wire transfers, makes those instruments vulnerable to misuse by criminals and terrorists. The FATF has strengthened transparency requirements in these areas, requiring reliable information be available about the beneficial ownership and control of companies, trusts and other legal persons or legal arrangements; and also, more rigorous requirements on the information which must accompany wire transfers.

International Cooperation: With the increasing globalization of money laundering and terrorist financing threats, the FATF has also enhanced the scope and application of international cooperation between authorities, providing for more effective exchanges of information for investigative, supervisory and prosecutorial purposes.

Operational Standards: The FATF Recommendations concerning law enforcement and Financial Intelligence Units have been significantly expanded, to clarify the role and functions of the operational agencies responsible for combating money laundering and terrorist financing.

New Threats and Priorities: New threats and priorities have been identified and addressed, including standards relating to financing of proliferation, corruption and politically exposed persons and tax crimes.

These revisions of the FATF Recommendations are aimed at strengthening the standards in areas of higher risk or where implementation could be enhanced, introducing new measures to address threats, such as the financing of proliferation of weapons of mass destruction, clarifying expectations on transparency and being tougher on corruption; and permitting a risk-based approach for financial institutions and other designated sectors to apply their resources more efficiently.

Going forward, the Bank will self-assess its compliance and, where necessary, enhance current practices to align with these revisions, in preparation of an anticipated review of its KYC/AML/CFT supervisory practices–to be undertaken by the Caribbean Financial Action Task Force, which carries out such assessments on behalf of the FATF.

Risk Based Supervision

In 2012, the Bank continued to progress the rollout of the Risk-based Supervision Framework (RBSF), initiated in late 2010. The focus was on completing the third and fourth rounds of risk assessments by the third quarter of 2012 and, importantly, to migrate from the RBSF project mode to an ongoing supervisory programme comprising full and simplified risk assessments. The transition to an ongoing risk assessment cycle is a key milestone for 2013, as the RBSF is the basis for an effective supervision function in the Bank.

The plans to complete the risk assessments by the third quarter of 2012 were considerably impacted by greater than anticipated time and effort in meeting data demands and related submissions for the FSAP exercise in the second half of 2012. A total of sixty-four (64) risk assessments (either full or simplified) have been concluded and, where necessary, the scope/timing of the risk assessments were modified, due to a shift in the risk profiles and/or changes to the status of the licensees. Consistent with the Bank's RBSF objectives, a supervisory plan for some thirty (30) risk-based assessments is under consideration for 2013.

Work continued on the development of a common set of core expectations for all control and oversight/governance functions, so that the onsite examiners and supervisors can use the same criteria for assessing risk control functions and communicating outcomes to the licensees. The Bank's priority is to focus on the alignment of current on-site examination templates to the off-site supervisory review process of the risks and control/oversight functions in the RBSF, and to map assessment criteria to regulations and guidelines.

A very important project that was largely completed in 2012 was the development of a management information system to support the RBSF. This system, which should be fully operational by early 2013, will facilitate the amalgamation and review of different risk areas by peer grouping.

Capital Adequacy

With the release of the Market Risk framework in 2012, the final element under the old Basel I regime, the Bank is now set to embark on enhancing its capital rules to conform to the Basel II and Basel III frameworks.

The Bank has established the foundation for aspects of Basel II through its RBSF, which takes into account Pillar II requirement as it relates to principles of supervisory review, risk management, transparency and accountability. Importantly, the RBSF requires banks to have a process for assessing their overall capital adequacy and a strategy to maintain capital levels. As Pillar II also expects the supervisor to assess this process, a significant next step for the Bank will be the alignment of the RBSF with the broader initiation of the Basel II/Pillar II programme on the "Internal Capital Adequacy Assessment Process" (ICAAP). The programme will be appropriately based on the banking industry profile in The Bahamas, and relevant training and development activities are planned for 2013.

In 2012, the Bank engaged the external auditors in a survey aimed at defining the practicalities of the minimum disclosure requirements under Pillar III - Market Discipline. Pillar III is a fundamental component of the Basel II Framework, which seeks to achieve greater transparency through disclosures by banks, in order to allow market participants to better assess the organization's capital and capital adequacy, risk exposures and risk assessment practices. The Bank intends to utilize the survey information, as well as feedback from a broad cross-section of its licensees, to inform national discretion/discussions regarding the appropriate level of public disclosures.

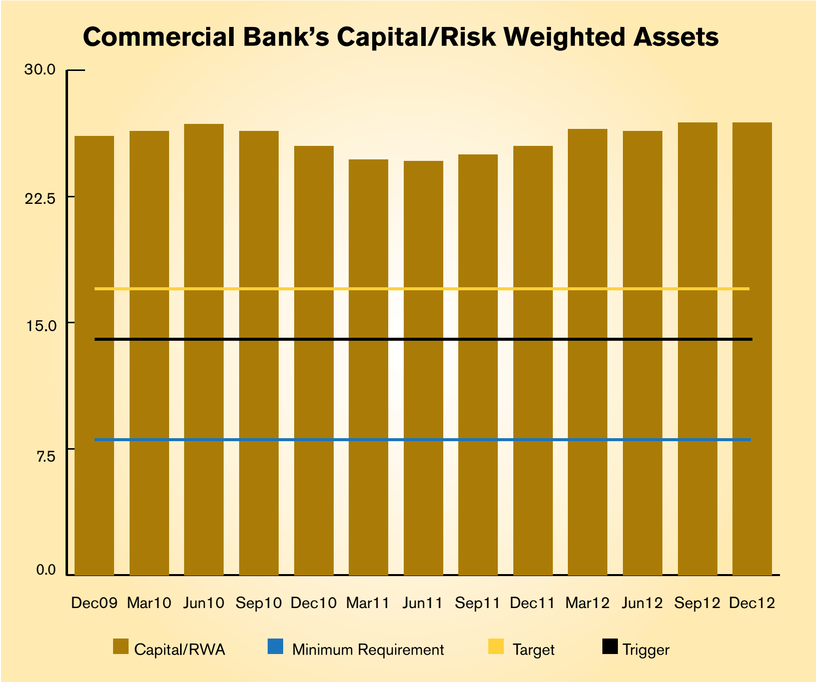
The Basel III capital requirements, which set out the new minimums for the regulatory capital ratios, namely, Common Equity Tier 1 capital to total risk weighted assets (CET1), additional Tier 1 capital to risk weighted assets and Tier 2 capital, are being phased into the Bank's capital requirements framework in 2013. In preparation for these changes, the Bank facilitated a roundtable discussion, in February 2012, with senior management of the domestic commercial banks regarding liquidity buffers, the graduating scale of Tier I equity and its acceptable components. Other key areas covered included:

- restricted eligibility on preference shares to qualify as Tier I & Tier II capital,

- restrictions to dividends, if the ratio for CET1 capital is not maintained, and
- the importance of accountability and transparency of capital ratios and deductions to capital.

The Bank's initial outreach was targeted to the commercial banks, as most of the international licensees, which are subsidiaries of G20 country groups, have already adopted the approach taken by their parent.

Ahead of any guidance from the Basel Committee or the Financial Stability Board, the Bank has always recognized the importance of ensuring that its domestic systemically important banks are well-capitalized. The commercial banks are currently subjected to trigger and target capital ratios of 14% and 17%, respectively—well above the levels proposed under the Basel framework. In 2012, the quality and quantity of the CET1 and Tier 2 capital levels for domestic commercial banks were, on average, slightly above 26.7% of risk weighted assets—up from 25.5% at end-December, 2011.



Commercial Banks

During 2012, the Bank conducted an industry seminar on stress testing with senior management of commercial banks, in preparation for the FSAP and the bottom-up and top-down stress testing exercises undertaken in July. The Bank also continued to monitor and hold periodic discussions with firms, relative to credit and liquidity risks and, effective 2012, incorporated discussions on operational risks and in-camera sessions with banks' chief internal auditors.

Credit Risk Reviews

Each month, supervisors conduct a critical analysis of credit risk indicators, based on prudential returns submitted by the banks. The data collected covers total Bahamian dollar loans, loan arrears, sectoral and large exposures, provisioning levels and restructured loans. Given the sustained high level of arrears, banks were continually encouraged to strengthen their loan underwriting policies and procedures; conduct credit portfolio reviews—inclusive of collateral assessments; and to make appropriate provisions through their loan management and credit risk functions for the declines in real estate values, where necessary, and also for the time lag in closing and realizing the proceeds from delinquent mortgages. One of the outcomes from these efforts was the maintenance by banks of specific provisions in line with the deterioration of their loan portfolios, and resilience in risk-adjusted capital ratios above the 17% regulatory minimum requirement.

Stress Testing

In 2012, the Bank measured the financial soundness of banks using its stress testing framework model, inclusive of credit, interest rate and liquidity risks. In the months leading up to the FSAP, the Bank worked closely with senior personnel from the commercial banks in ensuring their collation of micro level data for the FSAP team's stress testing model. The comparison of the Bank's top-down stress testing model with the bottom-up model used by the commercial banks proved to be useful and insightful, with similar results obtained from the three (3) stress tests conducted.

The credit risk stress test model assessed the factors of credit quality, payout ratios and haircuts on collateral and the underlying impact on the risk-adjusted capital levels on the 14% and 17% trigger and target ratios—using both system wide and bank specific perspectives. A comparative analysis, based on ownership structure, was conducted across banks, to determine, as a group, the average levels of capital and the corresponding capital ratios. The results of the test showed little variation between the bottom-up and top-down models.

The interest rate risk stress tests assessed the risks of the impact, from interest rate movements, on the bank's capital and profitability, using an upward and downward adjustment in interest rates—in the absence of an active yield curve for The Bahamas. The comparative analysis used for the capital risk stress test was also used for the interest rate risk stress test, producing a similar outcome.

Unlike the Bank's liquidity model, which focused on cash flow analysis–using maturity-wise analysis of assets and liabilities, the model employed by the FSAP team and the banks analyzed liquidity using 5-day and 30-day outflow stress horizons. Using various plausible scenarios, the test assessed whether or not a bank can sustain sporadic movements in liquidity with a 20% ratio used as a benchmark.

In 2013, the Bank plans to further develop the stress testing model, in line with new international standards and policies, which would enhance the oversight of domestic commercial banks, in the broader context of financial stability.

International Firms

The Bank continued its effort to monitor and ensure the safety and soundness of international firms, employing the main supervisory tools of on-site examinations, risk assessment meetings with senior officials of the firms, comprehensive analysis of quarterly, annual financial statements and other statutory returns, and liaising with other local and international regulators. Licensees were encouraged to ensure that robust systems and controls were in place to mitigate the various inherent risks associated with their business model.

Some thirty-three (33) meetings were convened between the Bank and the Internal Auditors of the international firms to discuss the scope and findings of their on-site examinations. These meetings represented 36% of the 92 unrestricted international firms. The main areas of focus covered overall governance structure, KYC/AML issues, risk management and compliance, IT and information security, business continuity and internal control systems.

Regulatory Reporting

During 2012, the Bank upgraded the Excel Reporting System (ERS), to facilitate new financial reporting requirements imposed on licensees exposed to Market Risk. This included the release of nine (9) new Microsoft Excel-based templates to cover reporting on trading activities for interest rate, foreign exchange, options, commodities and equities. *The Guidance Notes for the Completion of the Market Risk Reporting Forms* was also released to provide clarification on the data inputs for the various forms. Reporting obligations for market risk commenced in the third quarter of 2012.

On-site Examinations

As indicated in Table 1, twenty-nine (29) on-site examinations were completed in 2012 compared to thirty-seven (37) in 2011. The reduction in the number of completed examinations reflected, in combination, the Bank's involvement in the FSAP process, implementation of the risk-based approach to examinations and developmental initiatives within the Examination Unit. Among the completed examinations were five (5) commercial banks, with special emphasis on credit risk and the licensees' delinquency management process; nine (9) full scope examinations of complex and non-complex firms; and ten (10) special focus examinations of other complex and non-complex licensees covering reputation risk, credit risk, fiduciary risk, delinquency management and recommendations from previous examinations. In addition, two (2) visits to firms were conducted in response to requests from their Swiss home supervisory authorities.

Table 1: **ON-SITE EXAMINATIONS CONDUCTED**

	2010	2011	2012
Examinations			
Domestic Licensees	6	3	7
Other Licensees	2	17	17
Follow-up /Special focus	18	17	5
Total	26	37	29
Reports			
Finalized Reports	16	28	33
Reports in Progress	15	21	6
Total	31	49	39

Source: The Central Bank of The Bahamas

Over the year, thirty-three (33) examination reports (including seventeen (17) outstanding from 2011) were completed. Sixteen (16) reports were finalized and communicated to the licensees, and at the close of 2012, six (6) reports were in varying stages of being finalized or reviewed by the licensees.

Joint examinations with the Securities Commission of The Bahamas

In 2012, the Bank undertook two (2) joint examinations with the Securities Commission of The Bahamas (the Commission), utilizing the revised ***Protocol for the Joint On-site Examinations by the Central Bank and the Securities Commission of The Bahamas*** (the Protocol) which was formalized in February, 2012. This initiative serves to further streamline the on-site examination process for jointly regulated financial institutions, in terms of planning, execution, reporting and remediation of examinations.

Supervisory Policy and Guidance

The Bank is responsible for ensuring that the legal framework and its guidance for the prudential regulations and supervision of licensees remain relevant and current. Efforts in this respect included revisions to the eleven (11) guidelines and the formalization and release of two (2) new guidelines (See Box 3).

Legislative Initiatives

During March 2012, the Banks and Trust Companies (Liquidity Risk Management) Regulations, 2012 and the Banks and Trust Companies (Large Exposures) (Amendment) Regulations, 2012, came into force (2nd March 2012). The Regulations provide the legal framework for the large exposures and liquidity risk management regimes. The Banks and Trust Companies (Private Trust Companies) (Amendment) Regulations, 2012 also came into force on 24th December, 2012.

The Banks and Trust Companies Regulation (Amendment) Bill, 2012 and the draft Banks and Trust (Administrative Monetary Penalties) Regulations, 2012 are now well advanced. The proposed amendments to the principal Act, together with the proposed Regulations, seek to expand the Bank's powers to impose administrative monetary penalties for breaches of the principal Act or regulations made there under, or non-compliance with any direction, order, condition or limitation made by the Bank. The proposed amendments to the principal Act also seek to enhance the fit and proper requirements and include new provisions relating to controllers of licensees and empowering the Bank to impose prohibition orders against persons performing regulated functions, where persons do not, or no longer, meet the Bank's fit and proper requirements.

Domestic and International Co-operation

Domestic and international co-operation with other regulatory bodies continued within the context of established protocols. At the local level, senior staff from the Bank Supervision Department and the Legal Unit participated in the work of the Group of Financial Service Regulators (GFSR), which comprises the six (6) domestic regulators for the banks and trust companies, the securities industry, insurance companies, credit unions and financial and corporate service providers.

The Compliance Commission, Financial Intelligence Unit and Attorney General's Office also participated regularly in the GFSR forum. The Legal Subcommittee of the GFSR completed its work and forwarded recommendations to the authorities on the reporting of international wire transfers and the implementation of a fixed currency threshold-reporting regime in The Bahamas. The Legal Sub-Committee progressed its review of the domestic non-profit sector, and will make recommendations regarding any identified gaps in the AML/KYC/CFT regime, so as to ensure adequacy of the oversight mechanisms for the sector. The Committee is also finalizing its recommendation for legislative changes to the framework for cross-border transportation of currency.

Other Domestic Co-operation Initiatives

The Bank completed its work on a number of initiatives aimed at reducing regulatory overlaps and achieving greater rationalization of resources among the various regulators.

In February 2012, after a comprehensive review of existing arrangements, the Bank and the Securities Commission executed a revised Protocol for the Joint On-site Examinations of jointly regulated financial institutions. Emphasis was placed on ensuring the presentation of a "single face" to firms, to include, the issuance of one notice of an examination,

BOX 3: Revised and New Guidance Documents

REVISED GUIDELINES

- **Guidelines for Managed Licensees** (22nd March 2012) and the **Guidelines for Managed Branches** (22nd March 2012) were amended to enhance the requirements for those licensees which continue to be managed.
- **Guidelines for the Minimum Physical Presence Requirements for Banks and Trust Companies Licensed in The Bahamas** (22nd March 2012) were revised to: (i) permit employees of licensees to provide written translations of documents in response to on-site examination requests and (ii) specify the timeframe licensees must adhere to for the retrieval of records/documentation.
- **General Information and Application Guidelines for Non-Bank Money Transmission Service Providers and Non-Bank Money Transmission Agents** (22nd March 2012) now require that senior officers of money transmission businesses be approved by the Central Bank.
- **General Information and Application Guidelines for Private Trust Companies (PTCs) and their Registered Representatives** (2nd April 2012) was amended to state the requirements for the closure of a PTC and its removal from the PTC Register.
- Amendments to the **Large Exposures Guidelines** (20th April 2012) clarified which licensees are exempted from the Guidelines and the responsibilities of licensees' Board of Directors. The amendments also provide an exemption for licensees to facilitate group treasury functions and set out the conditions. Further, exemptions covered by letters of comfort have been amended, as parental guarantees will now be the new standard form of support going forward.
- **Guidelines on the Minimum Standards for Letters of Comfort and Parental Guarantees** (20th April 2012) have been revised to set out the minimum standards for parental guarantees to be considered acceptable.
- Amendments to the **Guidelines for the Management of Liquidity Risk** (20th April 2012) extend the applicability of the Guidelines to all public banks and/or trust companies, including the domestic commercial banks. However, the minimum liquidity ratio will apply to the domestic commercial banks only as an "observation ratio" and used for monitoring and assessing their overall liquidity positions. The revised Guidelines also expand upon themes and requirements addressed in the previous guidance and emphasize the importance of the Bank's supervisors assessing the adequacy of licensees' liquidity risk management frameworks.
- **Guidelines for the Corporate Governance of Banks and Trust Companies Licensed to do Business within and from within The Bahamas** (18th September 2012) were revised to: (i) outline the Bank's position on licensees vesting the chair of the Board of Directors and the Chief Executive Office of a licensee in the same person; and (ii) permit senior officials of restricted licensees and certain other licensees to serve as the Compliance Officer and the Money Laundering Reporting Officer.
- **Guidelines on the Prevention of Money Laundering and Countering the Financing of Terrorism** (28th November 2012) were revised to: (i) address issues identified by the Organization for Economic Cooperation and Development (OECD) in their peer review assessment of The Bahamas, against the OECD's Standards of Transparency and Exchange of Information for Tax Purposes; and (ii) clarify when the Bank expects a licensee to have its external auditors prepare and submit reports to the Bank on the adequacy of the licensee's AML/CFT policies and procedures.
- **General Information and Guidelines for Licence Applications for Banking and/or Trust Companies** (21st November 2012) were revised to establish a higher threshold for professional indemnity insurance (PII) coverage. Additionally, the minimum capital requirement for public trust companies that are not subsidiaries of a financial group (i.e. stand alone) has been reduced from US$2 million to US$1 million. The Bank has, however, reserved the right to impose a higher minimum capital level, based on the scale of business and the risk posed by the prospective trust company.

NEW GUIDELINES

- **Guidelines for the Management of Interest Rate Risk** (13th August 2012) provide high level principles and minimum procedures for managing the interest rate risk present in licensees' business activities.
- **Guidelines for the Management of Market Risk** (3rd December 2012) highlight the key elements of the prudential risk measurement and management framework for licensees which are engaged in activities that give rise to risks associated with potential movements in market prices for equity and interest rate instruments. These Guidelines apply to all public banks and bank and trust companies incorporated in The Bahamas (referred to as "banks") that have a trading book, as defined by the Bank, and which meet the *de minimis* threshold for the market risk capital charge.

a single request for advanced information, a unified team of examiners led by the Bank, a single Report of Examination (RoE), and a co-ordinated follow-up process for issues identified in the RoE.

In the area of supervisory guidance, the Bank and the Securities Commission coordinated the implementation of the market risk component of the Basel II Accord for licensees. This was launched in the third quarter of 2012, with the first returns received for the period ending September.

As a precursor to the development of a national financial crisis management plan, the Bank, in conjunction with the Insurance Commission, Securities Commission and representatives from the Ministry of Finance/Attorney General's Office, conducted a three-day crisis management workshop (Oct. 31-Nov. 2). The workshop, which was facilitated by the Toronto Centre, sought to develop regulators' capability for identifying, managing and resolving a financial crisis in The Bahamas. Steps are underway for the regulators to commence preparation of crisis management binders and documentation of contingency plans, during 2013.

Regional and International Co-operation

On the regional level, in January 2012, Bank Supervision's senior management participated in the Caribbean Group of Banking Supervisors (CGBS) College of regulators' meetings, for FirstCaribbean International Bank, RBC Royal Bank and Scotiabank, which took place in Guyana. Management was also represented at the regional planning session, taking place on the margins of this meeting, to discuss coordinated training efforts and regional cooperation for 2012. Work completed by the CGBS on the regional crisis preparedness plan will be used to inform the national effort.

At the international level, the Bank continued to cooperate with its regulatory partners to ensure that The Bahamas is not used by undesirable parties to avoid proper oversight, and equally to ensure that institutions established and based in The Bahamas comply fully with internationally accepted standards and norms. In May, the Bank participated in a KYC/AML/CFT supervisory meeting coordinated by the Canadian regulator, the Office of the Superintendent of Financial Institutions (OSFI), on the three (3) systemically important Canadian banks carrying out commercial banking business in The Bahamas. The meeting brought together key executives of the firms and supervisors to promote a better understanding of their respective business models and risk mitigation strategies with respect to AML/CFT/KYC oversight. A presentation was made by the Bank's representative on these entities' compliance with related international best practices and the governing KYC/AML/CFT regimes.

