



Gross Economic Contribution of the Financial Sector in The Bahamas (2005)

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GROSS ECONOMIC CONTRIBUTION OF THE FINANCIAL SECTOR IN THE BAHAMAS (2005)

INTRODUCTION

This article updates the Central Bank's survey on the contribution of the financial services sector to the economy of The Bahamas for the year 2005. The Bank has monitored employment and expenditure trends in the banking sector since the 1970s, more recently extending this exercise to other important activities including insurance, investment funds management and credit unions. Although the expanded coverage continues to improve, the scope of responses is not yet sufficient to permit aggregate analysis at the level of detail carried out for banks and trust companies. The exercise, nevertheless, permits more comprehensive inferences about trends in the sector's contribution.

Official estimates continue to place the financial sector's share of value added in The Bahamas' GDP between 15 to 20 percent. A significant share of this is derived from the marketing of international products and services. The Bahamas maintains a competitive edge in these activities owing to a variety of reasons, including its ability to support functional operations, backed by a sizeable pool of skilled labour, and a comprehensive regulatory infrastructure which sustains international confidence in the jurisdiction. Domestic services generate the remainder of the sector's economic benefits while also fulfilling the vital role of savings intermediation. Growth in the local sector's contribution is therefore correlated with the economy's performance, whereas the international sector thrives on a blend of external influences, of a competitive, regulatory and political nature.

According to the latest survey, indications are that the financial services sector's contribution to the economy increased further during 2005, with incremental gains in employment and average wages across most sectors. More noticeable growth in the scale of domestic operations contrasted with a less expansionary outcome on the international side—a development which was largely consistent with global trends vis-à-vis the streamlining of the size and location of operations, and reflected further structural adjustments to the enhanced regulatory infrastructure. Banking sector expenditures were retrenched, after the above average capital outlays and administrative expenses in 2004, while some core business growth

supported increased employment and stable outlays under investment funds management activities. The domestic insurance sector exhibited the strongest growth trends, following significant consolidation of operations in recent years. Credit unions, which have an exclusive local focus, maintained stable employment levels, but faced increased lending competition from banks, which dampened balance sheet expansion.

BANKING SECTOR

The outlook for the banking sector's contribution to GDP remained stable to positive during 2005; however, expenditures continued to be constrained by retrenchment of international operations. A number of managed banks and trusts companies were still transitioning into full compliance with the Central Bank's physical presence requirement, with an additional number deciding to surrender their licences. This, alongside the impact of continued mergers and rationalization of operations resulted in the revocation of 25 licenses, as opposed to the admission of 9 new licencees. As a result, there was a further decline in the number of licensed operations, to 250 from 266 in 2004. Public banking and trust operations decreased by 8 to 149, while restricted and non-active institutions fell by 8 to 101. The public licencees consisted of the euro currency branches of 34 foreign banks and trust companies and 93 Bahamian incorporated institutions, which together made up the offshore sector. The remaining 22 institutions, with domestic operations, consisted of 9 Authorized Agents and Dealers (commercial banks) and 13 Authorized Agents (12 trust companies).

Banking operations carried out through physical presence in the jurisdiction, which have a more direct impact on employment and expenditures, decreased in number to 205 from 213 in the previous year. Another 3 licencees were still in the process of establishing full physical presence, while a remaining 42 operated under restrictive management arrangements approved by the Central Bank.

The resilience of international banking and trust operations was more notable in the stable asset base of approximately \$300.0 billion. Indications are that the

value of fiduciary assets under management rose in comparison to 2004, while the number of companies under management (mainly IBCs) rose to 19,231 from 18,601 in 2004 and 15,147 in 2003. The domestic sector, inclusive of 22 public licenses, reported total assets of \$6.9 billion, an increase of 10.0% since 2004. Assets growth also supported a 35.1% boost in profits and a strengthening in the average return on assets ratio, to 3.47% from 2.70% in 2004.

EMPLOYMENT

Banking sector employment increased incrementally by 0.9% to 4,405 persons in 2005, continuing a soft upturn from job losses which occurred during 2002 and 2003. Gains were concentrated in the positions held by Bahamians, which strengthened further by 2.1% to 4,176, relative to the previous year's rise of 2.6%. This contrasted with the five year's average annual decline of 0.8% through 2004. Conversely, jobs held by non-Bahamians decreased by 16.4% to 229, reversing the previous year's increase of 3.4% to 274 and the average annual growth of 3.7% in the five years through 2004. As a result, the share of total employment accounted for by Bahamians firmed marginally to 94.8% in 2005.

