Financial Stability Report December, 2020

Issue No. 9

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PREFACE

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

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

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

EXECUTIVE SUMMARY

Risks to financial stability remained well contained in 2020, as the Central Bank sustained its risk-based approach to financial supervision, amidst the shock of the Novel Coronavirus (COVID-19) pandemic. In this environment, surveillance increased for both domestic and international supervised financial institutions (SFIs), with regard to their adjustments to the financial and business continuity risks posed by the pandemic. Further, the Central Bank released COVID-19 Guidance Notes to help inform SFIs' risk management practices and to delineate areas in which regulatory forbearance was forthcoming on prudential matters.

Moreover, from mid-March 2020, the effects of COVID-19 began to take an accelerated toll on the economy, negatively impacting employment conditions, which contributed to a deterioration in banks' credit quality indicators. In an effort to maintain financial stability, commercial banks implemented loan payment deferral programs for an initial 3 to 6 months period to assist customers whose debt servicing capacity had been adversely reduced by the pandemic. Further, the Central Bank prepared and issued tailored guidance notes to supervised financial institutions that would graduate the starting date at which loan loss provisioning would be required. In addition, the Bank Stability Index (BSI) and the Aggregate Financial Stability Index (AFSI) revealed that the sector's stability was sustained in 2020. Consolidated stress test results—which evaluate credit, liquidity, and interest rate risks—also showed that the domestic systemically important banks (DSIBs) remained resilient, despite the challenges posed by the pandemic.

Given very narrow capital adequacy buffers and significant exposures to the tourism industry, credit unions faced heightened stability risks, albeit institutions began to enjoy confidence through enhancing protection of membership in the Deposit Insurance Corporation in 2020. However, the COVID-19 impact on asset quality remained delayed. Hence, profitability indicators for credit unions exhibited some advancement, while liquidity levels remained significantly high.

In the insurance sector, performance indicators for both life and non-life insurance providers remained in-line with international benchmarks. The dominant life insurance sector profitability strengthened, while the non-life segment recovered, overturning losses in 2019, which were occasioned by a rise in claims associated with the passage of Hurricane Dorian. As a result, the insurance sector remained sound, reflected in the adequacy of its financial stability ratios.

Amidst the heightened pandemic risks and accelerated modernization trends in the payments system, the Central Bank extended the period of moratorium on the consideration of new license applications for Payment Service Providers (PSPs) and Money Transmission Businesses (MTBs), through September 2022. This continued to facilitate the stable, orderly adjustment of the system's expanded list of participants in the payments space.

Over the medium-term, the Central Bank will maintain its active and diligent surveillance of financial institutions, in order to ensure the stability of the sector. Ongoing focus will be on risk management practices regarding anti-money laundering (AML) and counter-financing of terrorists (CFT), along with the closing of any gaps identified in the risk and compliance systems of SFIs. The Bank will also continue to embrace policies that promote effective liquidity management, within the context of a recovery in the domestic economy and improved employment conditions, in order to mitigate the potential impact of higher credit demand on external reserves. In this context, robust liquidity could present accelerated medium-term credit expansion risk that would need to be managed. Nevertheless, the continued transition towards the credit bureau in 2020, underscored an improving medium-term environment for pricing and quantification of lending risks.

STRUTURE OF THE REPORT

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

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

Growth in the local economy remains linked to the performance in the tourism sector, which is dependent upon global economic developments. In 2020, the International Monetary Fund (IMF) estimated that the global economy contracted by 3.3%, vis-à-vis the 2.8% growth in 2019, as economic activity was dominated by the Novel Coronavirus (COVID-19) pandemic, along with measures to contain the spread. However, the global economy is expected to improve by 6.0% in 2021, contingent on progress on the international health front, effectiveness of the vaccines and the resumption of unrestricted global travel.

In the United States, economic developments revealed that real Gross Domestic Product (GDP) decreased by an annualized 3.5% in 2020, relative to the 2.3% expansion in 2019, owing to reductions in exports, personal consumption expenditure, private inventory investment and non-residential fixed investment, as well as a falloff in state and local Government spending. With regard to labour, the unemployment rate rose by 4.4 percentage points to 8.1%, while the annual inflation narrowed by 60 basis points to 1.2%. Against this backdrop, the Federal Reserve lowered the target range for the federal funds rate by 150 basis points to 0.00%-0.25%, in an effort to stimulate economic growth during a period of global shutdown.

In other major economies, economic developments reflected the retrenchment in global economic activity. In Europe, amid restrictions related to the spread of COVID-19, real GDP in the United Kingdom declined by an estimated 9.9%, a reversal from a 1.4% growth registered last year, underpinned by a falloff in services, production, construction output, Government consumption and business investment. Similarly, economic output for the euro area contracted by 6.6%, vis-à-vis a 1.2% growth in 2019. Likewise in Japan, real output fell by 4.8%, following a 0.7% increase in the previous year, underpinned by a reduction in private consumption and public spending. Conversely, China registered a 2.3% growth in real GDP, albeit a moderation from the 6.1% expansion in 2019.