The Bank was represented and contributed to the deliberations of the Group of International Financial Centre Supervisors' (GIFCS) meetings (Technical and the Plenary) in 2012, held in London and Istanbul, Turkey, respectively. The International Conference of Banking Supervisors' (ICBS) meeting was also held in Turkey during September, 2012, and was preceded by the Association of Supervisors of the Americas (ASBA) Plenary Meeting. Discussions focused on topical issues, such as the G-20 offshore initiatives, recent Basel Committee initiatives, and common issues arising out of the Financial Action Task Force (FATF).

The Bank continued to provide timely responses to information requests from foreign regulatory authorities. During 2012, a total of thirty (30) requests from fifteen (15) foreign regulatory authorities were received and responses provided (see Table 2).

Table 2: **REQUESTS FOR COOPERATION FROM FOREIGN REGULATORS IN 2012**

Country	Requests Received	Completed
Barbados	2	2
Brazil	5	5
Canada	2	2
Cayman Islands	1	1
France	1	1
Jamaica	1	1
Luxembourg	1	1
Peru	3	3
Singapore	2	2
Switzerland	3	3
Turks & Caicos Islands	4	4
Ukraine	1	1
Uruguay	1	1
United Kingdom	2	2
United States	1	1
Total Requests	**30**	**30**

Source: The Central Bank of The Bahamas

BOX 4: Financial Sector Assessment Programme (FSAP)

From time to time, all financial jurisdictions undergo various assessments of their regulatory and supervisory practices and one such exercise is the Financial Sector Assessment Programme (FSAP). The FSAP is an in-depth assessment, by the IMF, of a country's compliance with international standards for the banking, securities and insurance sectors, its resilience to shocks and the corresponding effectiveness of financial safety nets.

In 2012, the Bank, through its Legal Unit, coordinated efforts among the various regulators aimed at ensuring The Bahamas' readiness for a successful FSAP exercise, which took place during July (9th – 31st) and included a scoping visit in February 2012. The process entailed the updating of self-assessments of adherence to international standards and data submissions for IMF review, prior to the onsite interviews and verifications conducted by the IMF led twelve-member mission team.

The Bank's segment of the exercise focused on assessing compliance with the Basel Core Principles for Effective Banking Supervision (BCP), based on a detailed review of the existing legislative framework, guidelines and supervisory toolkits. There was also an in-depth review of interbank connectivity and the transmission of global economic shocks, as well as stress testing of the domestic banking system to extreme but plausible shocks.

Based on the closing meetings with the IMF Mission/the assessors, and the draft FSAP reports, The Bahamas' adherence to the BCP is viewed as positive and encouraging for the jurisdiction. The IMF's public Financial Sector Stability Assessment report will be finalized for discussion by its Board in early 2013 and released, shortly thereafter.

The FSAP assessors observed that The Bahamas has made clear and material progress in the main areas of financial oversight and that there have also been significant improvements in the oversight of the financial system since the IMF 2004 Offshore Financial Center (OFC) assessment of the jurisdiction. The report also noted that, based on stress testing result, the Bahamian financial system faces no threat to near-term financial stability.

In summary, the IMF FSAP Mission assessors broadly recognize that The Bahamas has in place a very strong legal and regulatory framework for bank supervision and the Bank also acknowledged the assessors' recommendations that guidelines and policies be further enhanced to reflect the current supervisory practices which, in themselves, are commensurate with international best practices. These expectations are aligned with the Bank's ongoing commitment to ensure the robustness of the domestic supervisory regime.

As recognized in the assessment, a number of initiatives were already underway that will allow The Bahamas to enhance its bank supervision legislative regime and policy framework, including:

- the introduction of a regime to impose administrative monetary penalties or fines in respect of contraventions of the Banks and Trust Companies Act, 2000 (BTCRA) or regulations made thereunder;
- enhanced/new provisions in the BTCRA in respect of fit and proper requirements, controllers of licensees, and that would empower the Bank to impose prohibition orders against persons performing regulated functions, where such persons do not, or no longer, meet the Bank's fit and proper requirements;
- the ongoing programme to achieve alignment with the international capital accords;
- reassessing the crisis management toolkit and developing a national financial crisis management plan; and
- the issuance of several key policy guidelines on operational risk and minimum disclosures.

By end-2012, the Bank had already made progress on a number of the observations, and has since undertaken an assessment of its supervisory resources, necessary to ensure timely execution of the recommendations of the FSAP team.

Membership in International and Regional Bodies

The Bank, represented by senior banking supervisory staff and the Legal Unit, continued to participate in discussions relating to regional and cross-border bank supervision in the following groups:

- Association of Banks of the Americas (ASBA)
- Group of International Financial Centre Supervisors (GIFCS)—formerly known as the Offshore Group of Banking Supervisors (OGBS)
- Caribbean Group of Banking Supervisors (CGBS)
- Caribbean Financial Action Task Force (CFATF)
  A number of staff also served on various technical working groups and committees within these organizations.

Regulated Entities

During 2012, the number of bank and trust company licensees decreased by ten (10) to 268 (see Table 3). The decline was predominantly in the restricted trust and nominee trust companies licence categories, which declined by nine (9). Of the 268 licensed entities, the number operating through physical presence decreased by ten (10) to 245, with the remaining twenty-three (23) being from predominantly G-10 countries and operating within approved restricted management arrangements.

Approximately fifty-five percent (55%) of licensees originate from G-10 countries, with the balance representing locally domiciled entities (28.0%) and various other jurisdictions (16.8%).

The Bank approved the registration of five (5) PTCs, bringing the total to seventy-four (74) at end-December, 2012. The number of Financial and Corporate Service Providers (FCSPs) that act as Registered Representatives grew by one (1) to five (5), and two (2) additional licensees advised the Bank of their intention to act as Registered Representatives of PTCs, increasing the number to fourteen (14). Licensed non-bank money transmission service providers totalled two (2), while registered non-bank money transmission agents increased to seven (7).

In keeping with its commitment to ensure appropriate corporate governance structures, as well as 'fit and proper' management of firms within the jurisdiction, the Bank reviewed and recommended approval for the appointment of one hundred and eighty-eight (188) directors and fifty-six (56) senior officers. For 2012, two hundred and thirty-one (231) meetings were held with licensees to discuss prudential issues and on-site inspections, and firms paid numerous courtesy visits to the Bank.

Table 3: **REGULATED ENTITIES**

	2010	2011	2012
Bank and Trusts	276	278	268
Banks & Trusts	72	70	70
Banks	41	40	38
Trusts	163	168	160
Private Trust Companies (Registered)	58	69	74
Non-Bank Money Transmission Business	3	3	2

Source: The Central Bank of The Bahamas

STRATEGIC FINANCIAL SECTOR INITIATIVES

The Bahamas Credit Bureau Project

In keeping with its stability mandate, the Bank is promoting the establishment of a credit reporting system in The Bahamas, inclusive of the legal, regulatory and technical frameworks which can support a credit bureau. The benefits of providing the mechanisms for credit activities, to be conducted on full and relevant information, include a reduction in lenders' exposure to risky loans, mitigation of the incidence of high non-performing loan rates, increased consumer access to credit and a range of financial products on more favourable terms and at competitive interest rates; imposition of a measure of discipline on debtor behaviour, and enhancement of the Bank's ability to monitor system risks, using accurate aggregated information on credit quality.

Significant progress was made during 2012 towards the establishment of the legal, regulatory and technical frameworks for a national credit reporting system. Under the auspices of the International Finance Corporation (IFC), a draft Credit Reporting Bill was prepared and reviewed by the key stakeholder commercial banks, the

Data Protection Commissioner and other significant credit providers. The Bank expects to be in a position to finalize and issue the document for public consultation in early 2013, with enactment to follow soon after. One of the key areas of focus in the review process was the drafting, for consideration by participants in the credit space, of a model consent clause that would permit them to supply relevant information on their borrowers to the credit bureau. With the continued assistance of the IFC, this dialogue is set to continue in early 2013 and, thereafter, broadened to include the process of selecting an appropriate credit bureau operator and organization of consumer education initiatives.

Credit Union Transition Project

The credit union sector remains an important avenue for providing alternative financial services to its members. At end-2012, total assets for the thirteen (13) credit unions were estimated at some $286.0 million; dominated by one major institution. The sector employed in excess of one hundred (100) persons.

The Bank continued work towards the eventual transfer of credit unions under its regulatory and supervisory oversight, following on the authorities' recognition of the increased level of intermediation of the sector and the Bank's overall responsibility for financial sector stability. The Transition Project (the Project), which commenced in September 2011; is for two years, and is being funded by the Commonwealth Secretariat.

The Executive Steering Committee (the Technical Advisor funded by the Commonwealth Secretariat, the Governor of the Central Bank, Director of Cooperatives, Manager Bank Supervision and Legal Counsel) of the Project met, throughout the year, with key sector stakeholders (the Bahamas Credit Union League and the Board and Management of the credit unions) to provide updates and to discuss matters impacting the governance and supervision of credit unions.

In a major milestone, the Committee concluded, in the third quarter, a draft Credit Unions Bill, incorporating elements of the existing Cooperative Societies Act, Ch. 314, the results of a benchmarking exercise of global standards for oversight of credit unions, and reflections from earlier discussions held with the League on corporate governance matters. The Draft Bill was forwarded to a special legal committee of the credit unions for review, and the Bank anticipates commencing closed consultations with the sector early in 2013.

On a parallel front, the Bank worked closely with the Department of Cooperatives on the development and refinement of the un-audited monthly financial report forms for credit unions. The objective is to ensure that comprehensive, consistent and timely information is being collected on the sector, in order to facilitate its proper oversight.

Capacity building is an important deliverable of the Project, and several training seminars on financial reporting and best practices in accounting standards were held for credit unions. These initiatives will be extended throughout 2013, with plans underway to conduct training for credit unions' directors, management and operation staff in areas such as risk management, loan portfolio management and corporate governance.

In November, the Commonwealth Secretariat performed a mid-term review, and confirmed that the Project was on course to meet the set purpose of strengthening the operational effectiveness of the credit union sector in The Bahamas, leading to a well regulated and resilient sector.

OTHER FINANCIAL SECTOR MANAGEMENT ACTIVITIES

Deposit Insurance Corporation (DIC)

The Bank has statutory responsibility to oversee the Deposit Insurance Fund (the Fund) for Bahamian dollar deposits in the banking system. The DIC insures Bahamian dollar deposits up to a maximum of $50,000 for any single depositor in each of its member institutions, which do not hold an equity position in the Corporation.

The DIC assesses the depository institutions at an annual premium equal to one twentieth of one percent (0.05%) of deposits, averaged over March 31 and September 30 of the preceding year. Based on average total insurable Bahamian dollar deposits in banks, of $5.5 billion during 2011 relative to $5.4 billion in 2010, premiums levied and collected in 2012 amounted to $2.8 million compared to $2.7 million in 2011. The accumulated assets of the Fund increased by $3.9 million to $27.6 million at end-2012, of which $24.5 million was held in Government bonds—an increase of $3.7 million over 2011.

During 2012, management of the Bank, tasked with oversight of DIC matters, commenced several strategic activities towards enhancing public awareness of the DIC and ensuring its operational effectiveness. Plans are well advanced for the launch, in early 2013, of a stand alone website for the DIC, complete with a deposit insurance calculator, frequently asked questions and a glossary. In line with observations and recommendations made during the recent FSAP review, an exercise is underway, with the assistance of experts from the Canadian Deposit Insurance Corporation (CDIC), to assess the target size for the Fund, and management is developing a comprehensive strategic plan and communications strategy for the DIC. The exercise will be extended into 2013, with a review of the legislative framework to ensure its adequacy for crisis preparedness.

At end-2012, there were twelve (12) member institutions of the DIC, which is a founding member of the International Association of Deposit Insurers (IADI).

Dormant Accounts Administration

Section 20 of the BTCRA directs licensees to transfer to the Bank, those accounts where "no transaction has taken place or no statement of account has been requested, or no written acknowledgement has been received from the customer, during a period of seven years". These transfers release licensees from liability for such accounts and protect the future claims of depositors.

BOX 5: Goals and Objectives of the National Credit Bureau

GOALS:

To facilitate the flow of relevant information required to establish the identity of borrowers and to accurately describe borrowers' indebtedness from all creditors providing services at the domestic level, and any additional information useful to fulfil the objectives of the system, in a streamlined format.

To make available information to the Bank for credit monitoring and macro-prudential supervision.

To support the development and implementation of risk management measures and tools, including security measures by credit reporting service providers and data providers.

The education of consumers and other participants in the credit reporting system.

OBJECTIVES:

Provide secure, efficient and reliable mechanisms for the exchange of information between creditors.

Ensure the effective use of technological advances to collect information from persons seeking credit and to store that information.

Establish as a pre-condition for data collection, processing and dissemination, that information provided to creditors on potential borrowers is relevant, accurate, timely and sufficient.

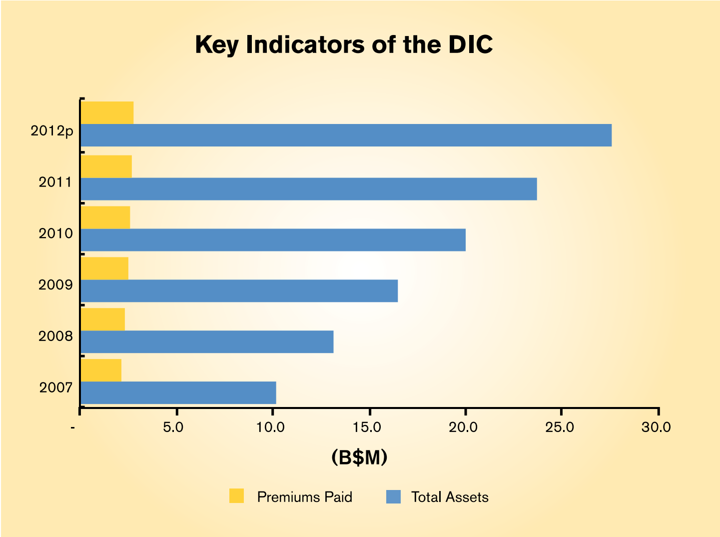
Establish a legal and regulatory framework that supports the management and mitigation of data security risks and other credit reporting related risks.

Establish a consumer dispute resolution mechanism.

Ensure that the legal and regulatory framework supports consumers' rights and provides them with specific tools to actively manage their participation in the credit reporting system, particularly regarding their personal data.

Enhance the Bank's oversight function of credit reporting systems, so as to ensure compliance with the laws and regulations, and to empower the Bank to take prompt action to resolve market failures.

Provide banks, non-bank financial institutions and other lenders with additional tools to evaluate the credit worthiness of their customers, and better equip the Bank to carry out macro-prudential monitoring of the economy.



To facilitate the transfer of dormant accounts to the Bank, licensees utilize the Dormant Accounts Web Reporting System (DARS). During 2012, eighty-five (85) licensees submitted a total of 1,123 dormant accounts, with value equivalent to B$3,579,554, and claims processed at B$437,360. At end-2012, dormant account balances outstanding, net of claims, aggregated B$70.6 million, and were denominated in eight (8) currencies–led by United States (51.1%) and Bahamian (38.0%) dollars.

INFORMATION TECHNOLOGY

During 2012, the Bank concluded several significant software and equipment acquisitions and upgrades and application development, to support greater business resiliency and operational efficiency, as part of the comprehensive enterprise business continuity project. Initiatives undertaken included:

- upgrades to the Content Management and Document Scanning solution, and the integration of document scanning and storage into an enterprise correspondence management solution with attendant workflow processes.
- testing and validation, and wider internal deployment of the digital signature solution, with enterprise wide implementation planned for early 2013;
- the upgrade to the SWIFT financial system; and
- the completion of back-file scanning of Exchange Control records, providing for the electronic retrieval of documents. These activities will be extended to the Bank Supervision and Banking Departments during 2013.

Building on earlier work undertaken in the area of records management, the Bank engaged a local vendor to assess the current environment with a view to ensuring its adequacy. Recommendations arising from this exercise will be implemented in 2013, including the establishment of a formal Records Management Unit under the Information Technology (IT) Department.

Among other initiatives undertaken to meet user requirements, IT provided project management for the automation of the risk-based supervisory framework for the Bank Supervision Department, the development of an enterprise correspondence management application, and the implementation of a new fixed asset tracking and management solution.

The Bank continued to make appropriate investments toward ensuring the robustness of its network and security infrastructure, and consistency of the IT governance framework with international standards.

STAFF TRAINING AND DEVELOPMENT

As a knowledge-based institution, the Bank continued to provide in-house, local and international training opportunities for staff to develop and strengthen their professional and technical skills. The objective is not only to meet existing operational needs of the Bank, but also future challenges, and to allow for career development.

During the year, a significant number of staff members benefited from a combination of in-house, local and overseas seminars. Numerous persons also travelled overseas to attend various meetings and conferences. Additionally, one (1) staff member travelled overseas for a familiarization visit.

In-house seminars, workshops and courses concentrated on technical training, creating greater awareness of the Bank's policies and procedures, changes in the legislative and supervisory environment, and the Bank's document management system. During March, eight (8) new staff members participated in the Annual Induction Training Course.

Staff of the Legal Unit participated in several overseas programmes aimed at keeping abreast of developments in anti-money laundering and of positions being undertaken by the international agencies, such as the Caribbean Financial Action Task Force (CFATF). Training initiatives also covered trends in payments oversight, credit reporting and foreign direct statistics.

Capacity building initiatives within the Research Department included further training in the areas of debt management, statistics and sustainability analysis, as well as payments oversight. Staff also enhanced their understanding and capability in financial programming and bank stress testing. Topics covered in various internal audit related-training sought to build further expertise in the areas of fraud detection, anti-money laundering, auditing tools and auditing within central banks.

Table 4: **WORKFORCE METRICS**

	2010	2011	2012
Staff Complement	240	233	232
Gender Distribution (%)			
Male	35	35	34
Female	65	65	66
Turnover Rate (%)	3.5	5.6	5.6

Source: The Central Bank of The Bahamas

Investments in up-skilling bank supervisory staff remained a priority for the Bank. Staff availed themselves of a series of training opportunities facilitated by international agencies, such as CEMLA, the CGBS, the FSI Institute and the FSA in the UK. These offered our staff important opportunities to become acquainted with new developments in the areas of Basel III, macro-prudential indicators, the supervision of systemically important firms, risk management, and internal controls.

To encourage and facilitate self-learning, employees pursued Bank-subsidized studies in areas of interest to themselves, and that could be useful to the institution. In 2012, enrolments in self-initiated training totalled thirty-six (36), of which half were by staff of the Bank Supervision Department. A majority of the enrolments were in professional certificate and diploma programmes offered by the Bahamas Institute of Financial Services (BIFS), including the Certified International Risk Manager, International Diploma in Anti-Money Laundering and Compliance and Trust Law and Administration.

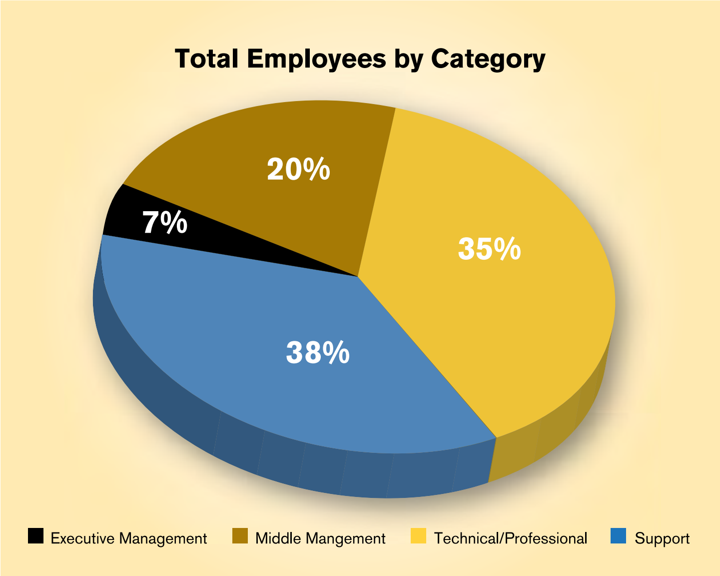
STAFF COMPLEMENT AND RELATIONS

The Bank's staff complement decreased slightly in 2012, standing at 232 at end-December (see Table 4). New recruits numbered twelve (12), separations seven (7), end of contract three (3), and retirements three (3). Of the total employee count, eighty-one (81) were technical/professional and eighty-nine (89) were support staff, with middle and executive management accounting for forty-six (46) and sixteen (16) persons, respectively.

The Annual Long Service Award Ceremony was held on the 25th January; eighteen (18) staff received awards for ten (10), twenty (20), and thirty (30) years of continuous service to the Bank.

During the year, the Bank was engaged in industrial negotiations with unions representing middle management and non-management employees. At year-end, a new contract was executed with the non-management union, and negotiations with the middle management union were nearing completion.

After carrying out a comprehensive compensation review exercise, in 2012 the Bank implemented changes to its compensation programme, aimed at recruiting and retaining talent needed to fulfil its mandate.