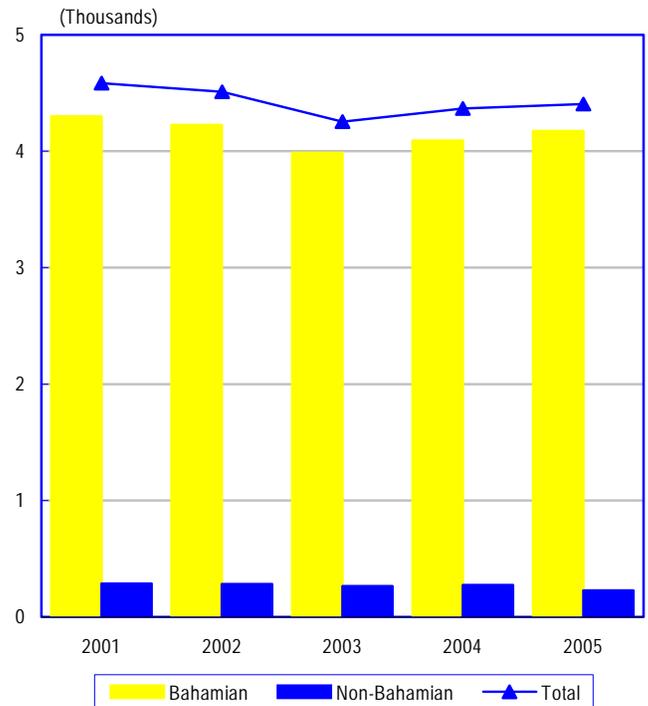
EXPENDITURE

Following reductions in non-staff operating expenses and a slowdown in capital investments, banks' total outlays in the economy contracted by \$44.1 million (9.5%) to \$419.0 million during 2005. While this contrasted with a significant run up of 16.5% in 2004, expenditure was still boosted in comparison to more tempered levels registered during 2002 and 2003.

After rising by 12.1% in 2004, operational outlays contracted by \$25.6 million (6.0%) to \$402.7 million, offsetting some of the five years' average growth of 4.2% through 2004. However, such costs firmed to 96.1% of total expenditures from 92.5% in the previous year. Subsequent to the extraordinary restructuring charges, which boosted administrative expenses by 18.6% in 2004, outlays decreased by \$24.2 million (12.2%) to \$173.6 million in 2005. In addition, various fees paid to the Government softened by 6.9% to \$17.6 million, marked by reductions for work permits (due to a decrease in the expatriate work-force), stamp duties and other fees. These were moderated by an increase in license fee

payments, following a hike in the rate schedule and in payments linked to growth in the formation and management of international business companies (IBCs).

Banking Sector Employment



However, salary expenses remained at \$209.1 million, following average yearly growth of 3.4% over the adjoining five years. Offset against increased employment, average annual compensation per employee declined marginally by 0.9% to \$47,469, partly reversing 2004's gain of 3.7% and contrasting with an average annual appreciation of 4.0% during 2000 to 2004. The entry level influences which affected this outcome were concentrated among Bahamians, where average pay declined by 0.1% to \$43,703. However, average remuneration for non-Bahamians advanced further, by 5.8% to \$115,965.

Banks' direct outlays on staff training continued to fluctuate, placed at \$2.4 million in 2005 compared to \$2.5 million in 2004. These however, understate total domestic resources directed at training, represented in the various programmes of study pursued at tertiary level institutions in The Bahamas and in the industry supported curricula of the Bahamas Institute of Financial Services.