1.2. Regional Environment

In 2020, most economies in the Caribbean region registered negative growth, combined with relatively high unemployment rates. Despite these developments, inflationary pressures remained contained over the review year. In addition, the regional financial sector remained stable and highly capitalized, making it resilient to external shocks. However, risks remain due to tourism-based economies exposure to volatile conditions within key source markets, while commodity-based economies were affected by the instability in international prices. Average real GDP growth for the region contracted by 6.0% in 2020, a switch from a growth of 1.5% in 2019 (see Table 2), as economic developments were adversely impacted by COVID-19. Specifically, Barbados' real output declined by 17.6%, extending the previous year's slight decrease of 0.1% in 2019, while real economic growth in both Belize and the Eastern Caribbean contracted by 14.1% and 14.0%, respectively. Further, reductions were noted for Suriname, Jamaica and Trinidad and Tobago by 13.5%, by

10.2% and by 7.8%, respectively. In contrast, Guyana's real GDP growth strengthened to 43.4% from 5.4% in 2019.

TABLE 1

Selected Indicators for Developed Economies (%)

	2014	2015	2016	2017	2018	2019	2020
GDP Growth Rates							
United States	2.5	2.9	1.6	2.2	2.9	2.3	(3.5)
Euro Area	1.4	2.1	2.0	2.4	1.8	1.2	(6.6)
United Kingdom	2.9	2.3	1.8	1.8	1.4	1.4	(9.9)
China	7.3	6.9	6.7	6.8	6.6	6.1	2.3
Japan	0.4	1.2	0.6	1.9	0.8	0.7	(4.8)
Unemployment Rates							
United States	6.2	5.3	4.9	4.4	3.9	3.7	8.1
Euro Area	11.4	10.9	10.0	8.6	7.9	7.6	7.9
United Kingdom	6.2	5.4	4.9	4.4	4.1	3.8	4.5
China	4.1	4.1	4.0	3.9	4.0	3.6	3.8
Japan	3.6	3.4	3.6	2.8	2.4	2.4	2.8
Inflation Rates							
United States	1.6	0.1	1.3	2.1	2.4	1.8	1.2
Euro Area	0.4	0.2	0.2	1.5	1.8	1.2	0.3
United Kingdom	1.5	0.0	0.7	2.7	2.5	1.8	0.9
China	2.0	1.4	2.0	1.6	2.1	2.9	2.4
Japan	2.8	0.8	(0.1)	0.5	1.0	0.5	(0.02)

Sources: IMF, International Statistical Bureaus

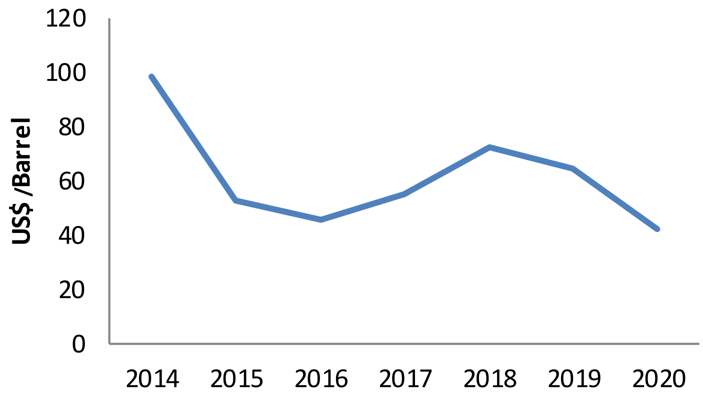
TABLE 2

Selected Caribbean Countries' GDP Growth Rates (%)

	2014	2015	2016	2017	2018	2019	2020
Bahamas	2.3	1.6	0.1	1.6	2.8	0.7	(14.5)
Barbados	(0.2)	2.2	2.3	(0.2)	(0.5)	(0.1)	(17.6)
Belize	3.7	3.4	(0.6)	1.4	3.0	0.3	(14.1)
Eastern Caribbean	2.9	2.6	2.7	1.2	3.0	2.8	(14.0)
Guyana	3.8	3.1	3.4	2.1	3.4	5.4	43.4
Jamaica	0.6	0.9	1.5	0.7	1.4	1.0	(10.2)
Suriname	0.3	(3.4)	(5.6)	1.7	2.0	2.3	(13.5)
Trinidad & Tobago	(1.3)	1.9	(6.5)	(2.0)	0.3	0.0	(7.8)
Average	**1.3**	**1.5**	**(0.6)**	**0.6**	**1.8**	**1.5**	**(6.0)**