PROPERTY MANAGEMENT, HEALTH AND SAFETY IN THE WORKPLACE

The Bank conducts its business from the Main Building, situated between Market Street on the west and Frederick Street on the east, and the leased Trimark Building, which is located north of the Main Building. Another leased property, in Freeport, Grand Bahama, is used to conduct Exchange Control related business. The Bank also owns the Great House, a historical building which serves as the employee cafeteria; the Balcony House, a two-storied period building presently managed by the Antiquities, Monuments and Museums, Corporation as a museum, and Verandah House, another period building, utilized by the BIFS as a training facility.

Workplace safety remained an important focus for the Bank and, in 2012, additional repair works were undertaken on various air-conditioning systems and controls, to ensure the availability of an appropriate working temperature within the Bank. Other works carried out included: air quality testing, the completion of outstanding structural repairs on the Main Building, and an upgrade of the fire protection systems. With the completion of restorative and other repairs, Balcony House was re-opened to the public, after being closed for two (2) years.

To encourage and promote healthy lifestyle activities, the Bank, under the theme "Renewing Body, Mind and Spirit", held its annual Health Promotion Week, June 18 – 22. Activities included health checkups, exercise classes, eye evaluations, a healthy food fair and numerous seminars and health workshops.

COMMUNITY RELATIONS AND OUTREACH

The Bank continued its educational outreach and community relations programme by hosting some thirty-eight (38) students from Government and Private Independent Schools to site visits, and offered work experience opportunities to several students.

In other community oriented activities, the Bank maintained the tradition of assisting with the annual Red Cross Fair, and sponsored the Transforming Spaces exhibit, which included six (6) art teachers and twenty-nine (29) art students.

Through its Junior Professional Summer Programme, the Bank afforded two (2) Bahamian students, with a cumulative grade point average of 3.5 and who were entering their final year of college, the opportunity to participate in an eight-week internship experience. Students were mentored by professionals of the Bank and given the opportunity to acquire an understanding of the inter-related operations of central banking.

The Bank celebrated the 29th anniversary of its Annual Art Competition and Exhibition–open to Senior and High School categories. This event continues to attract strong participation from upcoming artists. In addition, the Bank's gallery was the venue for seven (7) exhibitions by local artists.

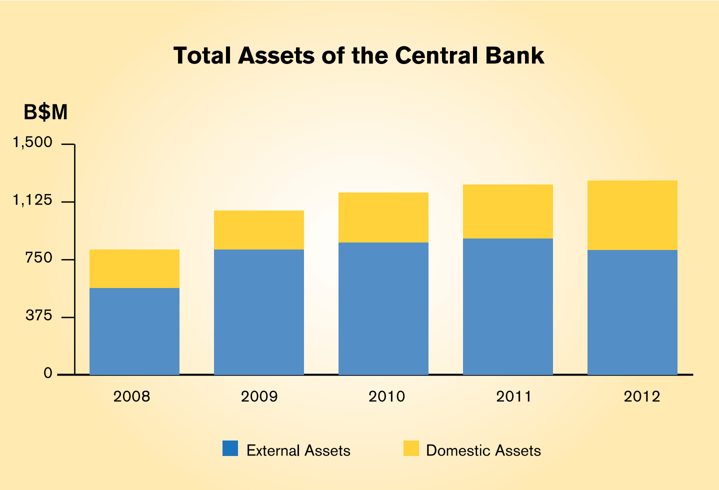
FINANCIAL HIGHLIGHTS

The Bank's financial outcome is primarily determined by the size and performance of the external reserves, the level of domestic and foreign interest rates, and underlying developments in the real sector. The Bank's financial statements for the year ended 31st December, 2012, along with comparable figures for 2011, are presented on pages 50 to 99 of this report.

During 2012, total assets of the Bank grew by $24.5 million (1.9%) to $1,260.0 million. Reflecting the weakness in real sector activity, which provides the main opportunities for growth in foreign exchange earnings, external assets declined by $74.7 million to $810.2 million–for a reduced 64.3% of the total. Cash and deposit balances firmed by $101.3 million, following on the conversion of SDR $96 million to US dollars to support liquidity requirements, and lowering the balance to $28.4 million. Scheduled maturities reduced the Bank's holdings of marketable securities, by $29.2 million to $555.6 million, which maintained a dominant 68.6% of the total.

Growth in domestic assets of $99.3 million was primarily attributed to increased holdings of Government paper. The $5.5 million rise in bonds was almost off-set by the $5.2 million decline in short-term advances. However, the portfolio of Treasury bills was enlarged by $103.5 million, as the primary investors, commercial banks, opted for higher yielding paper. The remaining domestic assets, in combination, declined by $4.6 million (13.4%) to $29.5 million.

The Bank's demand liabilities grew by $25.2 million (2.8%) to $933.1 million. The currency component was higher by $20.0 million (6.2%) at $344.0



million. Deposits held for banks were slightly down, by $2.2 million to $555.2 million; deposits for government and related agencies increased by $6.1 million to $24.9 million, while the remaining liabilities declined by $1.2 million to $9.0 million.

The Bank's main sources of income are the returns it makes on investments held. Of the $27.9 million in income, 58.4% ($16.3 million) was derived from interest on foreign investments, and 35.9% ($10.0 million) from interest on loans and domestic investments. Other income of $1.1 million and a realized exchange gain of $0.9 million, offset interest expense of $0.3 million and an unrealized exchange loss of $0.2 million.

Expenses for 2012 totalled $29.3 million. Staff costs increased by 42.4% and included an extraordinary outlay of $4.5 million to cover the cost of the removal of the provision for integration of the Bank's Pension plan benefits with those of the NIB. General and administrative costs moved up by 13.4% to $7.1 million and depreciation expenses, by $0.3 million.

Reflecting the extraordinary staff outlay, the Bank incurred a net and comprehensive loss of $1.4 million, compared with a net income of $5.7 million in 2011.

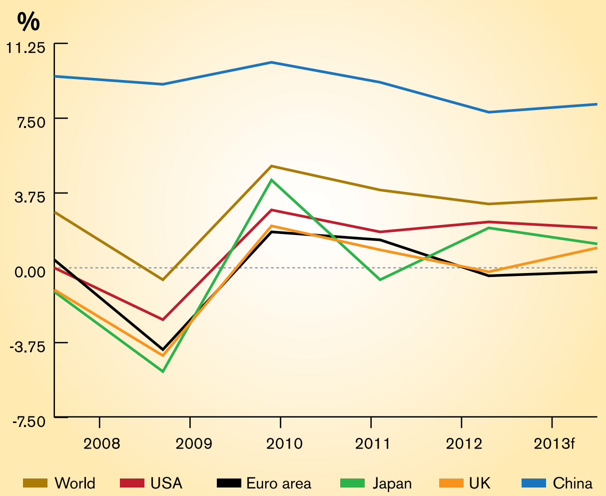
INTERNATIONAL ECONOMIC DEVELOPMENTS

Global economic conditions remained challenging in 2012, as the protracted recession in the euro-area, combined with below trend growth in the United States and Asia, resulted in weak consumer demand, limited job opportunities and mild inflation. Against this backdrop, most major central banks maintained their key policy rates at historically low levels and implemented further accommodative policy measures to support their economies. With interest rates at historic lows, investors opted for relatively "risky" assets, which contributed to broad-based gains in almost all of the main equity bourses during the year, and a general decline in the value of the US dollar against most major currencies.

Initial estimates from the IMF suggest that global growth slowed to 3.2% in 2012 from 3.9% in 2011, on account of tapered rates of expansion in both developed and emerging markets. Economic conditions in the United States improved somewhat in 2012, as growth in real GDP advanced by 0.4 of a percentage point to 2.2%. This outturn reflected a slowdown in import growth, combined with gains in residential investment, as the housing market improved, and there were smaller declines in government spending. Despite a modest rebound in economic activity in the third quarter—associated with hosting the 2012 Olympics—real GDP growth in the United Kingdom was flat for the year compared to a 0.9% gain in 2011, reflecting a falloff in the production and services industries. The euro area fell into recession in 2012, with GDP contracting by 0.5%, as fourth quarter output in the three (3) largest member states declined more than anticipated, while several southern states remained in austerity-led recessions. In Asia, China's economy grew by 7.8% in 2012, although below the year earlier 9.3% surge, with government stimulus measures boosting retail sales, industrial production and exports. Economic conditions were relatively subdued in Japan, as output rose 2.0% during the year, in comparison to a 0.6% contraction in the prior period, as result of growth in consumer spending and increased investment outlays.

Reflecting the sluggishness of the global recovery, employment conditions improved only marginally among the major developed economies in 2012. In the United States, the unemployment rate decreased by 0.7 of a percentage point to 7.8%, as an estimated 2.4 million, mainly professional services workers, were added to payrolls. The jobless rate in the United Kingdom fell to 7.8% in the three (3) months to December, from 8.4% in 2011. Amid worsening economic conditions—particularly in the southern member states—the unemployment rate in the euro area firmed to a record 11.8% at end-2012, up from the year-earlier 10.0%. Employment conditions were more favourable in the Asian economies, with the Chinese jobless rate steadying at 4.1% and that for Japan lowered to 4.4% from 4.6% in 2011.

Major Economies' Growth Rates



Inflation remained relatively benign during the year, due partly to low consumer demand and reduced energy prices. Growth in US consumer prices softened to 1.7% from 3.0% in 2011, influenced also by lower gains in food prices. With declining transportation, communication and housing costs, inflation in the United Kingdom tapered by 1.5 percentage points to 2.7%. The rate of increase in average consumer prices in the euro area softened by 0.5 of a percentage point to 2.2%, as communication costs contracted. In China, inflation was lower at 2.6% from 5.4% in 2011, while deflationary conditions persisted in Japan, where average costs fell by 0.1% in 2012.

In energy markets, the average cost of crude oil decreased slightly, by 0.3% to $111.38 per barrel over the year, mainly reflecting the sustained balance between supply and demand in the market, following a return to normal production levels after supply disruptions in 2012. On a point-to-point basis, the average cost advanced by 2.8% to $110.62 per barrel compared to end-December 2011. As investors increased their appetite for risk, the demand for gold as a "safe" investment decreased, resulting in a slowdown in price gains, to 6.5% from 27.1% in 2011 to $1,675.35 per troy ounce at end-December. The average price of silver contracted by 11.8% to $30.35 per troy ounce, in comparison to a 71.6% surge in 2011.

In an effort to support their economic recoveries, most central banks in major developed markets either maintained or loosened their already accommodative monetary policy stances during 2012. In the United States, the Federal Reserve kept its benchmark interest rate in the range of 0.00%-0.25% and, in November, executed its third round of "quantitative easing" by purchasing a further $40.0 billion in mortgage-backed securities each month until the end of 2012. In the following month, the Bank also set a target rate of 6.5 percent for the unemployment rate, before any policy tightening measures could be enacted. The Bank of England also left its official bank rate at 0.5% and increased the size of its asset purchase programme by a total of £100.0 billion, in February and July, to £375.0 billion. In light of the further intensification of the euro area's economic crisis, the European Central Bank (ECB), in February, provided additional liquidity to the financial markets through a further €530.0 billion in loans to banks. The ECB also lowered its key interest rates, by 25 basis points each, in July and implemented its "Outright Monetary Transactions" programme in September, to support member countries which were experiencing severe fiscal imbalances. The People's Bank of China's policy measures included reductions in its reserve requirements for deposit taking institutions, by 50 basis points, as well as its one-year benchmark deposit and lending interest rates in June and July, to 3.0% and 6.0%, respectively. Then, in September, in a bid to enhance banking system liquidity, the Bank injected US$40.0 billion into the financial system through the use of repurchase agreements. Monetary policy by the Bank of Japan remained accommodative during 2012, as the authorities increased the size of their Asset Purchase Programme, three times during the year, to ¥91 trillion. The Bank also eliminated the minimum bid yield for the purchase of both Japanese Government and corporate bonds.

Amid a decrease in investor demand for relatively safe assets, the US dollar depreciated against most of its major counterparts in 2012. The dollar fell by 4.3% vis-à-vis the British Pound, to £0.62, and by 1.8% relative to the euro to €0.76. Similarly, the dollar declined versus the Canadian dollar, Swiss Franc and Chinese Yuan, by 2.8% to CAD $0.99, by 2.4% to CHF 0.92 and by 1.1% to CNY 6.23. However, the dollar appreciated relative to the Japanese Yen, by 12.8% to ¥86.75, buoyed by increased optimism over the likelihood that the authorities would implement further measures to lower the value of the Yen.

Broad-based gains were registered in all key stock markets, supported by central banks' accommodative policy measures and investors' increased appetite for high yielding assets. In the United States, both the Dow Jones Industrial Average and the S&P 500 advanced, by 7.3% and 12.9%, respectively. European bourses also moved upwards, with Germany's DAX surging by 29.1%, while France's CAC 40 and the United Kingdom's FTSE 100 rose by 15.2% and 5.8%, respectively. Material gains were also posted by Japan's Nikkei 225 (22.9%) and China's SE Composite (3.2%).

The trade deficit in the United States narrowed by $19.5 billion to $540.4 billion, reflecting export growth of 4.4% to a record $2.2 trillion, supported in the last quarter by heightened petroleum exports, which surpassed import gains of 2.7%. In the United Kingdom, indications are that the trade gap widened by £14.1 billion to £37.7 billion, occasioned by import growth of 1.6%, along with a reduction in exports of 1.2%. The euro zone posted a trade surplus of €81.8 billion, in contrast to a deficit of €15.7 billion, buoyed mainly by improvements in overall trade in Germany, the Netherlands and Ireland, which offset declines in France, Greece and Spain. Buttressed by robust export growth, China's trade surplus firmed by 48.1% to US$231.1 billion over 2011's level; however, Japan's goods and services deficit rose, almost three-fold, to ¥6.9 trillion from ¥2.6 trillion, due to increased imports for the energy sector and lower exports.

Table 5: **SELECTED ECONOMIC INDICATORS (% CHANGE)**

	2009	2010	2011	2012
Real GDP	(4.9)	0.2	1.7	1.8
Unemployment Rate (actual mid-year)	14.2	n/a	15.9[2]	14.0[1]
Occupied Hotel Room Nights	(13.3)	3.0	0.0	7.4[2]
Hotel Occupancy (%)	49.5	51.5	54.0	60.5[2]
Total Arrivals	5.7	13.0	6.3	6.3
Mortgage Disbursements	(26.9)	(23.2)	(9.3)	(8.4)
Electricity Generation (mwh)	(5.7)	n/a	n/a	n/a
Consumer Price Index	1.9	1.3	3.2	2.4[3]
National Debt/GDP Ratio	50.7%	55.1%	55.3%	61.2%

SOURCE: The Central Bank of The Bahamas
[1]Based on November's survey [2]YTD September 2012 [3]Annualized through October 2012

DOMESTIC ECONOMIC DEVELOPMENTS

Overview

Indications are that the domestic economy expanded at a relatively modest pace of 1.8% in 2012, with mild gains in tourism output supported by a combination of the ongoing recovery in the key source markets and joint public/private sector incentive programmes, which boosted arrivals. The construction sector continued to benefit from several foreign financed projects in the tourism sector, alongside public sector infrastructure investments, although private domestic activity remained relatively subdued. In this context, however, the scope for employment gains was limited, with the jobless rate persisting well above its pre-recession levels. Despite the volatility in oil prices, the rise in average consumer price inflation was marginal, being linked primarily to higher prices for food and other related products.

The fiscal outcome for FY2011/12 showed a significant deterioration in the overall deficit, as the impact of higher capital spending negated a slight increase in revenues. This trend was also observed over the first six months of FY2012/13; the fiscal gap widened considerably, as a lower tax intake coincided with increased spending, mainly for salary and transfer payments. The Government issued domestic bonds to cover the majority of its financing needs, and also secured a US$180 million external loan in December. Consequently, the National Debt—inclusive of Government loan guarantees to the public sector—rose to an estimated 61.2% of GDP at year-end, up from 55.3% in 2011 (see Table 5).

In the external sector, the estimated current account deficit deteriorated, behind rising commodity prices and the typical heightened payments associated with foreign investment activities. As a result of strong net foreign inflows from tourism investments and government borrowings, the capital and financial account surplus expanded from the 2011 outcome.

Monetary developments featured a persistence of buoyant bank liquidity conditions throughout 2012, largely explained by the general softness in private sector demand and evidenced by broad-based weakness in bank credit to this sector. In particular, consumers continued to deleverage, commercial credits contracted and mortgages were almost flat—to contrast with a continuation of strong growth in claims on the public sector. As consumers and businesses alike faced persistent problems in meeting their debt obligations, the level of loan arrears remained elevated. In response, banks increased provisions against these potential losses, which had a contractionary impact on overall profitability levels. Borrowing conditions were also influenced by the high liquidity levels, which further tempered the weighted average deposit rate, which outpaced the reduction in the corresponding loan rate, and led to a widening in the average interest rate spread.

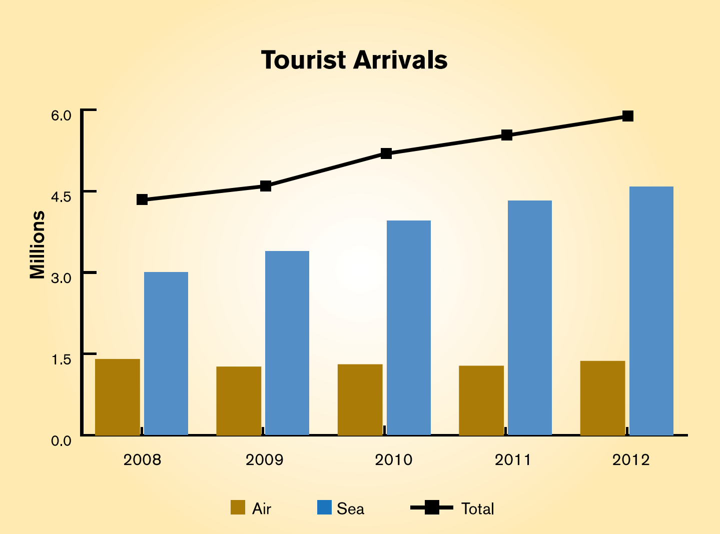
Sustained demand for foreign currency to facilitate import payments, and to a lesser extent banks' profit repatriations, in the context of weak receipts from real sector activities, resulted in a drawdown in external reserves over the review period. The year-end level was equivalent to an estimated 17.5 weeks of non-oil imports, compared to 19.7 weeks in 2011.

Real Sector

Tourism

Preliminary indications are that tourism output improved in 2012, supported by growth in the high value-added air segment of the market and ongoing joint public/private sector travel incentive campaigns. Total tourist arrivals increased by 6.3% to approximately 5.9 million, which was in line with the 2011 gain. Buoyed by growth in group business, the high value-added air segment—which accounted for 22.9% of total arrivals—rebounded by 7.1% to 1.4 million, from a 2.1% contraction in 2011. Sea traffic, at 77.1% of the total, gained by 6.1% to 4.6 million, although softening from the previous year's 9.1% upturn.

Based on first port of entry, visitor growth was concentrated in New Providence, where total visitor arrivals advanced by 9.3% to 3.3 million, outstripping the 2.9% rise for 2011. Both the air and sea components firmed, by 8.4% and 9.7%, respectively. In contrast, Family Island visitors recorded recessed gains, of 3.0% from 13.7% in 2011, reflecting a slowdown in sea passenger growth to 3.3%, which eclipsed the marginal 0.6% increase in air visitors. A similar outturn was experienced in Grand Bahama, where the gain in arrivals tapered from 4.8% in 2011 to 2.6%, based on slackened growth in the dominant sea segment to 2.0%; although air arrivals firmed by 6.9%.



Hotel performance indicators, based on a sample of fourteen (14) major properties on New Providence and Paradise Island, showed a 4.0% expansion in total room revenue for 2012, extending the year-earlier gain of 2.8%. This outturn reflected a 4.3 percentage point increase in the average occupancy rate to 68.3%; however, the average daily room rate (ADR) fell by 3.0% to $229.24, primarily in response to competitive factors. A breakdown of monthly revenue trends revealed a frontloading of gains during the key winter season, tapering off in the summer months and declining in the final two (2) months of the year, due in part to weather-related declines in occupancy rates.

Construction

During 2012, construction sector output continued to be supported by foreign investment-led projects and ongoing major public sector works. In contrast, private housing developments were subdued, amid sustained weakness in business conditions and high levels of non-performing mortgages.

Total mortgage loan disbursements for new construction and repairs—as reported by banks, insurance companies and the Bahamas Mortgage Corporation—fell by 28.1% to $106.8 million, more than double the 12.8% contraction in 2011. The residential component, at 96.4% of mortgage loan disbursements, slackened by 22.4% to $102.9 million, while commercial disbursements fell by three-quarters to $3.9 million. Based on the more forward looking indicator, mortgage commitments, the challenges facing the domestic private market are unlikely to abate over the near-term. The total number contracted by 43.5% to 508, with value lower by 18.5% at $90.7 million.

In terms of costs, the average interest rate for residential mortgages steadied at 8.2%, while the commercial rate rose slightly by 20 basis points to 8.6%.