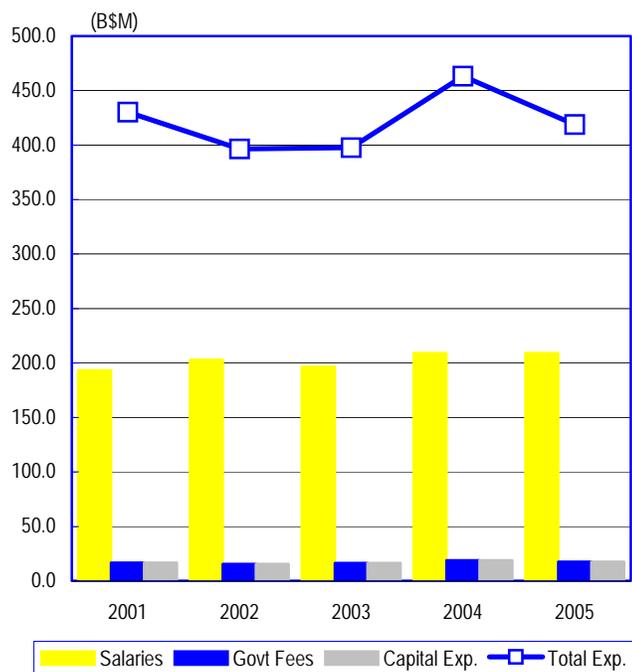
TABLE B. GROSS ECONOMIC CONTRIBUTION OF BANKS AND TRUST COMPANIES

Period	2000	2001p	2002p	2003p	2004p	2005p	2000	2001p	2002p	2003p	2004p	2005p						
							DOMESTIC						OFFSHORE					
A. TOTAL EMPLOYMENT	3,274	3,283	3,284	3,192	3,252	3,300	1,186	1,245	1,227	1,061	1,114	1,105						
1. Non-Bahamians	42	42	44	43	44	39	195	244	239	222	230	190						
2. Bahamians (of which)	3,232	3,241	3,240	3,149	3,208	3,261	991	1,001	988	839	884	915						
i) Local Banking	2,702	2,686	2,653	2,602	2,689	2,795	50	29	25	3	2	31						
ii) Offshore Banking	58	29	103	101	132	70	539	533	524	483	540	530						
iii) Trust Administration	280	316	248	287	240	229	148	169	174	168	153	222						
iv) Other	192	210	236	159	147	167	254	270	265	185	189	132						
	(B\$ Millions)																	
B. TOTAL OPERATIONAL COSTS (1+2+3+4)	216.4	227.7	227.3	224.6	257.2	239.0	146.8	151.7	149.7	157.5	171.1	163.7						
1. Salaries	119.9	121.5	128.8	128.9	132.4	135.6	63.0	71.7	74.0	67.7	76.7	73.5						
2. Government Fees	6.2	6.6	6.3	6.7	7.5	8.3	11.2	9.9	9.2	9.7	11.4	9.3						
i) Licence	3.0	3.0	3.1	2.7	2.8	4.5	5.7	5.0	4.2	3.9	4.2	4.8						
ii) Company Registration	0.3	1.1	0.7	0.7	0.7	0.7	0.7	1.4	2.1	0.7	0.7	1.1						
iii) Work Permits	0.4	0.5	0.4	0.5	0.6	0.5	1.8	1.8	1.9	1.8	1.8	1.8						
iv) Other Government Fees	2.5	2.0	2.2	2.7	3.4	2.6	3.0	1.7	1.0	3.4	4.7	1.5						
3. Staff Training	1.7	1.2	1.3	1.2	1.3	1.4	1.5	1.0	1.6	1.1	1.1	1.0						
4. Other Administrative Costs	88.6	98.4	90.9	87.8	115.9	93.7	71.1	69.1	64.9	78.9	81.9	79.9						
C. CAPITAL EXPENDITURE 1/	14.2	25.3	13.2	11.8	27.9	11.6	31.4	23.3	6.2	3.6	7.0	4.7						
D. TOTAL EXPENDITURE (B+C)	230.6	253.0	240.5	236.4	285.0	250.5	178.2	175.0	155.8	161.1	178.1	168.4						
E. AVERAGE SALARY (B\$'000)	36,619	36,381	39,217	40,379	40,723	41,091	53,134	57,603	60,318	63,808	68,840	66,516						

Source: The Central Bank of The Bahamas

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

Banks' Local Expenditure



Significant slowdown was also recorded in investment outlays, which reverted to \$16.3 million from an elevated \$34.8 million in 2004. Of note, were reduced spending for land purchases (76.8%), new premises (66.0%), renovation (56.2%) and office equipment and furniture (30.4%).