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

Chart 1
Oil Prices (Brent Crude Oil Index)



Source: Bloomberg

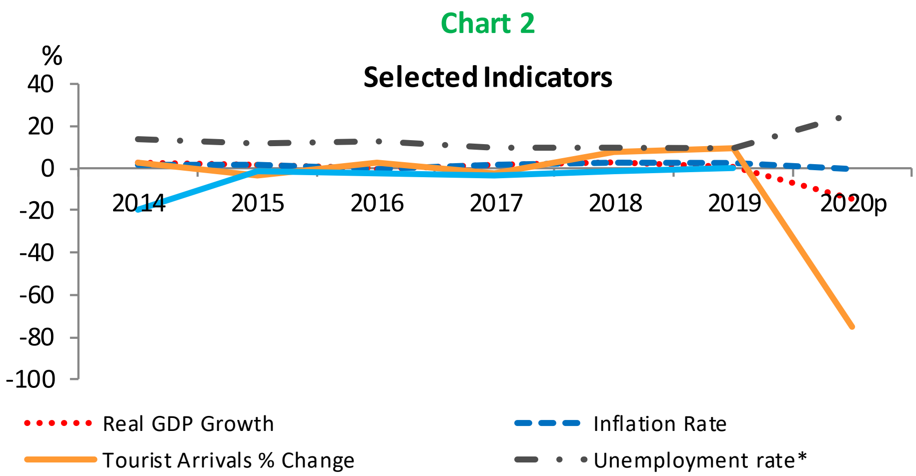
1.2. The Domestic Environment

The contraction in the domestic economy, reflective of the negative effects of the COVID-19 pandemic, contributed to the deterioration in banks' non-performing loans (NPLs). Nevertheless, the further progress towards startup of the credit bureau in January 2020, foreshadowed the improving medium-term environment ahead of financial institutions for credit risk management and new lending. Further, the considerable liquidity overhang in the banking system is expected to steadily decline over the long term, due to a series of measures, including the Central Bank's maintained objective to sell-off its holdings of Government securities to the public. In the meantime, the strengthening public debt management framework, with prospects after the pandemic for resumption of the fiscal consolidation effort should provide greater scope and incentives to shift claims off the Central Bank's balance sheet and absorb excess domestic liquidity.

With regard to the economy's performance, real GDP sharply contracted by 14.5% in 2020, vis-à-vis a 0.7% growth in 2019. Contributing to this outturn, globally imposed measures to contain the spread of the virus, impeded tourism sector activity, as the high value-added air segment posted record low levels of visitors, and the sea segment came to a standstill. In particular, total foreign arrivals sharply reduced by 75.2% to 1.8 million, a turnaround from a 9.5% expansion to 7.2 million in 2019. Underlying this development, sea arrivals declined by 75.4% to 1.4 million, a reversal from a 10.3% improvement to 5.6 million a year earlier. Similarly, air arrivals decreased by 74.8% to 418,329, contrasting with a 6.7% rise to 1.7 million in the prior year.

Reflective of the pass through effects of lower global oil prices, domestic inflationary pressures remained subdued in 2020. In particular, the Retail Price Index (RPI) for The Bahamas moderated to a muted 0.04% over the twelve months to December, from 2.49% in the previous year, as average cost gains declined for most of the items in the index.

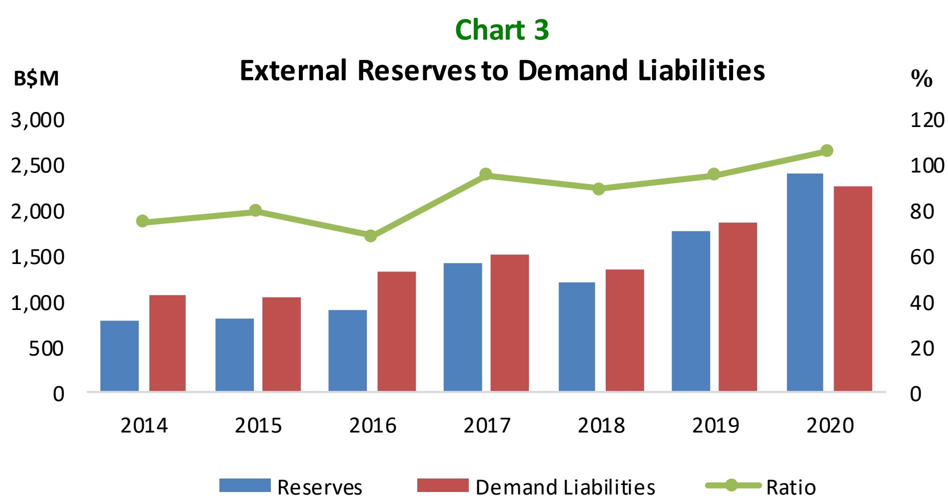
The overall fiscal deficit expanded to $788.2 million during FY2019/2020 from $219.3 million in FY2018/2019, due to negative effects stemming from the two major shocks, the COVID-19 pandemic and Hurricane Dorian. In the underlying developments, total revenue reduced considerably by $337.1 million (13.9%) to $2,089.2 million, while aggregate expenditure increased notably by $231.8 million (8.8%) to $2,877.4 million. Over the calendar year, the deficit surged to $1.3 billion in 2020 from $238.9 million in 2019, underpinned by an $856.9 million (34.1%) reduction in revenue collections and a $234.3 million (8.5%) falloff in total expenditure.