Prices

Domestic consumer price inflation, as measured by changes in the Retail Price Index for The Bahamas, slowed to 2.35% over the twelve-months to October 2012, down from 2.90% a year earlier. Underpinning this reduction was a significant deceleration in the average price gain for transportation, to 2.64% from 8.70% in the comparative 2011 period. Further, notable average price increases moderated for restaurants & hotels, by 1.0 percentage point to 1.81%, furnishing, household equipment & maintenance, by 90 basis points to 2.80% and education, by 90 basis points to 2.36%. Average costs also contracted for communication and recreation & culture, by 1.43% and 0.68%, respectively, a turnaround from gains of 1.31% and 2.56% in 2011. In contrast, prices for clothing & footwear firmed by 1.17%, reversing the year earlier decline of 0.58%. Other indices registering higher average cost gains were food & non-alcoholic beverages (by 1.8 percentage points to 3.07%), miscellaneous goods & services (by 70 basis points to 0.92%), medical care & health (by 24 basis points to 1.93%) and housing & other utility related—the largest component in the Index—by 20 basis points to 3.38%.

The impact of higher international oil prices was evidenced in the firming of domestic fuel costs. The average prices of both gasoline and diesel firmed, by 5.4% to $5.45 per gallon and 6.2% to $5.20 per gallon, respectively. Similarly, the Bahamas Electricity Corporation's average annual fuel charge, which adjusts to changes in fuel prices, advanced by 15.3% to 26.7 cents per kilowatt hour (kWh).

Employment

Labour market conditions improved slightly in 2012, reflecting the modest pace of the domestic economic recovery. According to the Department of Statistics' labour force survey, which was conducted for the second consecutive year on two (2) separate occasions—May and November—the jobless rate fell by 1.2 percentage points to 14.7% in May from 15.9% six months earlier, and the number of employed persons rose by 3,145. This momentum was maintained over the ensuing half-year, resulting in a further 70 basis point easing in the unemployment rate, to 14.0% in November. Two-thirds of the nine (9) industrial sectors registered increased employment, corresponding to a reduction in unemployment levels by 1,175 persons, while the combination of less discouraged workers and new entrants into the job market augmented the number of employed by 1,925 persons. Despite the overall job gains, unemployment among the 15-24 years age band—which consists primarily of college and university graduates—remained elevated, rising from 29.4% to 30.7% at end-November 2012, after a 4.6 percentage point fall in the May assessment period.

In terms of the major job centres, the jobless rate in New Providence—which comprises an estimated 71.8% of the labour force—fell by 1.1 percentage points to 14.0% between November 2011 and May 2012; the rate then dropped by a further 0.9 of a percentage point over the next six-month period to 13.1%. Conditions were more challenging in the Grand Bahama market, which accounts for approximately 15.2% of the labour force. There, the jobless rate dipped to 17.3% in May from 21.2% in 2011, but then rose by 0.7 of a percentage point to 18.0% by November 2012.

Fiscal Operations

FY2011/12 Performance

Despite modest gains in revenues, due to one-off inflows, the fiscal situation worsened for FY2011/12, as sustained growth in capital outlays underpinned a significant expansion in spending (see Table 6). Total revenue grew by 1.0% ($13.8 million) to $1,446.7 million, although 4.9% below budget estimates. Total outlays rose by 5.2% ($93.7 million) to $1,879.6 million, exceeding budgeted projections by less than 1.0%. At end-June, the overall deficit stood at $450.6 million, which was 21.6% ($80.0 million) above FY2010/11's outcome and 25.6% higher than expected.

Revenue

Tax revenue, at 88.2% of total receipts, contracted by 1.6% ($20.3 million) to $1,276.6 million—underperforming the budget estimate by 7.9%. In particular, non-international trade taxes receded by 12.5% ($81.9 million) to $575.1 million, due primarily to a 32.6% ($84.0 million) decline in related stamp taxes to levels consistent with past trends, following the previous year's surge linked to the sale of a local oil refinery. Selective taxes on tourism-related services also fell by 8.2% ($4.8 million), as the 6.0% growth in hotel occupancy taxes was eclipsed by a 40.6% contraction in gaming taxes from elevated levels in the comparable period, when significant arrears payments were received from a tourism-based entity. Further, departure tax receipts contracted by 1.3% ($1.3 million). Business and professional licence fees increased by 2.7% ($3.2 million), and property and motor vehicle taxes rose by 3.4% ($3.1 million) and 7.1% ($1.9 million), respectively. Receipts from other "miscellaneous" taxes were negligible, compared to $12.0 million in the previous fiscal year. However, supported by a significant one-time payment, taxes on international trade expanded by 11.8% ($75.4 million) to $712.2 million, which was a modest 0.8% below budgetary forecasts. This outturn comprised a 30.6% ($77.6 million) boost in excise taxes, attributed mainly to the payment of outstanding arrears by a public corporation, an 18.9% ($2.4 million) rise in export taxes, and a 10.2% ($1.6 million) gain in stamp tax on imports, which combined to offset a 1.8% ($6.2 million) decline in import tax collections.

Non-tax revenue expanded by 10.8% ($14.7 million) to $150.7 million, for a favourable 36.4% variance above budget estimates. Buoyed by the receipt of deferred interest payments, following the redemption of bond investments, as well as dividend payments, income from other sources surged by 38.1% ($14.5 million) to offset a $1.1 million contraction in profit inflows from public enterprises. Additionally, collections of fines, forfeits & administrative fees and proceeds from the sale of government property rose, by $0.9 million and by $0.4 million, respectively. Capital revenue, at $19.3 million, was buoyed by proceeds from the sale of a government building, following negligible levels a year earlier.

Expenditure

Current expenses, at 81.7% of total outlays, expanded by 1.6% ($25.2 million) to $1,549.7 million, and were 3.0% below the budget forecast. Consumption-related spending was higher by 7.8% ($69.7 million), boosted by gains in purchases of goods and services of 13.8% ($43.2 million), arising from an insurance-led 25.6% ($31.5 million) increase in contractual services. Personal emoluments, which constituted 39.2% of current spending, advanced by 4.5% ($26.4 million), whereas transfer payments contracted by 7.1% ($44.6 million). Interest payments fell by 11.7% ($24.7 million), led by a 15.6% ($25.5 million) reduction in the internal debt influenced by the lowering of the Prime Rate in June 2011, which countered an increase of 1.7% ($0.8 million) for external payments. Subsidies & other transfers also declined by 4.8% ($19.9 million), due largely to a reduction in transfers to households ($23.1 million) and non-profit institutions ($11.7 million) to trend levels, while more modest declines were registered for transfers abroad and to non-financial public enterprises, of $1.7 million and $1.2 million, respectively. In a modest offset, higher spending was posted for transfers to public corporations ($11.8 million) and subsidies ($6.5 million).

Capital expenditure grew by 18.9% ($39.1 million) to $245.4 million, and was 3.8% above budget projections. Buoyed by above-budgeted costs associated with Government's ongoing road works programme, infrastructure spending was higher by 17.5% ($30.1 million) at $202.0 million. Asset acquisitions also firmed, by 26.8% ($8.5 million) to $40.1 million, reflecting increased purchases of land, financial and other assets. Higher spending on property purchases, of 39.5% ($5.1 million), partly reflected the acquisition of a new Government headquarters, while equity investments grew by

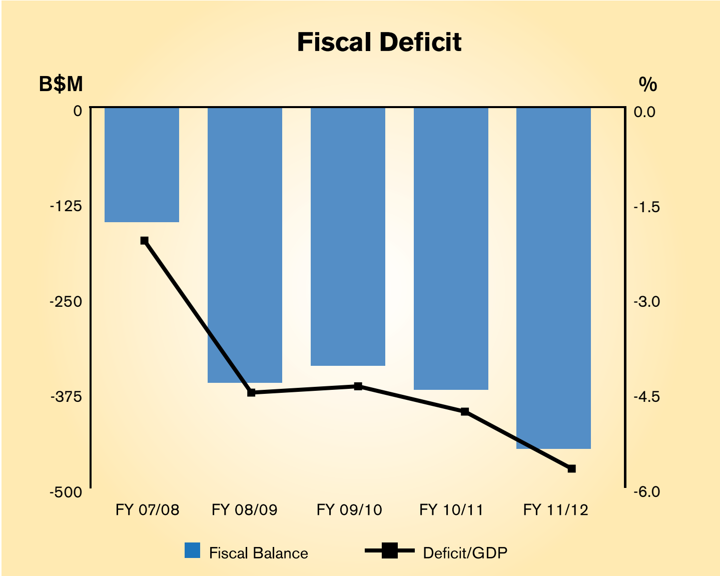
Table 6: **FISCAL INDICATORS (B$ MILLIONS)**

	FY2009/10	FY2010/11	FY2011/12	FY2012/13	
	Actual	Actual	Actual	Approved Estimates	Preliminary[1] Estimates
Government Revenue	1,302.5	1,433.0	1,446.7	1,536.1	664.8
as % of GDP	16.6	18.2	18.1	18.2	8.0
Government Expenditure	1,642.1	1,803.7	1,897.4	2,083.0	934.4
as % of GDP	20.9	22.9	23.7	24.6	11.3
Surplus/(Deficit)	(339.5)	(370.7)	(450.6)	(546.9)	(269.6)
as % of GDP	(4.3)	(4.7)	(5.6)	(6.5)	(3.3)

SOURCE: Ministry of Finance

Compiled according to the IMF's Government Finance Statistics Format. [1] July - December, 2012

21.5% ($1.8 million) and other asset purchases, by 15.3% ($1.5 million). Net lending to public enterprises for budgetary support advanced by 40.5% ($29.5 million) to $102.4 million, to more than double the budget estimate.



Financing

Almost four-fifths of the deficit for FY2011/12 was financed from domestic sources. Bahamian dollar borrowings, at $354.9 million, comprised $170.6 million in long-term bonds, $93.7 million in short-term loans and $90.6 million in Treasury bills. In addition, approximately $80.3 million in infrastructure-related external loans was drawn down from existing debt facilities. Debt repayments amounted to $84.1 million, of which approximately $75.0 million was utilized to reduce internal debt obligations.

First Six Months of FY2012/13

The Government's operations for the first half of FY2012/13 revealed a steady deterioration in the overall deficit, by 65.1% ($106.3 million) to $269.6 million, following on the previous year's 23.8% contraction, facilitated by extraordinary revenue receipts. Total revenue was down 7.2% ($51.9 million) to $664.8 million, alongside a $50.8 million (5.8%) expansion in aggregate expenditure to $930.8 million.

Revenue

Tax collections declined by $37.1 million (6.0%) to $583.1 million, and largely reflected an $84.8 million (21.7%) slump in international trade taxes to $305.3 million, vis-à-vis a $95.8 million (32.6%) gain a year earlier. In particular, excise taxes normalized with a decline of $86.3 million (41.6%), following the previous year's receipt of significant arrears payments. More marginal gains were posted for import taxes, of $1.6 million (1.0%), and for stamp taxes on imports, of $0.6 million (8.0%); and there was a timing-related drop in non-trade stamp taxes of $7.6 million (10.6%). In a significant offset, departure tax receipts were boosted by $34.4 million (82.0%) to $76.4 million, supported by arrears payments, while growth in property taxes of $11.2 million (22.2%) to $61.7 million benefited from enhanced revenue collection efforts. Smaller increases were recorded for business and professional fees, of $3.9 million (19.0%), and "unclassified" non-trade taxes, of $3.3 million (19.2%), while taxes on services and motor vehicles were up slightly, by $0.8 million (3.8%) and $0.2 million (2.1%), respectively.

Non-tax proceeds rose marginally by $3.0 million (3.8%) to $81.7 million, although inclusive of a nearly eight-fold ($7.2 million) hike in income from public enterprises to $8.1 million, arising from receipt of civil aviation fee arrears. Fines, forfeits & administrative fees also grew by $2.8 million (6.3%) to $47.2 million, whereas income from other sources fell by 22.6% ($7.4 million) to $25.4 million, to reverse the previous year's $12.6 million boost, associated with the receipt of deferred interest payments on bond investments. There were no capital revenues, compared with a $17.7 million receipt a year earlier, which was linked to the sale of a Government building.

Expenditure

The expansion in total outlays was mainly associated with a $37.3 million (5.2%) upturn in current expenditure to $749.2 million. Consumption expenses, which comprised some 59.8% of the total, increased by $15.8 million (3.6%) to $459.5 million, primarily behind the $12.6 million (4.4%) rise in wage & salary payments. Spending on goods & services firmed by a lesser $3.2 million (2.1%) to $160.0 million, inclusive of a $2.7 million rise in outlays related to rent, communication & utilities. Transfer payments, which expanded by $21.5 million (8.0%) to $289.7 million, included a $21.2 million (12.2%) advance in subsidies and other transfers, three-quarters of which were absorbed by public health administration. Higher transfers were directed to public corporations ($4.1 million), non-financial public enterprises ($1.2 million), non-profit institutions ($1.1 million) and households for pension payments ($0.5 million), while transfers abroad fell by $1.0 million. Reflecting the rise in total debt obligations, aggreggate interest payment rose slightly by $0.3 million (0.3%) to $94.5 million.

Capital expenditures grew by $15.3 million (15.3%) to $115.1 million, buoyed by an $18.2 million (23.6%) rise in outlays for major public works development projects. Transfers to non-financial enterprises, of $8.5 million, assisted with the purchase of aviation equipment, while direct asset acquisitions were halved to $10.0 million, as land purchase levels normalized following an extraordinary hike. Net lending to public corporations rose by $1.8 million (2.7%) to $70.0 million.

Financing

Budgetary financing for the first six (6) months of FY2012/13 totalled $647.6 million. The majority was derived from domestic sources as Government secured $325.0 million by way of long-term bonds, $54.9 million in Treasury bills and $53.0 million in loans & advances. This funding was augmented by a US$180 million external loan, obtained in December, alongside project-based external loan financing of $34.7 million. Debt repayments aggregated $158.7 million, the bulk of which (96%) was absorbed by internal Bahamian dollar obligations.

National Debt

Over the 2012 calendar year, the Direct Charge on the Government expanded by $590.0 million (15.5%) to $4,394.6 million, significantly ahead of 2011's $84.3 million (2.3%) gain. At end-December, the Direct Charge represented an estimated 53.9% of GDP, up from 48.3% in 2011 (see Table 7). Bahamian dollar denominated debt—which comprised 76.4% of the total—grew by $351.2 million (11.7%) to $3,357.3 million, while foreign currency claims were higher by $238.7 million (29.9%) at $1,037.3 million. By holder, the bulk of Bahamian dollar debt was held by commercial banks (35.4%), followed by the private sector (30.5%), public corporations (21.7%), the Central Bank (12.1%) and other local financial institutions (0.3%).

The Government's contingent liabilities rose by $41.4 million (7.5%) to $592.1 million, with most (64.2%) of the expansion attributed to increased loan guarantees for one public corporation. As a consequence of these developments, the National Debt moved higher by $631.4 million (14.5%) to $4,986.7 million at end-2012, outpacing the gain of $70.4 million (1.6%) for 2011. Correspondingly, the National Debt accounted for an increased 61.2% of GDP—up 5.9 percentage points from the 2011 ratio, which had registered a more modest increase of 1.0 percentage point.

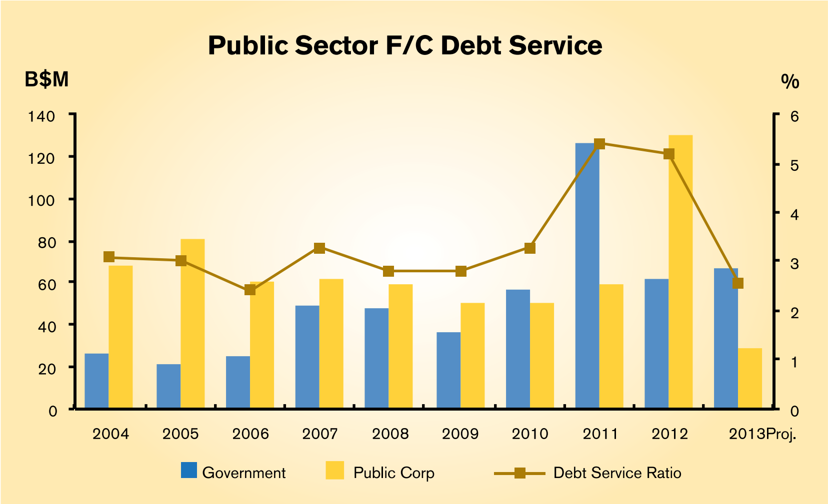
Foreign Currency Debt

Public sector foreign currency debt obligations expanded by $409.9 million (28.2%) to $1,863.0 million in 2012, as new drawings of $514.9 million outpaced amortization payments of $104.9 million. Reflecting the US$180 million loan in the final quarter of the year, debt obligations of the Government—which comprised 55.7% of the total—advanced by $238.7 million (29.9%) to $1,037.3 million. Similarly, the public corporation's segment firmed by $171.2 million (26.2%) to $825.7 million, buoyed by

Table 7: **DEBT INDICATORS (B$ MILLIONS)**

	2009p	2010p	2011p	2012p	Projections 2013[1]
A. EXTERNAL DEBT	766.7	915.1	1,041.7	1,448.3	1,550.0
as % of GDP	9.8	11.6	13.2	17.8	18.4
B. INTERNAL F/C DEBT	422.9	492.5	411.4	414.7	407.5
C. TOTAL F/C DEBT	1,139.6	1,357.7	1,453.1	1,863.0	1,957.4
as % of GDP	14.6	17.2	18.5	22.9	23.2
D. DEBT SERVICE RATIO[2]	2.8	3.3	5.4	5.2	2.6
E. DIRECT CHARGE	3,320.4	3,720.4	3,804.6	4,394.6	4,566.3
as % of GDP	42.5	47.2	48.3	53.9	54.1
F. NATIONAL DEBT	3,909.4	4,285.0	4,355.3	4,986.7	5,128.4
as % of GDP	50.0	54.3	55.3	61.2	60.8

SOURCE: Treasury Accounts, Treasury Statistical Printouts and Public Corporations' Quarterly Report
[1]Based on contractual obligations and planned borrowings [2]Excludes refinancing activities



increased borrowing by the public airport operator.

Foreign debt service payments rose by $6.1 million to $192.1 million at end-2012. Government's debt service payments fell by $64.5 million (50.8%) to $62.4 million, after the year earlier extraordinary increase associated with the liquidation of a short-term internal foreign currency loan. Debt servicing by public corporations more than doubled, to $129.7 million, due to activity by a major operator. At end-December, the ratio of debt service to goods and non-factor services fell by 20 basis points to 5.2%, while the Government's debt service as a percentage of revenues softened from 8.1% a year earlier to 4.5%.

By credit profile, the largest proportion of foreign currency debt was held by private capital markets (41.9%), followed by other "miscellaneous" institutions (24.9%), commercial banks (18.4%), multilateral institutions (12.6%) and bilateral agencies (2.2%). The average maturity of debt lengthened to 15.4 years, from 14.7 years in 2011.

Monetary Sector

Monetary conditions featured buoyant liquidity levels, as the challenging economic environment moderated private sector demand. However, external reserves contracted relative to 2011, reflecting the ongoing demand for foreign currency to facilitate import payments and less significant one-off inflows, which overshadowed modest net receipts from real sector activities. Amid elevated levels of loan arrears, banks maintained their conservative lending posture and increased provisions for loan losses. Consequently, bank profitability fell, while the interest rate spread widened, as the decrease in the average deposit rate eclipsed the contraction in the corresponding lending rate.

Liquidity

During 2012, banks' average net free cash balances were reduced by 19.1% to $361.1 million, reflecting increased holdings of Government securities. The level of net free cash reserves stayed within the $370 to $390 million range over the first four months of 2012, peaked during May and June at over $400.0 million, and then trended downward in the closing months of the year. At end-December, net free cash reserves were 12.9% below the 2011 level, at $322.8 million, and was a lower 5.4% of Bahamian dollar deposits, compared with 6.2% in the prior year.

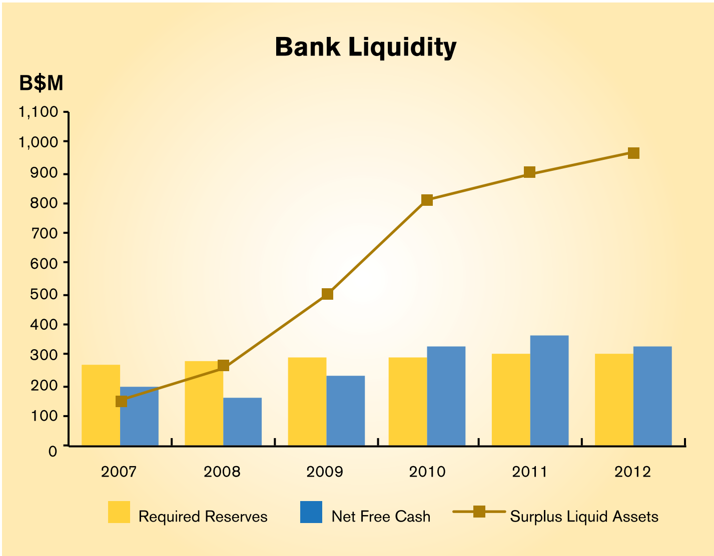
Banks' broader measure of liquidity, which includes holdings of government paper, posted an average monthly surplus of $931.8 million, up by 1.3% from 2011. After attaining a peak of over $1.0 billion in July, secondary liquid assets closed the year 7.9% higher at $967.1 million, down from last year's 10.9% gain. At end-December, excess liquid assets exceeded the statutory requirement by 99.6%, up from 92.5% in 2011.

Money Supply

Consistent with the mild rate of economic activity, growth in the overall monetary aggregates (M3) slowed during 2012, to $6.7 million (0.1%) at $6,303.7 million from $120.1 million (1.9%) in 2011.