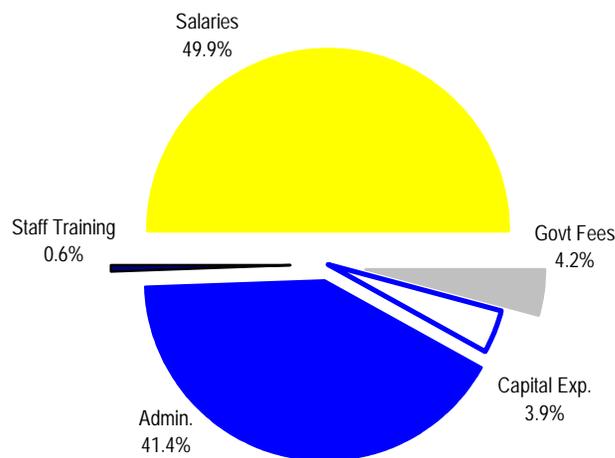
DOMESTIC VERSUS INTERNATIONAL BANKING

Because of important operations differences, it is useful to separately analyze developments in the domestic and international sectors. The domestic sector is comprised of a small number of retail banks, with more labour intensive operations, while international licensees engage more skilled labour and offer private portfolio and wealth management services to high net worth clients. Despite this distinction, most of the domestic licensees also conduct significant business with international clients.

Estimated employment among domestic banks and trust companies increased by 48 (1.5%) to 3,300 during 2005, contrasting with 9 (0.8%) fewer positions in the offshore sector, at 1,105. As a result, the share of total

employment generated by the domestic sector firmed incrementally to 74.9%. The number of Bahamians employed in these operations rose by 1.7% to 3,261, while expatriate employment decreased by 11.4% to 39. Consequently, the ratio of Bahamians to non-Bahamians in local operations rose to 84:1 from 73:1 in the previous year.

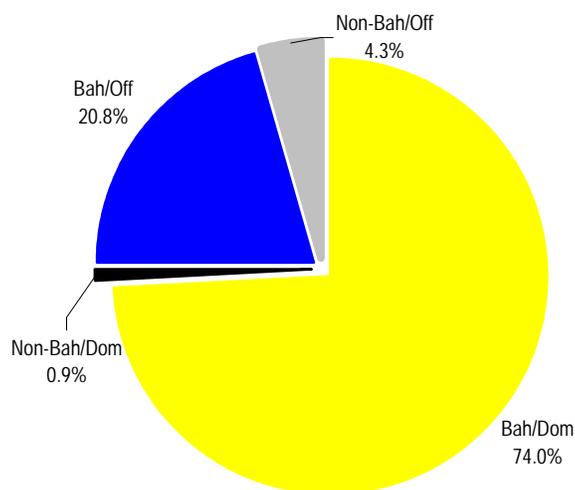
Banks' Expenditure Components (% of Total)



In the international sector, employment gains were also noted for Bahamians of 31 (3.5%) to 915 persons, while non-Bahamian positions decreased by 40 (17.4%) to 190. Correspondingly, the ratio of Bahamians to non-Bahamians in external operations increased to 5:1 from 4:1 in the previous year.

During 2005, domestic institutions accounted for an incrementally reduced share of banks and trust companies' total expenditures (59.8%), with the estimate narrowed by 12.1% to \$250.5 million. Operational costs fell by \$18.2 million (7.1%) to \$239.0 million, reflecting a 19.2% contraction in non-staff administrative expenses which were extraordinarily elevated in 2004 owing to restructuring cost incurred in a number of banks. In contrast, at nearly two-thirds of outlays, salaries rose by 2.4% and amounts paid to Government, by 10.7%, given the increased licence fee structure. However, investment expenditures declined by 58.4% to \$11.6 million, with outlays broadly curtailed for renovations, new premises, land purchases and office equipment and furniture.

Employment: Domestic & Int'l Banks (2005)



Largely owing to a reduced number of operations, international banks' gross expenditures declined by 5.4% to \$168.4 million. Operational costs contracted by 4.3%, owing to reductions in salaries (4.2%), government fees (18.4%) and non-staff administrative expenses (2.4%). Meanwhile, investment outlays fell by a third to \$4.7 million, highlighted by lessened expenditures on purchases and renovations of premises.

The higher skills content in international job functions accounts for above average wage compensation relative to the domestic sector. However, the gap narrowed, as with the lessening of the expatriate influence, average annual pay in the international sector softened by 3.4% to \$66,516. Conversely, average salaries in the local sector firmed marginally (0.9%) to \$41,091.

OTHER FINANCIAL SECTOR ACTIVITIES

Table C summarizes selected information on other financial sector activities, including some results from the Central Bank's expenditure and employment survey for 2005.

INSURANCE SECTOR

Available estimates of the insurance sector's contributions are more comprehensive in respect of the domes-

tic companies and a limited number of large brokerage operations. Respondents to the Central Bank survey provided employment for over 1,400 persons and incurred aggregate expenditures of \$121.5 million. These are therefore fairly representative of average employment and expenditure trends, but consequently understate the gross value of the sector's contribution.