* IMF Article IV estimates 2020

Source: Central Bank of the Bahamas, The Department of Statistics

Domestic monetary developments in 2020 included an expansion in bank liquidity, as the growth in deposits contrasted with the contraction in domestic credit. Similarly, external reserves expanded, reflective of the Government's external borrowing activities. Bank's credit quality indicators weakened in 2020 as a result of the negative effects stemming from the ongoing COVID-19 pandemic. Further, the weighted average interest rate spread narrowed during the year, due to the decline in the average loan rate exceeding the decrease in the corresponding deposit rate.



Source: Central Bank of The Bahamas

At end-2020, external reserves reached $2.4 billion, making it equivalent to an estimated 43.7 weeks of total merchandise imports, surpassing the 27.7 weeks at end-2019. The useable reserves, or balances remaining after statutory provisions for 50 percent of the Central Bank's demand liabilities, stood at $1,255.2 million, exceeding the $835.4 million registered in the prior year. Further, the improvement in the Central Bank's balance sheet continued in 2020, as the ratio of end-of year external reserves to demand liabilities strengthened to approximately 105.6, relative to 0.95 in 2019 and a low of 0.68 in 2016. The outcome partially reflected the divestiture from Central Bank holdings of Government debt that will persist over the medium-term. Since 2016, end of year holdings of debt (securities plus advances) declined by 65.5% ($479.4 million) to $252.5 million from previous year's levels. Over the last quarter of the year, the advances portion of these holdings decreased structurally by $120.1 million, compared with the increase of $60.1 million recorded in the relative period in 2019.

TABLE 3

The Bahamas: Macroeconomic Indicators

	2014	2015	2016	2017	2018	2019	2020
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	6.2	6.7	0.9	3.1	3.9	2.5	(24.7)
Real GDP Growth Rate (%)	2.3	1.6	0.1	1.6	2.8	0.7	(14.5)
Inflation Rate (Average chg in RPI)	1.3	1.9	(0.3)	1.5	2.3	2.5	0.0
Unemployment Rate (May)*	13.8	12.0	12.7	9.9	10.0	9.5	25.6
Overall Fiscal Balance (B$M)	(531.1)	(252.0)	(467.1)	(622.5)	(337.4)	(240.3)	(1,324.1)
% of GDP	(4.8)	(2.1)	(3.9)	(5.0)	(2.6)	(1.8)	(13.4)
Private Sector Credit (B$000)	6,366.9	6,299.7	6,170.8	5,982.9	5,886.2	5,891.6	5,766.1
Weighted Average Lending Rate (%)	11.8	12.3	12.5	11.8	11.3	10.5	10.4
Weighted Average Deposit Rate (%)	1.4	1.4	1.2	1.0	0.8	0.6	0.5
Treasury Bill Rate (%)	0.7	0.9	2.0	1.9	1.7	1.8	1.9
Gross Int'l Reserves (B$M)	787.7	811.9	904.0	1,417.4	1,196.3	1,758.1	2,382.2
Import Cover Ratio (Tot. Merch. (CIF) in week	11.4	14.1	16.5	21.9	17.4	28.2	59.2
Current Balance (B$M)	(2,192.6)	(1,478.3)	(1,472.7)	(1,697.7)	(1,199.3)	(359.2)	(2,290.7)
as % of GDP	(19.7)	(12.4)	(12.3)	(13.7)	(9.3)	(2.7)	(23.1)
Total Public Sector Debt (B$M)	7,101.8	7,460.0	7,898.9	8,832.1	9,247.9	9,435.8	10,808.0
of which: External	2,100.5	2,175.8	2,373.0	3,233.9	3,171.8	3,123.1	4,478.0
Internal	5,001.3	5,284.2	5,526.0	5,598.2	6,076.1	6,312.7	6,329.9
Total Arrivals ('000s)	6,320.2	6,112.1	6,265.0	6,135.8	6,622.0	7,249.5	1,794.5
Tourist Expenditure (B$M)	2,316.4	2,537.5	2,726.2	2,930.2	3,727.6	4,125.5	967.4
Construction Number of Permits Issued	1,418.0	1,299.0	1,136.0	1,269.0	1,503.0	1,399.0	n.a.
Value of Starts (B$M)	129.2	119.8	96.2	155.5	118.2	96.6	n.a.
Value of Completion's (B$M)	250.5	228.9	193.2	1,493.6	333.8	195.1	n.a.
Average Oil Prices (Brent Crude Oil Index)	98.5	52.6	45.8	55.0	72.4	64.7	42.3