Narrow money (M1) expanded by $140.1 million (9.8%), up from the year-earlier $100.2 million (7.5%) gain. Both demand deposits and currency in circulation posted strengthened increases, of $120.5 million (9.7%) and $19.6 million (10.0%), respectively.

By contrast, the dominant broad money (M2) aggregates contracted by 0.3% ($16.4 million), relative to a 2.3% ($138.6 million) rise in 2011. The fall-off in fixed deposits was higher at $161.8 million (4.5%) from $9.4 million (0.3%) a year earlier, and the growth in savings deposits moderated to $5.3



million (0.5%) from $47.9 million (4.7%). Following an $18.5 million (8.2%) reduction in 2011, domestic foreign currency deposits grew by $9.7 million (4.7%), owing mainly to increased balances by the public sector.

Domestic Credit

During 2012, the bulk of bank lending was directed to the public sector, with private sector credit weakened by a combination of lingering high unemployment, weak economic activity and banks' conservative lending posture.

The expansion in total domestic credit was higher at $148.1 million (1.7%) from $88.7 million (1.0%) in 2011, of which 91.6% was in Bahamian dollars. Banks' net claim on the Government surged by $153.0 million (10.6%), outstripping the prior year's $25.5 million (1.8%) advance, and was in the form of increased holdings of Government long and short term paper. Credit to the rest of the public sector also grew by $13.3 million (3.0%), to reverse last year's $11.6 million (2.5%) decline.

After recovering by $74.8 million (1.1%) in 2011, private sector credit contracted by $18.2 million (0.3%) (see Table 8). Analyzed by sector, personal loans, at a commanding 73.3% of the total, increased by a moderated $16.3 million (0.3%), relative to $73.9 million (1.5%) in 2011. Notable gains were also recorded for distribution ($45.0 million), transport ($4.8 million) and manufacturing ($3.0 million), while agriculture grew by a more muted $0.9 million. However, these were outpaced by a $70.8 million (15.1%) contraction in the 'miscellaneous' segment, versus a $72.0 million (18.1%) increase last year. Similarly, loans for tourism, entertainment and catering, construction and professional and other services fell by $5.0 million, $2.9 million, $2.6 million and $1.1 million, respectively, while declines in the other categories were under $1.0 million.

A further disaggregation of personal loans revealed contractions in both the consumer and overdraft segments, by $9.1 million (0.4%) and $0.7 million (0.7%), respectively, a turnaround from gains of $23.2 million (1.1%) and $20.1 million (27.0%) in 2011. In contrast, housing loans firmed by $43.2 million (1.5%), slightly above 2011's $40.3 million (1.4%) expansion. A breakdown of the consumer credit components showed that the largest declines were recorded for debt consolidation, credit cards, land purchase and medical expenses, of $38.6 million, $8.2 million, $7.0 million and $3.0 million, respectively, with smaller contractions registered for education ($1.2 million) and commercial vehicles ($0.3 million). In a partial offset, increases in credit were noted for loans for miscellaneous purposes ($37.2 million), private cars ($5.8 million), travel ($4.3 million), home improvement ($1.0 million) and furnishings & domestic appliances ($0.8 million).

Interest Rates

During 2012, the weighted average interest rate spread on domestic banks' loans and deposits widened by 51 basis points to 8.86 percentage points. Underlying this outturn was a 61 basis point reduction in the average deposit rate to 2.02%, which surpassed a 10 basis point softening in the weighted average loan rate to 10.88%.

On the lending side, both residential and commercial mortgage rates decreased by 27 and 8 basis points, to 7.50% and 8.29%, respectively, while rates on overdrafts softened by 22 basis points to 9.81%. In contrast, consumer loan rates firmed slightly, by 8 basis points to 13.43%, relative to 2012.

Reflective of the robust liquidity conditions, broad-based declines were recorded for all deposit categories. The average rate on demand deposits fell by 85 basis points to 0.45%, the average rate on savings balances lessened by 10 basis points to 1.65%, and the average range on fixed balances moved significantly lower and narrowed, to 1.60%-2.65% from 2.33%-3.20% in 2011.

Table 8: **FLOW OF CREDIT IN THE FINANCIAL SYSTEM (B$ MILLIONS)**

	Outstanding as at 2010	Absolute Changes 2011	Absolute Changes 2012	Outstanding as at 2012
Destination				
Government (net)	1,413.7	25.5	153.0	1,592.2
Central Bank	261.4	27.8	105.5	394.7
Domestic Banks	1,152.3	(2.3)	47.5	1,197.5
Rest of Public Sector	461.8	(11.6)	13.3	463.5
Central Bank	6.4	(0.4)	(0.3)	5.7
Domestic Banks	455.4	(11.2)	13.6	457.8
Private Sector	6,572.7	74.8	(18.2)	6,629.3
Domestic Banks	6,572.7	74.8	(18.2)	6,629.3
Consumer	2,140.9	23.2	(9.1)	2,155.0
Mortgages	2,840.1	40.3	43.2	2,923.6
Other Loans	1,591.7	11.3	(52.3)	1,550.7
Financing				
Liabilities (Net of Government)	6,191.0	119.4	(6.7)	6,303.7
Currency	194.5	2.4	19.6	216.5
Total Deposit liabilities	5,996.5	117.0	(26.3)	6,087.2
Demand deposits	1,341.0	61.1	139.5	1,541.6
Savings deposits	1,017.8	49.3	7.3	1,074.4
Fixed deposits	3,637.7	6.6	(173.1)	3,471.2
International reserves	860.4	24.5	(74.7)	810.2
*Other net external liabilities	(705.8)	101.7	2.3	(601.8)
Capital and surplus	2,285.4	76.1	178.1	2,539.6
Other (net)	(126.4)	(19.4)	195.9	50.1

SOURCE: The Central Bank of The Bahamas
* ( ) = increase

For the remaining key interest rates, both the commercial banks' Prime Rate and the Central Bank's Discount Rate were unchanged, at 4.75% and 4.50%, respectively. The buoyancy in liquidity also influenced a decline in the average Treasury bill rate by105 basis points to 0.2% in 2012.

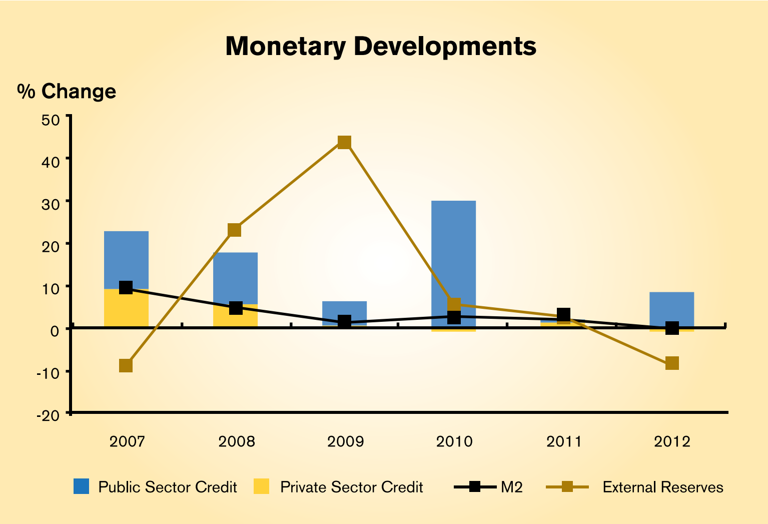
Net Foreign Assets

Reflecting a contraction in the Bank's net international reserves, the banking system's net foreign assets were lower by $72.4 million (25.8%) at $208.3 million, a reversal from a $127.8 million (83.6%) expansion in 2011.

After a $101.7 million (14.4%) retrenchment in 2011, when the Government repaid an internal foreign currency loan, the net foreign liabilities of banks fell marginally by $2.3 million (0.4%) to $601.8 million at end-December 2012. Amid weak foreign currency inflows from real sector activities and sustained demand for foreign currency payments—especially fuel—external reserves contracted by $74.7 million (8.4%) to $810.2 million, in contrast to 2011's $24.4 million (2.8%) upturn.

External reserves rose modestly over the first four (4) months of the year, in line with the increase in revenues generated by the tourism sector during the peak winter season. Government's receipt of foreign currency proceeds from the sale of a major tourism resort led to external reserves peaking during May at $942.0 million, before heightened demand conditions led to a downward trend during the remaining months of the year—although proceeds from Government's US$180 million loan boosted external reserves in December. As a result, the average monthly external reserve balance was $840.0 million, down $158.4 million (15.9%) from 2011.

Underlying the reduction in external reserves was a reversal in net foreign currency transactions, from a $9.2 million net purchase in 2011 to a $96.1 million net sale, as the 18.0% ($195.3 million) contraction in purchases outpaced the 8.4% ($90.0 million) falloff in sales. The Bank's net purchase from the Government contracted to $227.5 million from $332.5 million in the prior year, when the Government benefited from several significant one-off receipts, while the net



year, and advanced by 88 basis points to 13.9% of total loans. In a slight offset, short-term arrears, 31-90 days overdue, declined by $9.1 million (2.3%) to $382.9 million, compared to a $1.1 million reduction in 2012, and corresponded with a 12 basis point softening in the loan ratio to 6.1%.

By loan type, mortgage delinquencies, which accounted for the bulk (55.9%) of arrears, advanced by $49.4 million (7.6%) to $699.5 million, extending the $36.4 million (5.9%) gain for 2011. As a result, mortgage arrears grew by 1.4 percentage points to 22.6% of total loans. Consumer arrears, at 22.4% of the aggregate, firmed by $8.9 million (3.3%) to $280.2 million, versus a modest $1.5 million (0.6%) narrowing in 2011, while the ratio of consumer loan arrears to total loans firmed by 63 basis points to 13.4%, vis-à-vis an 11 basis point reduction a year ago. In contrast, commercial delinquencies contracted by $15.9 million (5.5%) to $270.8 million, a turnaround from the $34.2 million build-up last year. Accordingly, the corresponding ratio to total loans declined by one percentage point to 25.6%, compared to a 2.2 percentage point gain in 2011.

sale to 'other consumers' firmed by $20.6 million to $434.0 million–mainly related to fuel purchases; the latter was almost countered by the $20.3 million hike in the Bank's net purchase from commercial banks to $110.4 million.

At end-2012, the stock of external reserves stood at an estimated 17.5 weeks of non-oil merchandise imports, relative to 19.7 weeks at end-December 2011. After complying with the statutory requirement that the Bank hold the equivalent of 50% of its Demand Liabilities, 'usable' reserves fell by $86.8 million to $347.9 million.

Performance of the Banking Sector

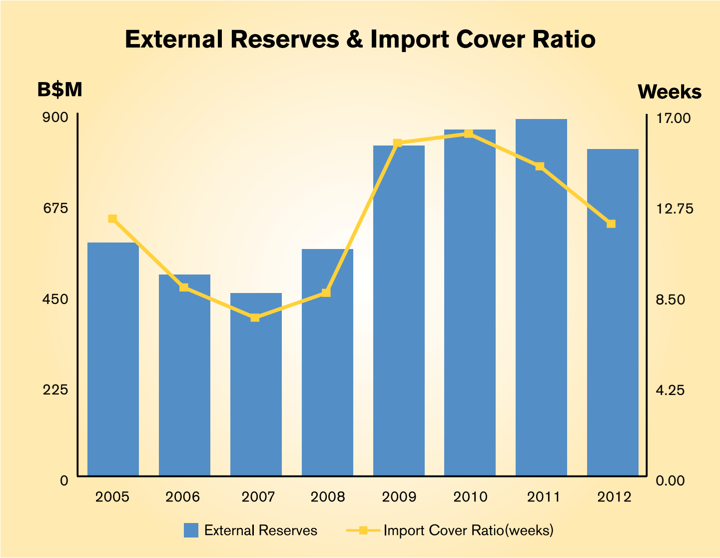
Credit Quality

Given the narrow scope of the domestic recovery and elevated unemployment levels, consumers continued to encounter difficulties in servicing their debt. This was evidenced in a deterioration in banks' credit quality indicators for 2012, albeit at a slower rate than in 2011. Total private sector loan arrears grew by $42.4 million (3.5%) to $1,250.5 million, compared to a year-earlier gain of $69.1 million (6.1%). The corresponding arrears rate firmed by 75 basis points to 20.0% of total loans, up from the 70 basis point increase registered in 2011.

The non-performing component–arrears in excess of 90 days and for which banks are no longer accruing interest–firmed by $51.5 million (6.3%) to $867.6 million, relative to a $70.2 million increase last

Capital Adequacy and Provisions

In a bid to minimize credit exposure risks, banks increased their provisions for bad debts, by $38.8 million (12.9%) to $339.3 million, extending the $27.8 million increment for 2011. As a result, the



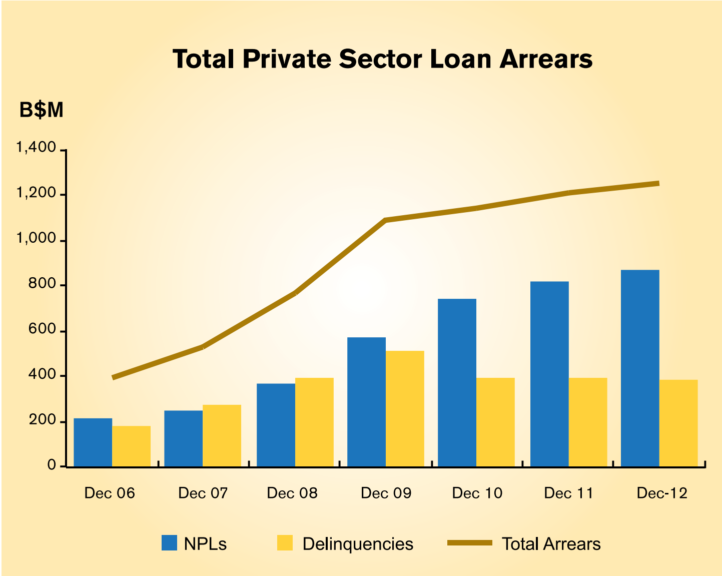
ratio of total provisions to loans trended upwards by 65 basis points to 5.3%. Similarly, the ratio of provisions to both arrears and non-performing loans rose by 2.3 percentage points to 27.1% and 39.1%, respectively. Banks also wrote-off a total of $233.2 million in delinquent loans, and recoveries amounted to $44.7 million.

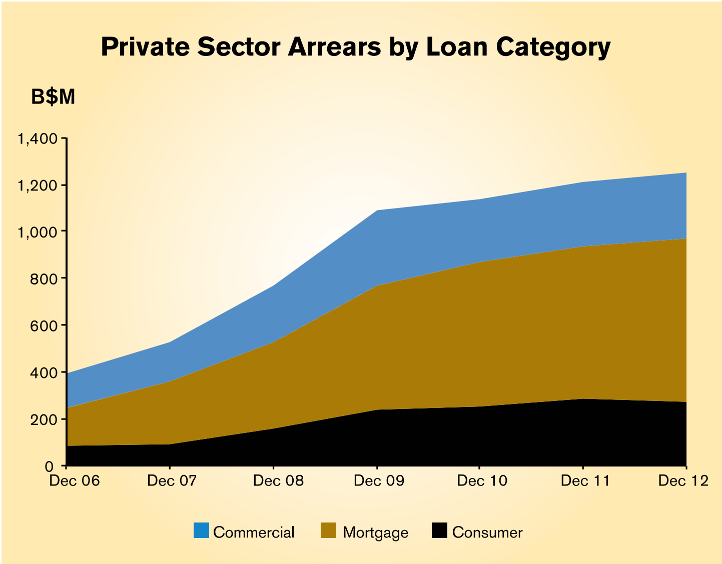
Bank Profitability

Banks' net income contracted by 26.5% ($60.8 million) to $168.4 million during the twelve months to September, following a 9.9% ($20.6 million) hike in the corresponding period of 2011. In the context of a generally lower interest rate environment, the net interest margin decreased by 2.3% ($12.0 million) to $513.3 million; interest income contracted by 8.4% ($60.7 million) to $665.5 million, to surpass the 24.2% ($48.7 million) fall in interest expenses to $152.2 million. After accounting for commission & forex income, which edged up by 1.2% ($0.3 million) to $23.1 million, the gross earnings margin decreased by 2.1% ($11.7 million) to $536.4 million, vis-à-vis a 4.8% ($25.2 million) advance in the comparative period.

Operating costs softened, as higher occupancy outlays ($3.8 million) were offset by declines in both staffing ($1.8 million) and other "miscellaneous" operating expenses ($2.8 million). Consequently, the reduction in the net earnings margin broadened to 4.4% ($11.0 million) at $235.8 million, from 1.4% ($3.6 million) a year earlier. Similarly, the loss from non-core operations was extended almost four-fold, to $67.4 million, owing to a $45.0 million (44.0%) hike in provisioning for bad debts and a $7.3 million (7.4%) decline in non-core revenues, which eclipsed the $2.4 million (16.9%) reduction in depreciation costs.

Similar trends were observed in the profitability ratios. The interest margin ratio receded by 22 basis points to 5.34%, while the commission & forex income ratio was virtually unchanged at 0.24%, resulting in the gross earnings margin moving lower by 23 basis points at 5.58%. These developments, together with a 7 basis point decline in the operational cost ratio, to 3.13%, resulted in a 16 basis point reduction in the net earnings margin to 2.45%. After accounting for depreciation and bad debt provisions, the net income ratio contracted by 67 basis points to 1.76%.





Capital Market Developments

Capital market activity was relatively brisk during 2012. Buoyed by two (2) significant share issues, both the trading volume and value were higher by 39.8% and 11.3% to 3.7 million valued at $15.9 million. The improvement in market activity was linked to the listing of the shares of a major port development company and an insurer during the second quarter, which extended the total number of publicly traded securities by two (2) to 27 by end-December 2012.

Nevertheless, share price declines caused the Bahamas International Securities Exchange (BISX) All Share Index to weaken by 1.4% to 1,346.3,

Table 9: **BALANCE OF PAYMENTS SUMMARY (B$ MILLIONS)**

	2010P	2011P	2012P
I. CURRENT ACCOUNT	(813.1)	(1,089.8)	(1,451.5)
i) Merchandise Trade (net)	(1,888.2)	(2,131.3)	(2,375.6)
Exports	702.4	833.5	942.4
Imports	2,590.6	2,964.8	3,318.0
of which: Oil	695.8	804.7	910.2
ii) Services (net)	1,312.5	1,313.8	1,214.7
Travel	1,919.2	2,007.8	2,081.1
Other	(606.8)	(694.0)	(866.4)
iii) Income (net)	(234.8)	(236.0)	(300.1)
iv) Current Transfers (net)	(2.6)	(36.2)	9.5
II. CAPITAL AND FINANCIAL ACCOUNT	1,141.4	986.4	1,032.6
i) Capital Account (Transfers)	(3.6)	(5.5)	(7.3)
ii) Financial Account	1,144.9	992.0	1,039.9
of which: Direct Investment	871.9	666.6	444.8
III. NET ERRORS AND OMISSIONS	(283.7)	127.8	344.1
IV. CHANGES IN EXTERNAL RESERVES[1]	(44.5)	(24.5)	74.7

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

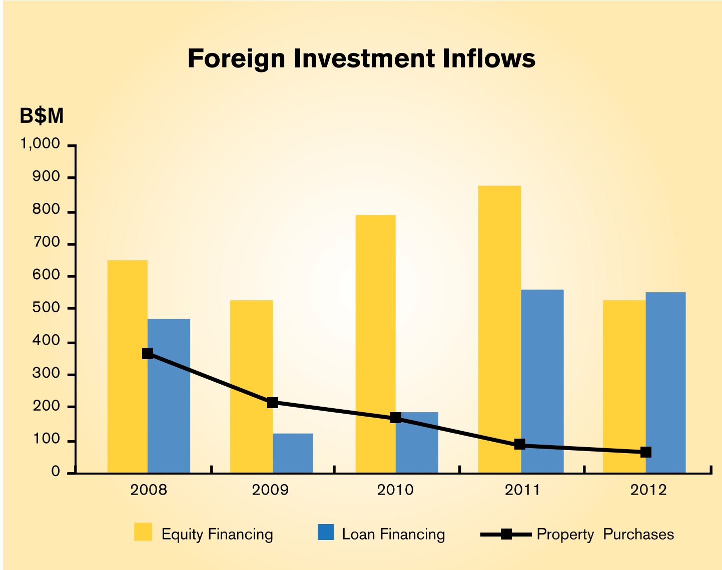
albeit a slowdown from the 8.9% reduction in 2011. Market capitalization softened by 0.53% to $2,869.6 million, which was slightly less than the 0.7% abatement in 2011.

International Trade and Payments

During 2012, increased imports, related partly to large-scale construction sector projects and higher fuel purchases, boosted the current account deficit by $361.7 million (33.2%) to $1,451.5 million (see Table 9). In contrast, the capital and financial account surplus improved by $46.2 million (4.7%) to $1,032.6 million, as Government's external borrowings in the latter half of the year and an expansion in loan-based foreign financing, supported growth in other "miscellaneous" investment inflows.