As reported by the Office of the Registrar of Insurance Companies, the number of licensed insurance companies, brokers, agents and managers in The Bahamas increased by 4 to 195 at end-2005. Operations in the domestic sector rose by 3 to 155, while licensed external insurers rose by 1 to 40. For 2004, the latest date for which information was available, combined assets of the domestic companies (life, health, property and casualty) were estimated at \$972.6 million, an increase of 9.2% over 2003, and on pace to eclipse the \$1 billion mark by 2005. Approximately 57.2% of total assets were concentrated among life and health companies.

From the Central Bank's survey, indications are that operational outlays in the insurance sector rose by 13.4% during 2005, accounting for 91.9% of total expenditures. Wage expenses increased by 9.1%, with the average salary up by 4.5% to \$44,024 per annum. This trend also encapsulated stronger employment growth of 4.4%. The share of insurance sector jobs held by Bahamians remained at approximately 98.0%.

INVESTMENT FUNDS INDUSTRY

Data from the Securities Commission revealed that the number of investment fund administrators, which support the bulk of the sector's employment and expenditures, remained at 59 during 2005—as an existing operation was taken over by a trust company and one new entity was licensed. Although the number of active funds under management decreased to 699 from 838, indications are that business activity increased during the year, as, the corresponding value of assets managed rose by 7.2% to US\$175.2 billion. Fund administrators also reported an increase in the number of IBCs under management.

As 29 of the banks and trust companies are also licensed as fund administrators, significant data on the sector are also captured under the banking sector estimates. A remaining 30 administrators are supervised exclusively by the Securities Commission, of which two-

Table C: Other Selected Financial Sector Statistics

	Unit	2001	2002	2003	2004	2005p
Investment Funds Administrations						
Licensed Mutual Funds	Number	673	706	721	838	699
Licensed Administrators	Number	58	61	66	59	59
<i>Asset Under Management</i>	<i>B\$ Billions</i>	94.5	97.3	107.4	163.4	175.2
<i>Average Annual Salaries</i>	<i>B\$</i>	61,497	59,836	59,862	57,099	57,159
<i>Operating Costs / Total Expenditures</i>	<i>%</i>	88.8	98.2	98.2	96.8	93.3
Insurance Companies and Agents						
Domestic Companies and Agents	Number	147	179	186	191	195
<i>Total Domestic Assets</i>	<i>Number</i>	120	144	150	152	155
<i>Average Annual Salaries</i>	<i>B\$ Millions</i>	682.55	740.70	890.84	972.6	n/a
<i>Operating Costs / Total Expenditures</i>	<i>B\$</i>	41,721	40,529	40,845	42,120	44,023
	<i>%</i>	96.9	97.7	96.9	94.6	91.9
External Insurers	Number	27	35	36	39	40
Credit Unions						
Number of Unions	Number	19	20	19	19	19
<i>Total Assets</i>	<i>B\$ Million</i>	120.4	132.5	150.1	159.9	176
<i>Employment</i>	<i>Number</i>	99	96	104	105	105
<i>Average Annual Salaries</i>	<i>B\$</i>	20,339	21,146	22,394	27,602	28,293
<i>Total Expenditures</i>	<i>B\$ Million</i>	5.12	6.17	6.08	7.99	6.87
<i>Operating Costs / Total Expenditures</i>	<i>%</i>	89.9	65.4	89.5	72.9	81.7
Bahamas International Securities Exchange (BISX)						
Listed Public Companies	Number	17	16	17	19	19
<i>Shares Traded</i>	<i>Thousands</i>	3,958	2,748	3,569	7,996	6,724
<i>Market Capitalization</i>	<i>B\$ Billion</i>	1.68	1.76	1.66	1.90	2.60

Sources:

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

thirds maintain some physical presence in The Bahamas. Information on the bulk of these operations indicate that employment in investment fund management activity rose by an estimated 7.3% in 2005, with jobs held by Bahamians accounting for 95.8% of the total. Meanwhile, average salaries paid in such functions firmed marginally to \$57,161. Although total expenditures were stable, operating costs fell as a percent of the total, to 93.3% from 96.8% in the previous year.

CREDIT UNIONS

According to the Department of Cooperative Development, the number of registered credit unions remained at 19 during 2005. While total assets reached \$176.0 million, after heightened competition from accelerated credit trends in the banking sector, the corresponding growth decelerated to 3.4% from 13.4% in 2004.