Source: Central Bank of The Bahamas, Department of Statistics, Bloomberg

*2020 rate represents forecasts

N/A - Not Available

CHAPTER 2: BANKING SECTOR

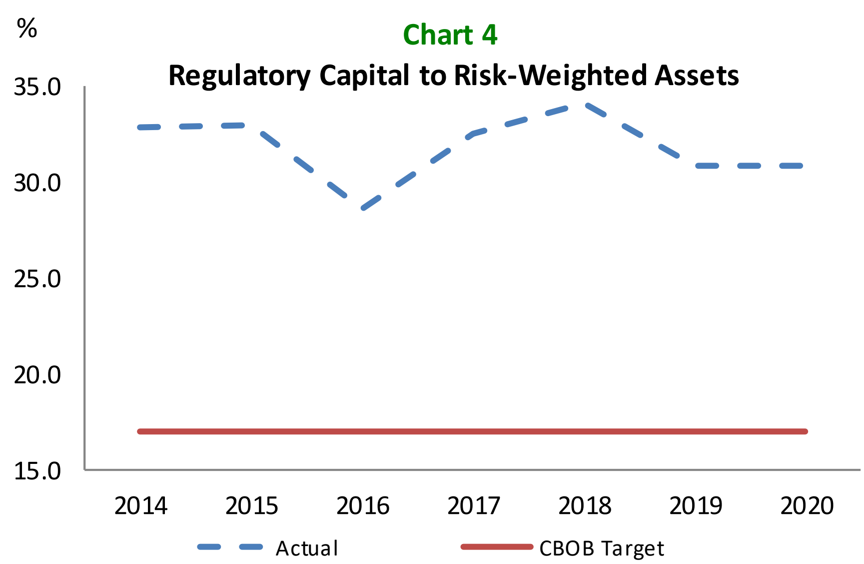
The Bahamas' exchange control regime disallows banks from undertaking domestic business activities other than through assets funded with domestic liabilities. Therefore, this averts any direct connection or balance sheet flows from direct international to domestic banking operations. As a consequence,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

2.1 Asset Trends

Total domestic assets of the banking system increased by 2.0% to $10.9 billion, a moderation from the 7.4% growth in 2019. Comprising the largest shares of these assets were loans and advances (61.9%), followed by securities (18.2%) and claims on the Central Bank, that is, cash and balances (16.0%). Meanwhile, "other" miscellaneous assets accounted for a relatively modest share (3.9%). Leading the deceleration in asset growth, the addition to banks' claims on the Central Bank decreased to 25.1%, compared to 48.1% in 2019. In addition, "other" miscellaneous domestic assets tapered by 17.2%, after a 24.1% increase in the preceding year. Further, banks' holdings of securities and loans & advances both reduced, by 1.5% and 0.3%, following respective gains of 4.8% and 1.4%, a year earlier.

2.2 Capital Adequacy

Domestic banks remained well capitalized during the review year. The ratio of average capital to risk weighted assets firmed by 10 basis points to 30.9% at end-December 2020, exceeding the Central Bank's target ratio of 17.0% of risk-weighted assets and the international benchmark of 8.0%.[1]



Source: Central Bank of The Bahamas

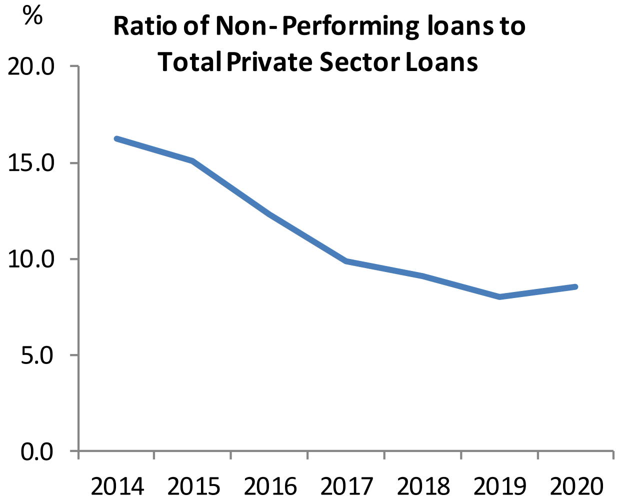
[1] The Central Bank imposes a "trigger" ratio of 14.0%, below which licensees would be required to implement measures to either reduce risk exposures or supplement their capital.