The merchandise trade deficit widened by an estimated $244.3 million (11.5%) to $2,375.6 million, attributed to a $353.2 million (11.9%) upturn in imports, which overshadowed growth in exports of $108.9 million (13.1%). Net non-oil imports were higher by $232.5 million (14.3%) at $1,863.3 million, explained primarily by increased imports of construction related machinery, while a combination of average volume and value gains elevated oil imports by an estimated $105.4 million (13.1%) to $910.2 million. On the product side, average per barrel price gains were posted for jet fuel (18.7% to $133.70) and aviation gas (10.4% to $160.23), with more moderate gains for motor gas (2.6% to $130.72) and gas oil (1.8% to $129.45), respectively. In contrast, the cost of propane fell by 14.8% to an average $63.33 per barrel.

The surplus on the services account narrowed by $99.0 million (7.5%) to $1,214.7 million, owing primarily to a $103.2 million (63.3%) expansion in the net payment for construction services—linked to major foreign investment projects. In addition, net outflows for transportation and other "miscellaneous" services rose by $68.3 million (34.9%) and $36.4 million (12.7%) to $264.1 million and $322.8 million, respectively. Offshore companies increased their local expenditures by 22.0% ($30.5 million) to $169.4 million, while more modest rises in outflows were recorded for insurance services ($7.7 million) and royalty & licence fees ($1.5 million). The steady recovery in the tourism sector contributed to an estimated $73.3 million (3.6%) rise in travel-related inflows to $2,081.1 million, and the net inflow for Government service more than doubled to $27.7 million.



The income account deficit worsened by $64.1 million (27.1%) to $300.1 million. Net private sector payments rose by $68.2 million (43.5%) to $225.0 million, owing to a $74.6 million hike in profit repatriations of non-banks, which negated a modest $6.4 million decline in commercial banks' dividend payments. In a slight offset, net outflows for employee compensation and official transactions narrowed by $2.8 million and $1.4 million, respectively, with the latter due to a contraction in Government interest payments by $1.8 million, which overshadowed a slight $0.4 million decline in Central Bank income.

Current transfers were reversed, from a net outflow of $36.2 million in 2011 to a net receipt of $9.5 million, occasioned in part by a $39.5 million (26.4%) contraction in private sector net outflows back to trend levels, as other "miscellaneous" transfers fell by almost five-fold to $15.6 million, eclipsing a $22.7 million increase in worker remittances. In addition, net inflows to the Government rose modestly by $6.2 million to $119.7 million.

The expansion in the capital and financial account surplus was attributed to a $268.8 million increase in other "miscellaneous" investment inflows to $638.4 million, the bulk of which was explained by the Government's $180.0 million external borrowing and infrastructure loan financing. Domestic banks' net short-term transactions normalized to a net outflow of $2.3 million from an extraordinary $101.4 million in 2011, when Government repaid a foreign currency loan. Similarly, other public sector capital transactions moderated by $38.1 million to $19.5 million, and higher loan-based financing for large-scale tourism projects, led to other "miscellaneous" investment inflows firming by $39.7 million to $382.4 million. In contrast, net direct investment inflows contracted by $221.9 million to $444.8 million, as equity investments fell by $205.1 million back to trend levels, after the surge reported in 2011 when the Government sold its majority stake in BTC, while real estate purchases narrowed by $16.8 million. Net outward portfolio investments fell modestly by $1.0 million to $43.2 million, reflecting a fall-off in equity investments by $10.4 million—related mainly to the Bank's BDR programme—which outstripped a $9.4 million increase in debt securities. Further, migrants' net capital transfers firmed by $1.7 million to $7.3 million.

After making adjustments for net errors and omissions, the overall balance in 2012, which corresponds to the change in Central Bank's external reserves, registered a deficit of $74.7 million, a reversal from a surplus of $24.5 million in 2011.

DOMESTIC ECONOMIC OUTLOOK FOR 2013

The Bahamian economy is expected to maintain a positive growth trajectory during 2013, extending the rebound witnessed over the past two (2) years, achieved through strong tourism and foreign investment led construction activity. However, downside risks remain, given uncertainties in the global environment—especially the concerns about the durability of the US recovery which has implications for tourism performance. Unemployment is likely to remain above pre-recession levels, although some gains are possible as the recovery broadens, while inflation should be relatively subdued.

Achievement of a more sustainable fiscal outcome remains dependent on the success of measures pursued by the authorities to improve revenue collections and administration, and curtail expenditures. The pace and durability of these fiscal consolidation efforts will also impact the extent to which greater long-term debt sustainability is achieved.

Monetary conditions should feature a continuation of the strong build-up in bank liquidity, as the combination of the high jobless rate, private sector indebtedness and banks' more conservative lending practices constrain private sector credit growth. As observed in recent years, the majority of borrowing is likely to be directed to the public sector. Despite the ongoing challenges in the banking system, banks' capital levels, on average, are forecasted to remain above the established target ratio of 17.0% of risk-weighted assets, mitigating any financial stability concerns.

The external position is poised to show a widening in the current account deficit position, primarily because of the large import requirements related to the major foreign investment projects underway—although substantially covered by net inflows on the capital account. An improved outcome for the external reserve position is dependent on the extent to which the economy is able to derive net foreign exchange inflows beyond the current needs, which includes a sizeable oil import bill.

The Central Bank of The Bahamas

FINANCIAL STATEMENTS

for the YEAR ENDED DECEMBER 31, 2012

and Independent Auditors' Report

PFK Bahamas
Chartered Accounts
Pannell House
44 Elizabeth Ave
P. O. Box N-8335
Nassau, Bahamas

INDEPENDENT AUDITORS' REPORT

To the Directors of

The Central Bank of The Bahamas

Report on the financial statements

We have audited the financial statements of the Central Bank of The Bahamas (the "Bank") which comprise the statement of financial position as of December 31, 2012, and the related statements of comprehensive (loss)/income, changes in equity and reserves and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The financial statements for the year ended December 31, 2011 were jointly audited by two other firms of chartered accountants, who issued an unqualified audit report thereon, dated April 16, 2012.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Central Bank of The Bahamas as of December 31, 2012 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000.

March 12, 2013
Nassau, Bahamas

The Central Bank of The Bahamas

STATEMENT OF FINANCIAL POSITION

As of December 31, 2012

(Expressed in Bahamian dollars)

	Notes	2012	2011
ASSETS			
PROPERTY, PLANT AND EQUIPMENT	5	**$ 13,019,120**	**$ 13,080,382**
EXTERNAL ASSETS	6		
Cash and deposits		199,860,038	25,054,161
Bank deposits maturing over 3 months		16,608,461	90,112,879
Marketable securities issued or guaranteed by foreign governments	7	555,641,104	584,852,339
International Monetary Fund:	8		
Bahamas reserve tranche		9,621,549	9,611,194
Special drawing rights		28,432,220	175,261,663
		810,163,372	**884,892,236**
DOMESTIC ASSETS			
Bahamas Development Bank bonds	9	4,055,545	4,055,697
Advances to Bahamas Government	10	106,297,056	111,462,558
Bahamas Government Registered Stocks	11	171,340,130	165,825,643
Loans to Bahamas Development Bank	12	4,767,347	5,168,815
Bridge Authority bonds	13	896,326	875,839
Clifton Heritage Authority bonds	14	638,423	638,434
Bahamas Government Treasury bills	15	129,740,549	26,195,352
Currency inventory		8,033,513	8,380,035
Retirement benefit asset	30	309,425	4,773,796
Receivables and other assets		10,761,779	10,119,957
		436,840,093	**337,496,126**
TOTAL ASSETS		**$ 1,260,022,585**	**$ 1,235,468,744**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

STATEMENT OF FINANCIAL POSITION

As of December 31, 2012

(Expressed in Bahamian dollars)

	Notes	2012	2011
LIABILITIES, EQUITY AND RESERVES			
DEMAND LIABILITIES			
Notes in circulation	16	$ 324,894,895	$ 305,545,092
Coins in circulation		19,097,761	18,406,307
Deposits by commercial banks	17	555,202,567	557,366,772
Deposits by Bahamas Government and Bahamas Government agencies		24,894,592	18,754,446
Deposits by international agencies	19	371,514	255,533
Accounts payable and other liabilities		2,945,884	2,473,978
Provision for Investment Currency Market		3,566,710	3,028,781
Health insurance subsidy benefit for retirees	31	2,114,110	2,027,771
		933,088,033	**907,858,680**
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	8	**191,230,734**	**191,053,969**
EQUITY AND RESERVES			
Authorized and fully paid capital	20	3,000,000	3,000,000
Exchange equalization account	20	2,626,719	(137,034)
Contingency reserve		750,000	750,000
Other reserves		10,389,415	9,799,944
Building fund	20	6,980,403	6,980,403
General reserve	20	111,957,281	116,162,782
		135,703,818	**136,556,095**
TOTAL LIABILITIES, EQUITY AND RESERVES		**$ 1,260,022,585**	**$ 1,235,468,744**

The financial statements, as approved by the Board of Directors and authorized for issuance on March 12, 2013, are signed on its behalf by:

Governor **Director**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

STATEMENT OF COMPREHENSIVE (LOSS)/INCOME

For the Year Ended December 31, 2012

(Expressed in Bahamian dollars)

	Notes	2012	2011
INCOME			
Interest on foreign investments	21	$ 16,323,989	$ 16,457,523
Interest on loans	21	1,064,935	1,282,421
Interest on domestic investments	21	8,948,814	8,765,794
Unrealized exchange loss	21	(179,276)	(606)
Realized exchange gain	8, 21	957,673	-
Interest expense	21	(327,546)	(792,601)
Other income	21	1,106,447	2,080,700
Total income		**27,895,036**	**27,793,231**
EXPENSES			
Staff costs	22, 30	20,481,022	14,387,965
General and administrative	22	7,144,149	6,297,656
Depreciation	5	1,711,613	1,417,859
Total expenses		**29,336,784**	**22,103,480**
NET COMPREHENSIVE (LOSS)/INCOME		**$ (1,441,748)**	**$ 5,689,751**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

STATEMENT OF CHANGES IN EQUITY AND RESERVES

For the Year Ended December 31, 2012

(Expressed in Bahamian dollars)

	Authorized and Fully Paid Capital	Exchange Equalization Account	Contingency Reserve	Other Reserves	Building Fund	General Reserve	Total
Balance at January 1, 2011	$ 3,000,000	$ (136,428)	$ 750,000	$ 9,799,944	$ 6,980,403	$110,472,425	**$130,866,344**
Transfer of unrealized exchange loss	-	(606)	-	-	-	606	**-**
Net comprehensive income	-	-	-	-	-	5,689,751	**5,689,751**
Balance at December 31, 2011	**3,000,000**	**(137,034)**	**750,000**	**9,799,944**	**6,980,403**	**116,162,782**	**136,556,095**
Transfer of realized exchange loss (Note: 8)	-	2,943,029	-	-	-	(2,943,029)	**-**
Additional SDRs received (Note: 8)	-	-	-	589,471	-	-	**589,471**
Transfer of unrealized exchange loss	-	(179,276)	-	-	-	179,276	**-**
Net comprehensive loss	-	-	-	-	-	(1,441,748)	**(1,441,748)**
Balance at December 31, 2012	**$ 3,000,000**	**$ 2,626,719**	**$ 750,000**	**$10,389,415**	**$ 6,980,403**	**$111,957,281**	**$135,703,818**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2012

(Expressed in Bahamian dollars)

	Notes	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net comprehensive (loss)/income		**$ (1,441,748)**	**$ 5,689,751**
Adjustments for non-cash items:			
Discount earned on marketable securities	7	(1,067,580)	(791,919)
Depreciation	5	1,711,613	1,417,859
Loss on disposal of property, plant and equipment		-	1,907
Interest income		(25,459,179)	(27,435,909)
Interest expense		327,546	792,601
Net cash used in operating activities before changes in operating assets and liabilities		(25,929,348)	(20,325,710)
Decrease/(Increase) in operating assets:			
Currency inventory		346,522	1,294,431
International Monetary Fund - special drawing rights	8	(1,347,339)	30,662
Retirement benefit asset	30	4,464,371	(584,434)
Receivables and other assets		(587,867)	(704,672)
(Decrease) increase in operating liabilities:			
Notes in circulation	16	19,349,803	15,778,536
Coins in circulation		691,454	321,684
Deposits by commercial banks	17	(2,164,205)	39,542,037
Deposits by Bahamas Government and Bahamas Government agencies		6,140,146	(11,168,035)
Deposits by international agencies	19	115,981	140
Provision for Investment Currency Market		537,929	1,211,151
Health insurance subsidy benefit for retirees	31	86,339	93,773
Accounts payable and other liabilities		471,906	(53,631)
Net Cash Provided By Operating Activities		**2,175,692**	**25,435,932**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2012

(Expressed in Bahamian dollars)

	Notes	2012	2011
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	7	$ -	$ (114,304,297)
Proceeds from maturities/redemptions of marketable securities	7	30,000,000	30,000,000
Purchase of property, plant and equipment	5	(1,650,351)	(2,418,643)
Advances made to Bahamas Government	10	(50,069,444)	(76,600,000)
Advances repaid by Bahamas Government	10	55,000,000	78,000,000
Purchase of Bridge Authority bonds	13	(20,200)	(23,800)
Purchases of Bahamas Government Registered Stock	11	(78,083,800)	(23,106,900)
Proceeds from sales and maturities of Bahamas Government Registered Stock	11	72,596,300	21,388,900
Repayments of loans by Bahamas Development Bank	12	400,000	400,000
Purchase of Bahamas Government Treasury bills	15	(399,543,734)	(73,972,494)
Proceeds from the sale and maturities of Bahamas Government Treasury bills	15	296,042,371	47,788,077
Maturing Bank deposits maturing over 3 months		73,504,418	19,965,621
Interest received		26,474,843	28,105,347
Net Cash Provided By/(Used in) Investing Activities		**24,650,403**	**(64,778,189)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from sale of SDRs		148,343,192	-
Funds obtained through collateralized financing	18	150,000,000	-
Funds repaid under collateralized financing	18	(150,000,000)	-
Interest paid		(356,569)	(855,999)
Net Cash Provided By/(Used in) Financing Activities		**147,986,623**	**(855,999)**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**174,812,718**	**(40,198,256)**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		25,101,275	65,299,531
CASH AND CASH EQUIVALENTS AT END OF YEAR		**$ 199,913,993**	**$ 25,101,275**
CASH AND CASH EQUIVALENTS ARE COMPRISED OF THE FOLLOWING:			
Cash and deposits		$ 199,860,038	$ 25,054,161
Cash on hand (included in receivables and other assets)		53,955	47,114
		$ 199,913,993	**$ 25,101,275**

The accompanying notes form an integral part of these financial statements.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

1. GENERAL INFORMATION

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

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

There were no new and revised IFRSs that have been applied in the current year.

2.1 New and revised IFRSs affecting presentation and disclosure only

Amendments to IFRS 7 Disclosures - Transfers of Financial Assets in the current year. The amendments increase the disclosure requirements for transactions involving the transfer of financial assets. In the current year, the Bank transferred U.S. treasury notes as collateral for a repurchase agreement. The Bank continues to recognize the carrying value of notes and has recognized the cash received as secured borrowing.

2.2 New and revised IFRSs in issue but not yet effective

<u>Issued, relevant but not effective</u>

1. IFRS # 9 - Financial Instruments

The new standard requires all financial assets within the scope of IAS 39 to be stated at amortized cost or fair value where the intention is to hold such instruments to collect the contractual cash flows which are repayments of capital and interest. All other investments are stated at fair value at the end of each reporting period. Furthermore, where changes in the fair value of financial liabilities at fair value through profit or loss can be attributed to changes in credit risk, those changes are recognized in other comprehensive (loss)/income.

The only exception would be when such treatment would give rise to, or enlarge an accounting mismatch in profit and loss. The standard is effective for years commencing on or after 1 January 2015, with earlier adoption permitted.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

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

2. IFRS # 13 - Fair Value Measurement

The Standard defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. It applies to both financial instrument items and non-financial instrument items where other standards require or permit fair value measurements and disclosures about fair value measurements.

IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

<u>Amendments to Existing Standards</u>

1. IAS # 1 - Classification and presentation

The revised standard requires entities to group items in other comprehensive income as items which may be subsequently recycled to profit or loss, or those that will not. The revised IAS 1 is effective for years beginning on or after 1 July 2012.

2. IAS # 16 - Classification of servicing equipment

Servicing equipment would be classified as items of property, plant and equipment when they are used for more than one period. If the servicing equipment is used for less than one period, then it would be classified as inventory. The amendment is effective for periods commencing on or after 1 January 2013.

3. IAS # 19 - Amended standard resulting from post-employment benefits and termination benefits

IAS 19 has been significantly revised and the following changes have been made:

Actuarial gains and losses are renamed 'remeasurements' and are now required to be recognized in other comprehensive income. The options to recognise actuarial gains and losses in profit and loss or to use the corridor approach to defer actuarial gain or losses have been removed. Remeasurements will not be recycled through profit and loss.

- Past-service costs will be recognized in the period of a plan amendment while unvested benefits will no longer be spread over a future-service period.
- A curtailment now occurs only when an entity significantly reduces the number of employees. Curtailment gains or losses are accounted for as past-service costs.
- Costs for a funded benefit plan will include net interest income or expense, calculated by applying the discount rate to the net benefit asset or liability. This will replace finance charge and expected return on plan assets. There will be less flexibility in income statement presentation, where benefit cost should be split between:
  1. The cost of benefits accrued in the current period and benefit changes; and
  2. Finance expense or income.
- Enhanced disclosure requirements, most notably the characteristics of amounts recognized in the financial statement and the risks and characteristics of benefit schemes.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

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

- Taxes related to benefit plans should be included either in the return on assets or the calculation of the benefit obligation, depending on their nature.
- Investment management costs should be recognized as part of the return on assets; other costs of running a benefit plan should be recognized as period costs when incurred.
- Under the new standard any benefit that has a future-service obligation is not a termination benefit. A liability for a termination benefit is recognized when the entity can no longer withdraw the offer of the termination benefit or recognizes any related restructuring costs.

The amendments are effective for periods beginning on or after 1 January 2013.

4. IFRS # 7 - Amendments relating to offsetting of assets and liabilities

The amended standard requires disclosures to include information that will enable users of the financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognized financial assets and financial liabilities. The amendment is effective for periods commencing on or after 1 January 2013.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

(a) Statement of compliance

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

(b) Basis of preparation

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

(c) Revenue recognition

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

(d) Leases

The Bank as lessee

Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Foreign currency translation

i. Functional currency and presentation currency

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

ii. Transactions and balances

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

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

(f) Borrowing costs

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

(g) Retirement benefit plan

The Bank's retirement plan is a contributory defined benefit plan with participants being permanent employees who joined the Bank prior to age 55. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each statement of financial position date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Bank's pension obligations and the fair value of the plan's assets are amortized over the expected average remaining working lives of the participating employees. Past service costs arising from plan amendments are recognized immediately to the extent that the benefits are already vested, and otherwise are amortized on a straight-line basis over the average period until the benefits become vested. Contributions are made by employees at 5% of basic salary and the difference by the Bank, which amounted to 16.90% (2011: 11.60%).

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

(h) Health insurance subsidy for retirees

The Bank pays a portion of the group life and health insurance (GLHI) premium for retirees who elect to remain covered by the Bank's GLHI policy after retirement. The amount recognized in the statement of financial position represents the present value of the retirement benefit obligation.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Fiduciary items

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

(j) Property, plant and equipment

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

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

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

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

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

The Bank reviews the estimated useful lives of property, plant and equipment at the end of the reporting period. If management's expectations differ from previous estimates, indicating signs of impairment, then, changes are made to the estimated useful lives of property, plant and equipment.

(k) Provisions

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

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

(l) Financial instruments

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

(m) Financial assets

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

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

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

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

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

Classification of financial assets

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

i. Loans and receivables

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

- Advances to Bahamas Government
- Loans to Bahamas Development Bank
- Bahamas Government Registered Stocks
- Bahamas Development Bank bonds
- Bridge Authority bonds

Section 29(1)(c) of the Act requires that the total amount of Government issued or guaranteed securities held at any time by the Bank, which mature beyond five years after their date of issue, shall not exceed 20% of the demand liabilities of the Bank. At the statement of financial position date, such securities held by the Bank, which matured beyond five years after their date of issue, was 19.08% (2011: 19.18%) of demand liabilities.

The Act further requires that any holdings of Government issued or guaranteed securities should not have maturities extending beyond 20 years from the date of their acquisition. The Bank held no securities maturing beyond 20 years, at either December 31, 2012 or 2011.

ii. Available-for-sale financial assets

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

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

iii. Held-to-maturity financial assets

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

Marketable securities issued or guaranteed by foreign governments and Clifton Heritage Authority bonds are classified as held-to-maturity investments. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest rate method less any impairment.

Financial assets at amortized cost and the effective interest method

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

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Debt instruments meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method less any impairment, with interest income recognized in the statement of comprehensive (loss)/income.

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

(n) Impairment of financial assets

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

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

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

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is decreased and the decrease is recognized in the statement of comprehensive (loss)/income. At year end, there were no indicators of impairment.

(o) Derecognition of financial assets

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Financial liabilities

Financial liabilities are any liabilities that are contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Bank; or a contract that will or may be settled in the Bank's own equity instrument. Financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities.