The Central Bank's survey revealed that the number of persons employed by credit unions was unchanged at 105. Average annual compensation remained competitive against other domestic financial services providers. However, estimates, though increased to \$28,295 from \$27,600 in 2004, were biased downward, owing to the significant use of part-time resources. Expenditures decreased by 14.0% to \$6.9 million during 2005, still preserving healthy average annual growth since 2000 of 7.6%. Operational expenses fell by 3.6% to \$5.6 million, however, the salary component, which accounted for 52.9% of the total, rose by 2.5% and. Also, capital spending was almost halved to \$1.2 million, following significant investments in real estate during 2004.

CAPITAL MARKETS DEVELOPMENTS

Investor confidence was more upbeat in the domestic capital markets during 2005, as gains, especially in the third quarter, moved the market higher. Despite a 16.3% falloff in trading volumes, to 6.7 million shares, the value of shares traded on the Bahamas Investment Securities Exchange (BISX) rose by 49.4% to \$36.3 million. Further, the BISX All Share Price Index appreciated by 30.0% to 1,350.7 points continuing the (19.7%) gain reported in the previous year. The broader Fidelity Capital Market Limited Index (Findex), which captures over-the-counter trading, also advanced by 28.4% to 551.9 points, extending the previous year's gain of 14.9%. As there were no new initial public offerings

(IPOs), the number of publicly traded companies listed on BISX was unchanged at 19; albeit, total market capitalization increased by 34.8% to \$2.6 billion.

The most significant development affecting the capital markets during 2005 was the Government's acceptance of a set of proposals from the Central Bank to relax a broad range of Exchange Control measures affecting overseas investments by residents. Many of these changes, which became effective in January 2006, are intended to stimulate increased activity on BISX. In particular, subject to a 5 percent limit against the Bank's external reserves, up to \$25 million annually has been earmarked for direct purchases of external securities publicly traded on major foreign stock exchanges, which will be backed by issues of Bahamian Dollar Depository Receipts (BDRs) listed on BISX. The Government also approved a framework to permit temporary residents with a right to work in The Bahamas and foreign owned businesses in the domestic market to invest in local securities. Moreover, consent was given for the facilitation of the eventual cross-listing on BISX of public securities traded on Caricom stock exchanges and vice-versa, within an annual net outflow limit of \$20 million.

RECENT REGULATORY DEVELOPMENTS

A sound, dynamic and efficient regulatory infrastructure is vital to the operations of the financial services sector, including the advantages enjoyed in the provision of international services. Developments during 2005 were headlined by the Government's appointment in June of a Financial Services Regulatory Reform Commission, to consider options for consolidating the supervision of financial services activities in The Bahamas. The Commission is chaired by the Minister of State for Finance, Senator, the Honourable James Smith, and has representation from all of the regulatory agencies.

Otherwise, regulatory efforts were concentrated at the agency level, aimed at enhancing the implementation of the legislative regime introduced since 2001. The Group of Financial Services Regulators (GFSR), comprised of the five domestic supervisors, continued to actively co-ordinate inter-agency cooperation on supervisory matters and in June published an Information Sharing Handbook, to inform overseas regulators of the procedures to follow when making requests of The Bahamas for cross-border cooperation.

In the banking sector, the Central Bank introduced five additional regulations and guidelines affecting the operations of its licensees, targeted, inter alia, at a further strengthening of the anti-money laundering framework and addressing balance sheet issues related to liquidity and risk management. As part of the consultative process, industry and public comment was invited on five draft guidelines on a further range of risk management issues. The Bank also continued to provide direct assistance to foreign regulators, receiving and responding to 33 requests from 20 countries, and signed Memoranda of Understanding (MOUs), with two additional regulators, establishing direct protocols for future cooperation.

CONCLUSION

The 2005 survey indicated that the financial services sector's contribution to the Bahamian economy was

stable to marginally firmed during year, with mixed trends in the various sub-sectors and with separate, varying factors explaining the domestic versus international developments.

At its base, the sector will continue to be supported by a cadre of highly skilled professionals and the expanding product range which permits diversified business growth. Efforts continue to focus on strengthening the supervisory and regulatory processes, harmonization of external cooperative mechanisms and refining the legislative regime, to sustain confidence in The Bahamas as a choice jurisdiction for international business—a focus which reinforces prospects for resumed medium-term growth in the sector.