2.3 Asset Quality

Banks' credit quality indicators deteriorated during the year, as a significant share of their clientele faced financial challenges stemming from the contraction in the domestic economy related to the COVID-9 pandemic. In June 2020, domestic banks reported that approximately one-third of credit facilities were granted deferred payment arrangements[2]. As of December 2020, however, most arrangements had unwounded, with deferred balances representing a reduced 9.1% of private sector loans. While a year-on-year shift towards arrears was evident, the full impact of the pandemic is expected to register over the course of 2021, potentially into 2022, as the employment certitude of more borrowers become clearer. Nevertheless, total private sector loan arrears grew by 12.6% to $773.1 million in 2020, contrasting with a 15.3% falloff in 2019, largely reflecting increases in mortgage and consumer delinquencies. As a result, the ratio of arrears to total private sector loans rose by 1.7 percentage points to 13.8%, following a 2.2 percentage point decrease in the prior year.

Chart 5

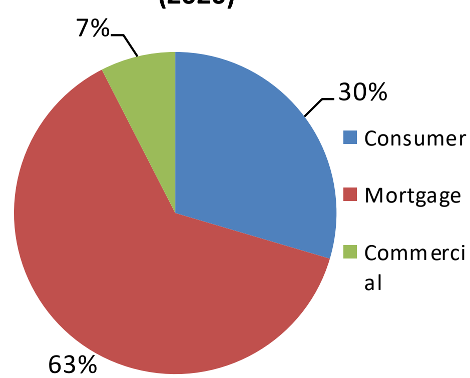
Ratio of Non-Performing loans to Total Private Sector Loans



Source: Central Bank of The Bahamas

Chart 6

Composition of Private Loan Arrears (2020)



Source: Central Bank of The Bahamas

Based on an analysis of delinquencies by average age, short-term arrears (31-90 days) expanded by 28.5%, vis-à-vis a 20.7% decline registered in 2019. Contributing to this outturn, were additions to the mortgage, commercial and consumer segments, of 46.9%, 18.4% and 0.2%, respectively. In addition, non-performing loans increased by 4.5% to $474.6 million, a reversal from a 12.2% falloff in the prior year, occasioned by a 25.9% rise in the consumer component. In contrast, long-term commercial and mortgage delinquencies tapered by 18.2% and by 0.1%, respectively. Consequently, the ratios of short and long-term arrears to total private sector loans both rose, by 1.2 and by 0.5 percentage points, to 5.3% and 8.5%, respectively.

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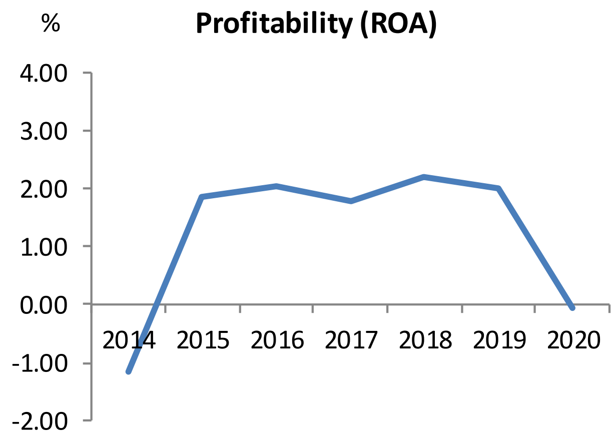
[2] Loans on deferral were not included in the NPL figures.

2.4 Profitability

Domestic banks registered a net loss of $6.7 million in 2020, a turnaround from a net profit of $255.5 million in 2019. Underlying this development was the pandemic induced surge in bad debt provisioning. Banks also noted some higher expenses for non-staff outlays—including professional services, Government fees and maintenance. Consequently, the ratios of net income to average monthly assets (ROA), and to equity (ROE) registered a negative to 0.1% and 0.3%, respectively, relative to a positive 2.4% and 10.7% in 2019 (see Table 4).