Financial liabilities at fair value through profit or loss are initially recognized and subsequently measured at fair value with any gains or losses recognized in profit or loss. Other financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method, where applicable. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

(q) Derecognition of financial liabilities

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

(r) Cash and cash equivalents

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

(s) Currency inventory

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

(t) Numismatic coins

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

(u) Investment Currency Market provision

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

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Such accounting estimates and judgments are disclosed in Notes 3 (g), (h), (j), (n), 8, 24, 30 and 31.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

5. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings and Renovations	Office Equipment	Computer Software	Office Furniture and Fittings	Other Fixed Assets	Total
COST							
As of January 1, 2012	2,452,938	14,283,442	10,067,141	7,824,337	6,293,693	283,442	41,204,993
Additions	-	371,212	365,575	754,932	158,632	-	1,650,351
Disposals	-	-	(251,384)	(103,052)	(22,316)	-	(376,752)
Transfers	-	-	(100,228)	100,228	-	-	-
As of December 31, 2012	**2,452,938**	**14,654,654**	**10,081,104**	**8,576,445**	**6,430,009**	**283,442**	**42,478,592**
ACCUMULATED DEPRECIATION							
As of January 1, 2012	-	6,458,014	7,713,768	7,629,011	6,040,376	283,442	28,124,611
Charge for the year	-	466,274	407,455	713,389	124,495	-	1,711,613
Retirement	-	-	(244,158)	(110,278)	(22,316)	-	(376,752)
As of December 31, 2012	**-**	**6,924,288**	**7,877,065**	**8,232,122**	**6,142,555**	**283,442**	**29,459,472**
NET BOOK VALUE							
As of December 31, 2012	**$ 2,452,938**	**$ 7,730,366**	**$ 2,204,039**	**$ 344,323**	**$ 287,454**	**$ -**	**$ 13,019,120**
COST							
As of January 1, 2011	2,452,938	13,095,216	9,034,781	7,730,300	6,265,439	283,442	38,862,116
Additions	-	1,188,226	1,105,744	94,037	30,636	-	2,418,643
Retirement	-	-	(73,384)	-	(2,382)	-	(75,766)
As of December 31, 2011	**2,452,938**	**14,283,442**	**10,067,141**	**7,824,337**	**6,293,693**	**283,442**	**41,204,993**
ACCUMULATED DEPRECIATION							
As of January 1, 2011	-	6,004,438	7,155,222	7,428,495	5,909,014	283,442	26,780,611
Charge for the year	-	453,576	630,023	200,516	133,744	-	1,417,859
Disposals	-	-	(71,477)	-	(2,382)	-	(73,859)
As of December 31, 2011	**-**	**6,458,014**	**7,713,768**	**7,629,011**	**6,040,376**	**283,442**	**28,124,611**
NET BOOK VALUE							
As of December 31, 2011	**$ 2,452,938**	**$ 7,825,428**	**$ 2,353,373**	**$ 195,326**	**$ 253,317**	**$ -**	**$ 13,080,382**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

6. EXTERNAL ASSETS

External assets comprise those assets defined by Section 18(1) of the Act. The Act also requires that the value of external assets shall not at any time be less than 50% of the value of the aggregate of the notes and coins in circulation and other demand liabilities of the Bank. At year end, external assets represented 86.82% (2011: 97.43%) of such liabilities. Accrued interest totalling $8,461 (2011: $112,879) is included in bank deposits maturing over three months.

7. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS

Section 18(1) of the Act requires that marketable securities issued or guaranteed by foreign governments, which mature beyond 5 years, shall at no time constitute more than 30% in value of the Bank's external assets. At December 31 2012, marketable securities held by the Bank, which mature after 5 years, constituted 28.93% (2011: 27.21%) of the Bank's external assets.

The movements in marketable securities are as follows:

	2012	**2011**
Beginning balance	580,757,236	495,661,020
Purchases at nominal value	-	120,000,000
Discount on purchases	-	(5,695,703)
Redemptions/maturities	(30,000,000)	(30,000,000)
Discount earned	1,139,626	990,046
Amortized premium	(72,046)	(198,127)
Total	551,824,816	580,757,236
Add: Accrued interest	3,816,288	4,095,103
Ending balance	**$ 555,641,104**	**$ 584,852,339**

The fair value of these securities at the year end date was $601,269,447 (2011: $629,049,801). These securities bear interest at rates varying between 1.25% and 4.75% (2011: 1.12% and 4.88%).

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

8. INTERNATIONAL MONETARY FUND

Background

The International Monetary Fund (IMF) is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

The Bahamas was admitted as a member of the IMF on August 21, 1973.

Quota, Subscriptions and Reserve Tranche

The IMF's quota system was created to raise funds for loans. Each IMF member country is assigned a quota, or contribution, that reflects the country's relative size in the global economy. Countries contribute money to a pool through a quota system from which countries with payment imbalances can borrow funds temporarily.

Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account, which is essentially a specified basket of four (4) major international currencies (i.e., the U.S. Dollar, Japanese Yen, Euro, and Pound Sterling).

The Bahamas is assigned a quota of SDR 130,300,000 which represents 0.05% of the total quota allocated by the IMF.

The quota is payable partly in SDRs or specified international currencies, and partly in the member's own currency/promissory notes. The difference between a member's quota and the IMF's total holdings of its currency/promissory notes is a country's Reserve Tranche Position (RTP). The member country can access its reserve tranche funds at its discretion, and is not under an immediate obligation to repay those funds to the IMF.

Bahamas Tranche

The IMF reserve tranche represents the amount by which The Bahamas' quota of SDRs with the IMF exceeds subscription payments as noted below:

	2012		2011	
	SDR	**$**	**SDR**	**$**
Quota	130,300,000	200,260,662	130,300,000	200,045,137
Subscription payments in prom notes	(119,509,883)	(183,677,116)	(119,706,653)	(183,781,533)
Subscription payments in currency	(4,529,837)	(6,961,997)	(4,333,067)	(6,652,410)
Reserve tranche	**6,260,280**	**9,621,549**	**6,260,280**	**9,611,194**

The reserve tranche was purchased from the Government of The Bahamas in 1976. Subsequent to that purchase, the Bank has funded 25% of each increase in the IMF subscriptions of The Bahamas by issuing interest-free promissory notes which are payable on demand. In the opinion of the Directors, it is not probable that an outflow of resources employing economic benefits will be required to settle these promissory notes, which total $52,693,362 (2011: $55,405,184). Consequently, this amount is not recognized in the Bank's statement of financial position, nor as a contingent liability.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

8. INTERNATIONAL MONETARY FUND (Continued)

SDR Holdings and SDR Allocation

The IMF may allocate SDRs to member countries in proportion to their IMF quotas. SDRs allocated is treated as a liability in the financial statements of a member, with an equal asset initially being recorded in the form of SDR Holdings.

Once allocated, members can hold their SDRs as part of their international reserves or sell part or all of their SDR holdings. Members can exchange SDRs for freely usable currencies (and vice versa) among themselves and with prescribed holders; such exchange can take place under a voluntary arrangement or under designation by the IMF.

IMF members can also use SDRs in operations and transactions involving the IMF, such as the payment of interest on and repayment of loans, or payment for future quota increases.

Consequently, a member's SDR Holdings (asset) and SDR Allocation (liability) can be different at a point in time.

The IMF pays interest at the SDR interest rate on the amount that a member's net holdings exceed their cumulative allocations. Conversely, if a member's SDR holdings are below its allocation, it incurs a net interest obligation.

Interest on SDR holdings and allocations are received/paid quarterly. The SDR interest rate is determined weekly on each Friday and is based on a weighted average of representative interest rates on 3-month debt in the money markets of the basket of four (4) SDR international currencies.

SDR Holdings

	2012		2011	
	SDR	**$**	**SDR**	**$**
Beginning balance	114,121,104	175,218,628	114,161,549	175,812,752
Additional SDRs received	383,048	589,471	-	-
Remuneration & other charges	(12,753)	(19,600)	(40,445)	(62,094)
Sale of SDRs	(96,000,000)	(147,544,309)	-	-
Currency movement	-	175,609	-	(532,030)
	18,491,399	28,419,799	114,121,104	175,218,628
Add: Accrued interest		12,421		43,035
Total		**28,432,220**		**175,261,663**

Additional SDRs were received during the year as a result of a free distribution from the IMF.

96,000,000 SDRs were sold on December 20, 2012 to increase liquidity (Note: 29 - liquidity risk management). This sale was from the last SDR holdings received in 2009.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

8. INTERNATIONAL MONETARY FUND (Continued)

There were cumulative net unrealized exchange losses being carried in the exchange equalization account (refer to statement of changes in equity and reserves) on the 96,000,000 SDRs between the dates of receiving the holdings (August 28, 2009 and September 9, 2009) and the start of the current fiscal year (January 1, 2012) of $ 2,943,029, which was realized in 2012, and transferred to general reserve, with no impact in the current year's statement of comprehensive (loss)/income.

There were cumulative net realized exchange gains on the 96,000,000 SDRs between the start of the current fiscal year (January 1, 2012) and the date of sale (December 20, 2012) of $ 957,673 which was realized in 2012, and recognized as a realized exchange gain in the current year's statement of comprehensive (loss)/income. This amount is not transferred to the exchange equalization account in the statement of changes in equity and reserves.

SDR Allocation

	2012		2011	
	SDR	**$**	**SDR**	**$**
Beginning balance	124,413,351	191,007,566	124,413,351	191,600,883
Currency movement	-	205,788	-	(593,317)
Ending balance	124,413,351	191,213,354	124,413,351	191,007,566
Add: Accrued interest		17,380		46,403
Total		**191,230,734**		**191,053,969**

In accordance with a resolution of the Board of Governors of the IMF, effective December 11, 1978, The Bahamas became a participant in the Special Drawing Rights Department of the IMF, receiving a total allocation of SDR 10,230,000 between 1979 and 1981. A general allocation took effect on August 28, 2009 and a special allocation on September 9, 2009 and increased the Bank's allocations to SDR 124,413,351. The Special Drawing Rights allocation bore interest during the year at rates varying between 0.03% and 0.15% (2011: 0.11% and 0.58%).

9. BAHAMAS DEVELOPMENT BANK BONDS

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

	2012	2011
Balance	4,000,000	4,000,000
Add: Accrued interest	55,545	55,697
Total	**$ 4,055,545**	**$ 4,055,697**

These bonds bear interest at the Bahamian prime rate of 4.75% with $2,000,000 maturing on August 1, 2025 and November 1, 2025, respectively.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

10. ADVANCES TO BAHAMAS GOVERNMENT

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

At the year end date, advances to the Government were 7.84% (2011: 9.17%) of the lesser of such revenues.

The movements in advances for the year are as follows:

	2012	**2011**
Beginning balance	110,587,608	111,987,608
Additions	50,069,444	76,600,000
Redemptions/maturities	(55,000,000)	(78,000,000)
Total	105,657,052	110,587,608
Add: Accrued interest	640,004	874,950
Ending balance	**$ 106,297,056**	**$ 111,462,558**

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

Rate	**2012**	**2011**
0.000%	18,608	37,018,608
0.084%	969,000	4,969,000
0.097%	22,970,444	-
0.135%	7,099,000	-
0.218%	20,000,000	-
0.640%	20,000,000	20,000,000
0.840%	8,600,000	8,600,000
0.970%	26,000,000	38,000,000
1.080%	-	2,000,000
	$ 105,657,052	**$ 110,587,608**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

11. BAHAMAS GOVERNMENT REGISTERED STOCKS

The movements in Bahamas Government Registered Stocks are as follows:

	2012	2011
Beginning balance	164,005,500	162,287,500
Purchases	78,083,800	23,106,900
Redemptions/maturities	(72,596,300)	(21,388,900)
Total	169,493,000	164,005,500
Add: Accrued interest	1,847,130	1,820,143
Ending balance	**$ 171,340,130**	**$ 165,825,643**

The fair value of these stocks at year-end date was $175,124,327 (2011: $169,766,099). Bahamas Government Registered Stocks bear interest at rates ranging between 4.35% and 6.00% (2011: 4.75% and 8.75%).

12. LOANS TO BAHAMAS DEVELOPMENT BANK

This balance is comprised of two Government Guaranteed loan facilities made available in accordance with Section 29(1) (f) of the Act.

The movements in loans to Bahamas Development Bank are as follows:

	2012	2011
Beginning balance	5,150,000	5,550,000
Repayments	(400,000)	(400,000)
Total	4,750,000	5,150,000
Add: Accrued interest	17,347	18,815
Ending balance	**$ 4,767,347**	**$ 5,168,815**

The loans bear interest at 2.00% (2011: 2.00%), with $750,000 and $4,000,000 maturing on October 21, 2018 and October 28, 2024, respectively.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

13. BRIDGE AUTHORITY BONDS

The movements in the Bridge Authority bonds are as follows:

	2012	2011
Beginning balance	862,100	838,300
Purchases	20,200	23,800
Total	882,300	862,100
Add: Accrued interest	14,026	13,739
Ending balance	**$ 896,326**	**$ 875,839**

The fair value of these bonds at year-end date was $931,962 (2011: $918,774). These bonds bear interest at rates ranging from 1.00% to 1.63% (2011: 1.00% to 1.63%) per annum over the Bahamian prime rate. The actual rates ranged between 5.75% to 6.375% at December 31, 2012 with $459,500, $403,900, $4,000 and $14,900 maturing on March 24, 2014, 2019, 2024 and 2029, respectively.

14. CLIFTON HERITAGE AUTHORITY BONDS

The Bank is the registrar for the Clifton Heritage Authority bonds guaranteed by The Bahamas Government. The bonds, which mature on May 20, 2025, bear interest at 5.25%. The balance of the Clifton Heritage Authority bonds is made up as follows:

	2012	2011
Balance	634,600	634,600
Add: Accrued interest	3,823	3,834
Total	**$ 638,423**	**$ 638,434**

The fair value of these bonds at year-end was $667,902 (2011: $669,529).

15. BAHAMAS GOVERNMENT TREASURY BILLS

Bahamas Government Treasury bills are discounted at rates ranging between 0.04% and 0.4963%, maturing sixty days to one year. The Bahamas Government Treasury bills are measured at fair value grouped into Level 3.

The movements in the Bahamas Government Treasury bills are as follows:

	2012	2011
Beginning balance	26,184,417	-
Purchases	399,543,734	73,972,494
Redemptions/maturities	(296,042,371)	(47,788,077)
Total	129,685,780	26,184,417
Add: Discount earned	54,769	10,935
Ending balance	**$ 129,740,549**	**$ 26,195,352**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

16. NOTES IN CIRCULATION

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

Notes	2012	2011
$ 0.50	653,043	642,186
$ 1.00	20,656,956	20,023,349
$ 3.00	1,874,841	1,862,907
$ 5.00	10,018,630	9,720,605
$ 10.00	15,218,100	14,593,160
$ 20.00	51,997,040	49,018,100
$ 50.00	93,668,750	86,798,550
$ 100.00	130,727,700	122,806,400
Other banknotes	79,835	79,835
	$ 324,894,895	**$ 305,545,092**

17. DEPOSITS BY COMMERCIAL BANKS

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

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

18. COLLATERALIZED FINANCING

Collateralized financing refers to securities sold under agreements to repurchase, which consists of U.S. treasury notes. The Bank enters into this type of transaction in order to meet temporary liquidity requirements. US$ 150,000,000 was borrowed in October 2012 at 0.35% and repaid in December 2012.

19. DEPOSITS BY INTERNATIONAL AGENCIES

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

20. EQUITY AND RESERVES

Capital management - The Bank's objectives when managing capital, which is a broader concept than 'equity' on the face of the statement of financial position, are:

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

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

At December 31, 2012, and 2011, the Bank's paid up capital was equal to the authorized capital of $3,000,000.

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

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

General reserve - Section 7(2) of the Act requires that, at the end of any year where the amount in the general reserve exceeds twice the authorized capital of the Bank or 15% of its demand liabilities, whichever is greater, the excess shall be paid to the Consolidated Fund, unless the Minister of Finance determines otherwise.

The balance of the general reserve at the year end amounted to $111,957,281 (2011: $116,162,782) equivalent to 12.00% (2011: 12.80%) of demand liabilities.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

21. INCOME

	2012 $	2011 $
Interest on foreign investments		
Demand deposits	51,679	75,627
Fixed deposits	344,190	685,374
Marketable securities	15,928,120	15,696,522
	16,323,989	16,457,523
Interest on loans		
Loans to Bahamas Development Bank	99,827	107,888
Government advances	634,875	869,821
Staff	330,233	304,712
	1,064,935	1,282,421
Interest on domestic investments		
Bahamas Development Bank bonds	190,000	202,219
Bahamas Government Registered Stocks	8,441,589	8,306,161
Bridge Authority bonds	51,625	52,727
Bahamas Government Treasury bills	232,283	169,336
Clifton Heritage bonds	33,317	35,351
	8,948,814	8,765,794
Unrealized exchange loss	(179,276)	(606)
Realized exchange gain	957,673	-
Interest expense on IMF allocation	(212,340)	(792,601)
Interest expense on repurchase agreement	(115,206)	-
	(327,546)	(792,601)
Other income		
Bank statutory fines	9,747	944
Commission on foreign currency sales	636,400	905,749
Premium on Investment Currency Market	143,157	311,816
SDR Interest	189,021	724,692
Other	128,122	137,499
	1,106,447	2,080,700
Total income	**$ 27,895,036**	**$ 27,793,231**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

22. EXPENSES

	2012	**2011**
Staff costs		
Salaries, wages and gratuity	11,742,523	11,373,344
Group insurance plan	1,347,597	1,286,683
Staff pension fund (Note 30)	6,030,037	520,058
Staff training	353,373	306,008
National insurance	378,487	351,264
Responsibility allowance	165,000	113,541
Other	464,005	437,067
	$ 20,481,022	**$ 14,387,965**
General and administrative		
Currency	1,410,835	1,301,191
Professional fees	1,399,207	1,093,254
Utilities	1,134,496	1,095,679
Repairs and maintenance	965,270	772,184
Rent	554,143	528,660
Insurance	241,230	231,053
Stationery and office supplies	95,264	70,470
Subscription and membership fees	228,362	171,487
Directors' remuneration	44,375	45,000
Other	1,070,967	988,678
	$ 7,144,149	**$ 6,297,656**

23. THE DEPOSIT INSURANCE CORPORATION

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

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

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

24. COMMITMENTS & CONTINGENCIES

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

Leases

The Bank leases office space, by entering into annual lease agreements, and is committed to the following payments.

2012	2011
$ 455,057	$ 455,057

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

25. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities:

	2012	2011
EXTERNAL ASSETS		
Geographic Region		
North America	99.74%	88.44%
Europe	0.16%	10.13%
Other	0.10%	1.43%
	100.00%	100.00%
Industry		
Financial Sector	100.00%	100.00%
OTHER ASSETS		
Geographic Region		
Bahamas	100.00%	100.00%
Industry		
Government Sector	100.00%	100.00%
DEMAND LIABILITIES		
Geographic Region		
Bahamas	99.97%	99.97%
Other	0.03%	0.03%
	100.00%	100.00%
Industry		
Financial Sector	100.00%	100.00%
OTHER LIABILITIES		
Geographic Region		
North America	100.00%	100.00%
Industry		
Financial Sector	100.00%	100.00%

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

26. RELATED PARTY TRANSACTIONS

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

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

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

The following balances and transactions relate to key management personnel:

(a) Compensation:

	2012	2011
Senior officials' salaries and short-term benefits	$ 1,611,585	$ 1,639,242
Directors' remuneration	$ 44,375	$ 45,000

(b) Other assets include secured loans to employees totalling $9,566,138 (2011: $9,147,785), of which the following relates to key management personnel:

Loans:

	2012	2011
Beginning of the year	1,178,454	950,863
Advances during the year	123,162	422,850
Repayments during the year	(154,987)	(195,259)
End of the year	**$ 1,146,629**	**$ 1,178,454**

(c) Post-employment pension and medical benefits:

	2012	2011
Pension payments	345,794	455,707
Gratuity	358,527	322,414
End of the year	**$ 704,321**	**$ 778,121**

27. FIDUCIARY ITEMS

Section 24 of the Central Bank of The Bahamas Act, 2000 authorizes the Bank to accept unclaimed customer deposits that are required to be transferred to it by a bank in The Bahamas in accordance with the Banks and Trust Companies Regulation Act, pay interest on money deposited and pay out money to any person entitled thereto. At December 31, 2012, the Bank held assets consisting of bank accounts in respect of the unclaimed customer deposits of $70,560,587 (2011: $68,938,454). These amounts are excluded from the statement of financial position.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

28. FAIR VALUE OF FINANCIAL INSTRUMENTS

With the exception of Marketable Securities, Bahamas Government Registered Stocks, Bridge Authority Bonds and Clifton Heritage Authority Bonds, the fair values of which are stated in Notes 7, 11, 13 and 14 respectively, the Directors consider that the carrying amounts of all of the other assets and liabilities approximate their fair value.