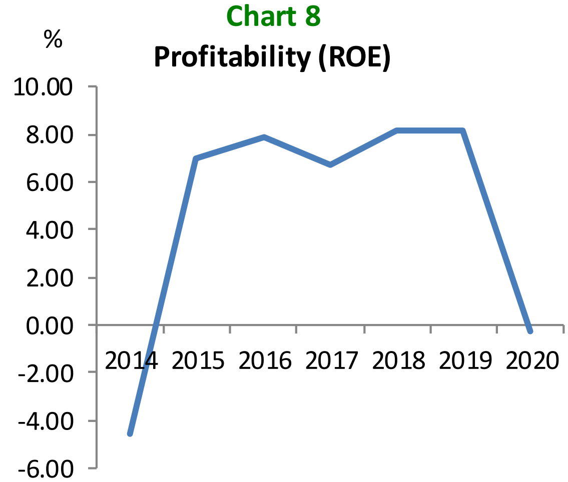
Total provisions for bad debt more than doubled to $254.8 million from $96.1 million in 2019, leading to a 1.4 percentage point firming in the associated ratio of average assets, to 2.3%. In addition, operating costs increased by 17.4%, elevating the attendant ratio by 47 basis points, to 4.10% of average assets, as the rise in non-staff outlays outpaced reductions in occupancy and staff costs. Further, depreciation costs rose by 45.0%, elevating the relevant ratio by 4 basis points, to 0.15% of average assets. The effective interest rate spread widened by 80 basis points, to 7.97%. In particular, the ratio of net interest income to average assets moved lower by 24 basis points to 4.75%, as the 2.7% decrease in interest income offset the 20.8% falloff in interest expense. In contrast, the ratio of commission and foreign exchange income to average assets edged up by 1 basis point to 0.36%.

Chart 7
Profitability (ROA)



Source: Central Bank of The Bahamas

Chart 8
Profitability (ROE)



Source: Central Bank of The Bahamas

2.5 Liquidity

Bank liquidity remained high in 2020, largely reflecting a gain in banks' statutory balances with the Central Bank. As a share of total assets, banks' holdings of liquid assets firmed by 2.3 percentage points to 32.4%, albeit a deceleration from the 3.5 percentage point growth recorded a year earlier. Meanwhile, the ratio of liquid assets to short-term liabilities rose by 4.1 percentage points, extending the preceding year's increase of 3.3 percentage points.

As banks' outstanding loan balances reduced, the ratio of deposits to total loans grew by 36 basis points to 114.7%, although a slowdown from the 10.6 percentage point addition in 2019. However, the ratio of demand deposits to total deposits narrowed by 8 basis points to 45.1%, after a 4.5 percentage point rise in the previous year (See Table 4).

TABLE 4

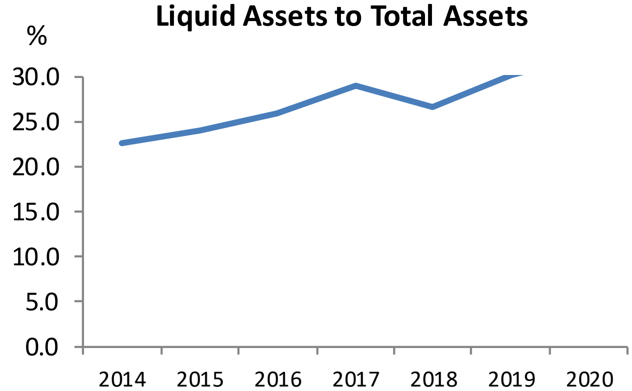
Key Domestic Banks Financial Stability Indicators (%)

	2014	2015	2016	2017	2018	2019	2020
Liquidity Indicators							
Loan to Deposit Ratio	109.6	108.6	100.9	95.4	96.4	87.5	87.2
Deposits to Loan Ratio	91.2	92.1	99.1	104.8	103.7	114.3	114.7
Demand Deposits to Total deposits	31.7	32.6	37.2	39.0	40.7	45.2	45.1
Liquid Assets to Total Assets	22.7	24.1	25.9	29.0	26.6	30.1	32.4
Liquid Assets to Short-Term Liabilities	34.4	37.0	37.8	42.7	38.3	41.6	45.7
Credit Risk Indicators							
NPL to Total Private Sector Loans	16.2	15.1	12.3	9.9	9.1	8.0	8.5
Total Assets Growth rate	(1.4)	1.8	1.6	2.3	(2.4)	7.4	2.0
Loans & Advances Growth rate	(2.3)	(0.3)	(0.6)	(4.1)	0.9	1.4	(0.3)
Capital Adequacy							
Regulatory capital to risk-weighted assets (avg)	32.8	33.3	28.6	32.5	34.1	30.8	30.9
Trigger Ratio	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Target Ratio	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Profitability Indicators							
ROAA (annualized)	(1.2)	1.9	2.0	1.8	2.2	2.0	(0.0)
ROAE (annualized)	(4.6)	7.0	7.9	6.8	8.2	8.2	(0.3)
Net interest income to average earning assets (annualized)	5.3	5.4	5.3	5.1	5.1	5.0	4.8
Net interest income to gross income	69.8	70.5	69.4	69.4	68.5	77.7	107.9
Non interest expenses to gross income	66.3	47.4	48.4	52.1	49.7	58.3	97.0
Personnel expenses to non interest expenses	34.8	46.8	44.0	40.8	41.2	39.0	32.6
Trading and fee income to total income	3.0	3.9	3.2	3.8	3.8	5.4	8.3
Effective Interest Rate Spread	6.8	7.1	7.2	7.1	7.1	7.2	8.0