December 31, 2012

	Loans and Receivables (amortized cost) $	Fair Value Through Profit and Loss $	Held-to-Maturity (amortized cost) $	Available for Sale $	Total Carrying Amount $
EXTERNAL ASSETS					
Cash and deposits	199,860,038	-	-	-	199,860,038
Bank deposits maturing over 3 months	16,608,461	-	-	-	16,608,461
Marketable securities issued or guaranteed by foreign governments	-	-	555,641,104	-	555,641,104
International Monetary Fund:					
Bahamas reserve tranche	-	9,621,549	-	-	9,621,549
Special drawing rights	-	28,432,220	-	-	28,432,220
DOMESTIC ASSETS					
Bahamas Development Bank bonds	4,055,545	-	-	-	4,055,545
Advances to Bahamas Government	106,297,056	-	-	-	106,297,056
Bahamas Government Registered Stocks	171,340,130	-	-	-	171,340,130
Loans to Bahamas Development Bank	4,767,347	-	-	-	4,767,347
Bridge Authority bonds	896,326	-	-	-	896,326
Clifton Heritage Authority bonds	-	-	638,423	-	638,423
Bahamas Government Treasury bills	-	-	-	129,740,549	129,740,549
Currency inventory	8,033,513	-	-	-	8,033,513
Retirement benefit asset	309,425	-	-	-	309,425
Receivables and other assets	10,761,779	-	-	-	10,761,779
TOTAL	**522,929,620**	**38,053,769**	**556,279,527**	**129,740,549**	**1,247,003,465**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

28. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

December 31, 2012

	Fair Value Through Profit and Loss $	Other Financial Liabilities $	Total Carrying Amount $
DEMAND LIABILITIES			
Notes in circulation	324,894,895	-	324,894,895
Coins in circulation	19,097,761	-	19,097,761
Deposits by commercial banks	-	555,202,567	555,202,567
Deposits by Bahamas Government and Bahamas Government agencies	-	24,894,592	24,894,592
Deposits by international agencies	-	371,514	371,514
Accounts payable and other liabilities	-	2,945,884	2,945,884
Provision for Investment Currency Market	-	3,566,710	3,566,710
Health insurance subsidy benefit for retirees	2,114,110	-	2,114,110
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	191,230,734	-	191,230,734
TOTAL	**537,337,500**	**586,981,267**	**1,124,318,767**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

28. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

December 31, 2011

	Loans and Receivables (amortized cost) $	Fair Value Through Profit and Loss $	Held-to-Maturity (amortized cost) $	Available for Sale $	Total Carrying Amount $
EXTERNAL ASSETS					
Cash and deposits	25,054,161	-	-	-	25,054,161
Bank deposits maturing over 3 months	90,112,879	-	-	-	90,112,879
Marketable securities issued or guaranteed by foreign governments	-	-	584,852,339	-	584,852,339
International Monetary Fund:					
Bahamas reserve tranche	-	9,611,194	-	-	9,611,194
Special drawing rights	-	175,261,663	-	-	175,261,663
DOMESTIC ASSETS					
Bahamas Development Bank bonds	4,055,697	-	-	-	4,055,697
Advances to Bahamas Government	111,462,558	-	-	-	111,462,558
Bahamas Government Registered Stocks	165,825,643	-	-	-	165,825,643
Loans to Bahamas Development Bank	5,168,815	-	-	-	5,168,815
Bridge Authority bonds	875,839	-	-	-	875,839
Clifton Heritage Authority bonds		-	638,434	-	638,434
Bahamas Government Treasury bills	-	-	-	26,195,352	26,195,352
Currency inventory	8,380,035	-	-	-	8,380,035
Retirement benefit asset	4,773,796	-	-	-	4,773,796
Receivables and other assets	10,119,957	-	-	-	10,119,957
TOTAL	**425,829,380**	**184,872,857**	**585,490,773**	**26,195,352**	**1,222,388,362**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

28. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

December 31, 2011

	Fair Value Through Profit and Loss $	Other Financial Liabilities $	Total Carrying Amount $
DEMAND LIABILITIES			
Notes in circulation	305,545,092	-	305,545,092
Coins in circulation	18,406,307	-	18,406,307
Deposits by commercial banks	-	557,366,772	557,366,772
Deposits by Bahamas Government and Bahamas Government agencies	-	18,754,446	18,754,446
Deposits by international agencies	-	255,533	255,533
Accounts payable and other liabilities	-	2,473,978	2,473,978
Provision for Investment Currency Market	-	3,028,781	3,028,781
Health insurance subsidy benefit for retirees	2,027,771	-	2,027,771
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	191,053,969	-	191,053,969
TOTAL	**517,033,139**	**581,879,510**	**1,098,912,649**

29. FINANCIAL RISK MANAGEMENT

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

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

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

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the statement of financial position date. Credit exposures arise principally in loans and advances, debt securities and other bills in the Bank's asset portfolio. The Investment Committee monitors credit risk management and control and regular reports are provided to the Board of Directors. The Directors do not consider that the Bank is exposed to any significant credit risk because its financial assets consist primarily of cash and securities issued or guaranteed by either foreign Governments or The Bahamas Government.

Exposure to credit risk

	2012	**2011**
(a) Governments / Gilt-edged	1,001,072,608	973,208,649
(b) Banks with minimum credit-rating of A+	216,468,499	115,167,040
(c) Local Government Institutions	10,357,641	10,738,785
(d) Loans to staff members	9,566,138	9,147,785
	$ 1,237,464,886	**$1,108,262,259**

Market risk

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

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

Currency risk

Apart from the Bank's assets and liabilities with the IMF, which are denominated in SDRs, its exposure to foreign currency risk is limited. The only other significant foreign currency is the U.S. dollar, on which there is no exposure because the Bahamian dollar and U.S. dollar are at par. The Bank manages any other foreign currency exposure using internal hedging techniques, by matching assets and liabilities wherever possible.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

The following table presents the carrying amounts of the Bank's assets and liabilities by currency.

	BSD	USD	GBP	EUR	SDR
As of 31 December 2012					
Assets					
Cash and deposits	-	199,540,644	245,166	74,228	-
Bank deposits maturing over 3 months	-	16,608,461	-	-	-
Marketable securities	-	555,641,104			-
IMF:					
Bahamas reserve tranche	-	-	-	-	9,621,549
Special drawing rights	-	-			28,432,220
Domestic assets	436,840,093	-	-	-	-
Property, plant and equipment	13,019,120	-	-	-	-
Total assets	**$449,859,213**	**$771,790,209**	**$ 245,166**	**$ 74,228**	**$ 38,053,769**
Liabilities					
Notes in circulation	324,894,895	-	-	-	-
Coins in circulation	19,097,761	-	-	-	-
Deposits by commercial banks	555,202,567	-	-	-	-
Deposits by Bahamas Government and Bahamas Government agencies	24,894,592	-	-	-	-
Deposits by international agencies	-	371,514	-	-	-
Accounts payable and other liabilities	2,797,457	140,753	7,674	-	-
Provision for Investment Currency	3,566,710	-	-	-	-
Health insurance subsidy benefit	2,114,110	-	-	-	-
IMF allocation of SDR	-	-	-	-	191,230,734
Total liabilities	**$932,568,092**	**$ 512,267**	**$ 7,674**	**$ -**	**$191,230,734**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

The following table presents the carrying amounts of the Bank's assets and liabilities by currency.

	BSD	USD	GBP	EUR	SDR
As of 31 December 2011					
Assets					
Cash and deposits	-	24,415,628	565,409	73,124	-
Bank deposits maturing over 3 months	-	90,112,879	-	-	-
Marketable securities	-	584,852,339			-
IMF:					
Bahamas reserve tranche	-	-	-	-	9,611,194
Special drawing rights	-	-			175,261,663
Domestic assets	337,496,126	-	-	-	-
Property, plant and equipment	13,080,382	-	-	-	-
Total assets	**$350,576,508**	**$699,380,846**	**$565,409**	**$ 73,124**	**$184,872,857**
Liabilities					
Notes in circulation	305,545,092	-	-	-	-
Coins in circulation	18,406,307	-	-	-	-
Deposits by commercial banks	557,366,772	-	-	-	-
Deposits by Bahamas Government and Bahamas Government agencies	18,754,446	-	-	-	-
Deposits by international agencies	-	255,533	-	-	-
Accounts payable and other liabilities	2,387,589	69,282	17,107	-	-
Provision for Investment Currency	3,028,781	-	-	-	-
Health insurance subsidy benefit	2,027,771	-	-	-	-
IMF allocation of SDR	-	-	-	-	191,053,969
Total liabilities	**$907,516,758**	**$ 324,815**	**$ 17,107**	**$ -**	**$191,053,969**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

Sensitivity of B$ compared to foreign currencies reflected in these financial statements is as to follows:

	Average Rate		Year-end Spot Rate	
	2012	**2011**	**2012**	**2011**
US$ 1	1.0055	1.0051	1.0000	1.0000
GBP 1	1.5938	1.6125	1.6246	1.5556
EUR 1	1.2931	1.3999	1.3182	1.2986
SDR 1	1.5817	1.5347	1.5369	1.5352

Special Drawing Rights (SDRs), the IMF's unit of account, which is essentially a specified basket of four (4) major international currencies (i.e., the U.S. Dollar, Euro, Japanese Yen, and Pound Sterling). The weightage of each currency is as follows:

Currency	December 31, 2012	December 31, 2011
US$	41.9%	41.9%
EURO	37.4%	37.4%
Japanese Yen	9.4%	9.4%
GBP	11.3%	11.3%
	100.0%	100.0%

Interest rate risk

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

Certain of the Bank's financial assets and liabilities are exposed to interest rate risk. Marketable securities carry an average yield of 2.83% (2011: 2.81%); however, if these securities had a reduced average yield of 2.71% (2011: 2.77%), derived from their varying yields at the lower end of the spectrum, income for the year and equity at year end would have been reduced by $666,769 (2011: $257,113). Had the yield been tilted towards the higher end of the spectrum, to 2.94% (2011: 2.84%), income for the year and equity at year end would have increased by $611,205 (2011: $151,431).

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

As at December 31, 2012, if interest rates had been 50 basis points higher, with all other variables remaining constant, the increase in equity and net operating result for the year would amount to approximately $265,000 (2011: $575,835), arising from cash and deposits. If interest rates had decreased by 50 basis points, the decrease in equity and net operating result for the year would amount to approximately $265,000 (2011: $575,835).

	December 31, 2012	December 31, 2011
	$	$
Fixed Rate Instruments		
Financial Assets	1,020,638,335	750,005,105
Financial Liabilities	-	-
Variable Rate Instruments		
Financial Assets	204,555,344	346,640,476
Financial Liabilities	191,230,734	191,053,969

Liquidity risk

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

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

An increased demand for foreign currency decreased liquidity towards the end of 2012. To meet temporary liquidity needs, the Bank entered into a repurchase agreement in the amount of US$ 150,000,000 in October 2012, which was subsequently repaid in December 2012 (Note: 18). The Bank also sold 96,000,000 SDRs, the equivalent of US$ 148,343,192 in December 2012, increasing its liquidity level (Note: 8).

Liquidity risk management process

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

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

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

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

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
	$	$	$	$	$	$
As of December 31, 2012						
Period of maturity						
Financial Assets						
Cash and deposits	199,860,038	-	-	-	-	199,860,038
Bank deposits maturing over 3 months	-	16,608,461	-	-	-	16,608,461
Marketable securities issued or guaranteed by foreign governments	-	10,143,869	10,008,986	301,089,178	234,399,071	555,641,104
International Monetary Fund:						
Bahamas reserve tranche	9,621,549	-	-	-	-	9,621,549
Special drawing rights	28,432,220	-	-	-	-	28,432,220
Bahamas Development Bank bonds	-	-	-	-	4,055,545	4,055,545
Advances to Bahamas Government	106,297,056	-	-	-	-	106,297,056
Bahamas Government Registered Stocks	-		1,023	2,889,690	168,449,417	171,340,130
Bahamas Government Treasury Bills	-	105,212,705	24,527,844	-	-	129,740,549
Loans to Bahamas Development Bank	-	-	-	-	4,767,347	4,767,347
Bridge Authority bonds	-	-	-	466,666	429,660	896,326
Clifton Heritage Authority bonds	-	-	-	-	638,423	638,423
Currency inventory	8,033,513	-	-	-	-	8,033,513
Retirement benefit asset	-	-	-	-	309,425	309,425
Receivables and other accounts	10,761,779	-	-	-	-	10,761,779
Property, plant and equipment	-	-	-	-	13,019,120	13,019,120
Total financial assets	**363,006,155**	**131,965,035**	**34,537,853**	**304,445,534**	**426,068,008**	**1,260,022,585**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
	$	$	$	$	$	$
As of December 31, 2012						
Period of maturity						
Liabilities						
Notes in circulation	324,894,895	-	-	-	-	324,894,895
Coins in circulation	19,097,761	-	-	-	-	19,097,761
Deposits by commercial banks	555,202,567	-	-	-	-	555,202,567
Deposits by Bahamas Government and Bahamas Government agencies	24,894,592	-	-	-	-	24,894,592
Deposits by international agencies	371,514	-	-	-	-	371,514
Accounts payable and other liabilities	2,945,884	-	-	-	-	2,945,884
Provision for Investment Currency Market	3,566,710	-	-	-	-	3,566,710
Group Insurance Subsidy Benefit	-	-	-	-	2,114,110	2,114,110
International Monetary Fund allocation	191,230,734	-	-	-	-	191,230,734
Total financial liabilities	**1,122,204,657**	**-**	**-**	**-**	**2,114,110**	**1,124,318,767**
Net liquidity gap, December 31, 2012	**(759,198,502)**	**131,965,035**	**34,537,853**	**304,445,534**	**423,953,898**	**135,703,818**

The Central Bank of The Bahamas
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

	Up to 1 Month	1 to 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 Years	Total
	$	$	$	$	$	$
As of December 31, 2011						
Period of maturity						
Financial Assets						
Cash and deposits	25,054,161	-	-	-	-	25,054,161
Bank deposits maturing over 3 months	-	-	90,112,879	-	-	90,112,879
Marketable securities issued or guaranteed by foreign governments	-	5,099,439	25,192,641	313,754,791	240,805,468	584,852,339
International Monetary Fund:						
Bahamas reserve tranche	9,611,194	-	-	-	-	9,611,194
Special drawing rights	175,261,663	-	-	-	-	175,261,663
Bahamas Development Bank bonds	-	-	-	-	4,055,697	4,055,697
Advances to Bahamas Government	111,462,558	-	-	-	-	111,462,558
Bahamas Government Registered Stocks	-	-	17,345	1,319,125	164,489,173	165,825,643
Bahamas Government Treasury Bills	-	26,195,352	-	-	-	26,195,352
Loans to Bahamas Development Bank	-	-	-	-	5,168,815	5,168,815
Bridge Authority bonds	-	-	-	446,761	429,078	875,839
Clifton Heritage Authority bonds	-	-	-	-	638,434	638,434
Currency inventory	8,380,035	-	-	-	-	8,380,035
Retirement benefit asset	-	-	-	-	4,773,796	4,773,796
Receivables and other accounts	10,119,957	-	-	-	-	10,119,957
Property, plant and equipment	-	-	-	-	13,080,382	13,080,382
Total financial assets	**339,889,568**	**31,294,791**	**115,322,865**	**315,520,677**	**433,440,843**	**1,235,468,744**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

29. FINANCIAL RISK MANAGEMENT (Continued)

	Up to 1 Month $	1 to 3 Months $	3 Months to 1 Year $	1 to 5 Years $	Over 5 Years $	Total $
As of December 31, 2011						
Period of maturity						
Liabilities						
Notes in circulation	305,545,092	-	-	-	-	305,545,092
Coins in circulation	18,406,307	-	-	-	-	18,406,307
Deposits by commercial banks	557,366,772	-	-	-	-	557,366,772
Deposits by Bahamas Government and Bahamas Government agencies	18,754,446	-	-	-	-	18,754,446
Deposits by international agencies	255,533	-	-	-	-	255,533
Accounts payable and other liabilities	2,473,978	-	-	-	-	2,473,978
Provision for Investment Currency Market	3,028,781	-	-	-	-	3,028,781
Group Insurance Subsidy Benefit	-	-	-	-	2,027,771	2,027,771
International Monetary Fund allocation	191,053,969	-	-	-	-	191,053,969
Total financial liabilities	**1,096,884,878**	**-**	**-**	**-**	**2,027,771**	**1,098,912,649**
Net liquidity gap, December 31, 2011	**(756,995,310)**	**31,294,791**	**115,322,865**	**315,520,677**	**431,413,072**	**136,556,095**

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, such as the use of internal audit.

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

30. CONTRIBUTORY DEFINED RETIREMENT BENEFIT PLAN

The movements in the contributory defined benefit obligation over the year are as follows:

	2012	2011
Present value of obligation at start of year	42,581,822	36,267,721
Interest cost	2,165,268	2,102,793
Current service cost	1,645,727	1,265,796
Past service cost - vested benefits	4,970,624	-
Benefits paid	(1,844,393)	(1,926,408)
Actuarial loss on obligation	3,959,625	4,871,920
Present value of obligation at end of year	**$ 53,478,673**	**$ 42,581,822**
Fair value of plan assets at start of year	46,628,682	44,557,097
Expected return on plan assets	2,448,641	2,547,070
Contribution paid - by employer	1,448,051	986,879
Contribution paid - by employees	420,556	419,074
Benefits paid	(1,844,393)	(1,926,408)
Actuarial gain on plan assets	51,185	44,970
Fair value of plan assets at end of year	**$ 49,152,722**	**$ 46,628,682**

The actuarial loss at December 31, 2012 represented 7.40% (2011 loss: 11.44%) of the plan liabilities; and the actuarial gain was 0.10% (2011 gain: 0.10%) of the plan assets.

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

	2012	2011
Present value of funded obligations	(53,478,673)	(42,581,822)
Fair value of plan assets	49,152,722	46,628,682
	(4,325,951)	4,046,860
Unrecognized actuarial loss	4,635,376	726,936
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	**$ 309,425**	**$ 4,773,796**

The Central Bank of The Bahamas

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

30. CONTRIBUTORY DEFINED RETIREMENT BENEFIT PLAN (Continued)

Summary of plan investments, in accordance with IAS 19:

	2012	2011
Cash	168,439	36,290
Interest receivable	563,283	582,374
Other receivable	-	1,918
Bahamas Government Registered Stocks	47,999,900	45,504,000
Other bonds	326,100	326,100
Shares	100,000	185,000
Accounts payable	(5,000)	(7,000)
Total	**$ 49,152,722**	**$ 46,628,682**

The expense recognized in the statement of comprehensive (loss)/income in respect of the Bank's contributory defined retirement benefit plan is as follows:

	2012	2011
Current service cost	1,225,171	846,722
Interest cost	2,165,268	2,102,793
Expected return on plan assets	(2,448,641)	(2,547,070)
Past service cost - vested benefits	4,970,624	-
	$ 5,912,422	**$ 402,445**

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

	2012	2011
Net assets at beginning of year	4,773,796	4,189,362
Net expense recognized in net income	(5,912,422)	(402,445)
Employer contributions	1,448,051	86,879
	$ 309,425	**$ 4,773,796**

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NOTES TO FINANCIAL STATEMENTS

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30. CONTRIBUTORY DEFINED RETIREMENT BENEFIT PLAN (Continued)

The Bank intends to contribute approximately 22.6% of gross payroll to the plan during 2013 (2012: actual 16.9%).

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

	2012	2011
Discount rate	5.00%	5.00%
Expected return on plan assets	5.25%	5.25%
Expected rate of salary increase at age 18	4.00%	6.50%
Expected rate of salary increase at age 59	4.00%	2.50%
Cost of living adjustment for active employees	2.50%	2.50%
Average expected remaining working lives of employees (years)	14.2	14.7

The actual return on plan assets during the year was $2,499,826 (2011: $2,592,040). The expected return on plan assets has been arrived at using a weighted average return approach.

The expected rate of salary increase has been revised consistent with past experience and future expectations to ensure more realistic actuarial estimates.

Experience History

	2012	2011
Present value of funded obligations	$ (53,478,673)	$ (42,581,822)
Fair value of plan assets	49,152,722	46,628,682
	(4,325,951)	4,046,860
Experience gain on plan assets	51,185	44,970
Experience gain on plan obligations	867,314	-

During the current fiscal year, the benefits of the retirement plan were changed from 'integrated' to 'non-integrated'. Past service cost arising from plan amendments has been recognized in the current year within staff pension fund cost (Note: 22). The increased obligation as a result of plan amendments has resulted in the pension asset being depleted.

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31. HEALTH INSURANCE SUBSIDY BENEFIT FOR RETIREES

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

	2012	2011
Present value of obligation at start of year	2,257,422	1,992,358
Interest cost	113,993	115,976
Current service cost	72,534	71,431
Benefits paid	(100,188)	(93,634)
Actuarial loss on obligation	29,814	171,291
Present value of obligation at end of year	**$ 2,373,575**	**$ 2,257,422**

	2012	2011
Contribution paid - employees' and employer's contributions	100,188	93,634
Benefits paid	(100,188)	(93,634)
	$ -	$ -

The expense recognized in the statement of comprehensive (loss)/income in respect of the health insurance subsidy benefit for retirees is as follows:

	2012	2011
Current service cost	72,534	71,431
Interest cost	113,993	115,976
	$ 186,527	**$ 187,407**

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

	2012	2011
Net liability at beginning of year	2,027,771	1,933,998
Net expense recognized in net (loss)/income	186,527	187,407
Employer contributions	(100,188)	(93,634)
	$ 2,114,110	**$ 2,027,771**

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31. HEALTH INSURANCE SUBSIDY BENEFIT FOR RETIREES (Continued)

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

	2012	**2011**
Discount rate	5.00%	5.00%
Expected return on plan assets	0.00%	0.00%

Experience History

	2012	**2011**
Present value of funded obligations	(2,373,575)	(2,257,422)
Fair value of plan assets	-	-
	(2,373,575)	(2,257,422)
Experience gain/(loss) on plan assets	-	-
Experience gain/(loss) on plan obligations	29,814	-

32. COMPARATIVES

Prior year comparatives relating to related party transactions - post employment pension and medical benefits has been reclassified to conform to the presentation in the current year.

THE CENTRAL BANK OF THE BAHAMAS

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