Source: Central Bank of The Bahamas

Chart 9

Liquid Assets to Total Assets



Source: Central Bank of The Bahamas

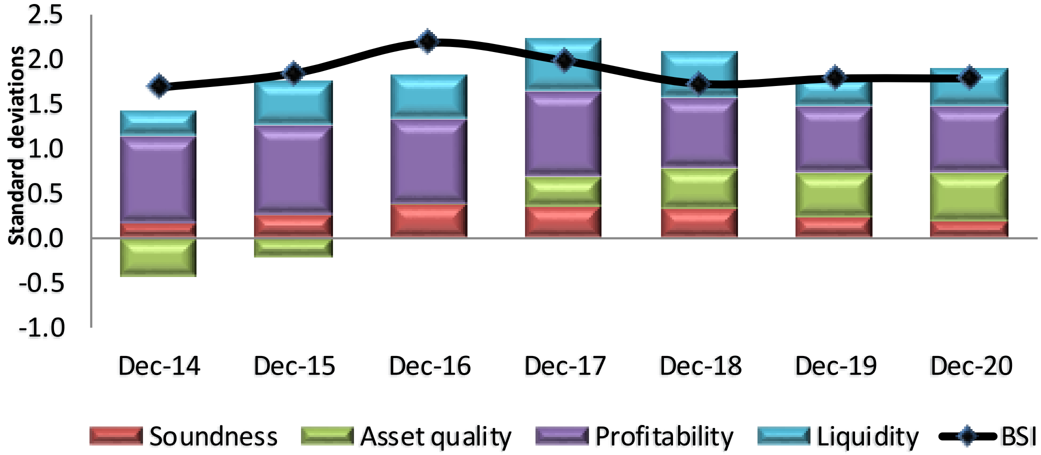
2.6 An Assessment of the Stability of the Banking Sector

2.6.1 The Banking Stability Index

The Banking Stability Index (BSI) is an aggregate indicator of the soundness of the Deposit-Taking Institution sector. It was calculated as a normalized weighted average of key performance indicators, namely capital adequacy, asset quality, profitability and liquidity. Each variable was normalized using statistical standardization, which allows for the different variables to be on the same scale. In 2020, the Banking Stability Index (BSI)—which measures the soundness of deposit taking institutions (DTIs) in The Bahamas—was relatively stable as measures were introduced to protect the banking sector from disruptions as a result of the COVID-19 pandemic. The index was unchanged at 1.79 vis-à-vis 2019, suggesting that risk to the sector remained low. Specifically, the normalized asset quality indicator increased to 0.62 from 0.53 in the previous year, while the liquidity indicator was relatively stable at 0.42. However, the normalized profitability indicator weakened to 0.65, from 0.75, as return on equity declined. Further, indicators of respective capital adequacy and interest rate edged down to 0.13 and 0.02, from 0.14 and 0.03 in 2019. Overall, the BSI held steady on a standard deviation of 0.8 from December 2019, implying that liquidity levels within the sector remained robust, as the share of liquid assets to total assets strengthened.

Chart 10

Banking Stability Index and its indicators for The Bahamas



Source: Central Bank of The Bahamas

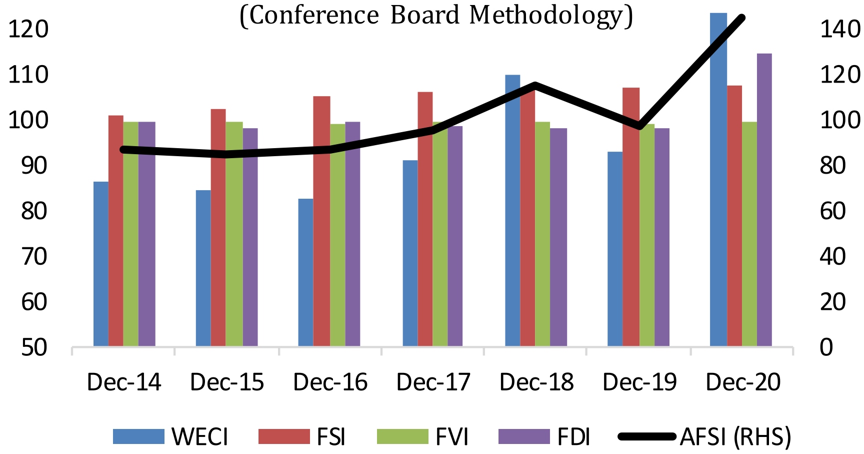
2.6.2. Aggregate Financial Stability Index

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

The overall ASFI index rose to 122.5 from 98.8. A disaggreation of the components showed that the world economic climate sub-index grew to 147.02, from 84.31 a year earlier, largely reflecting a rise in exchange market volatility. Further, the financial development index advanced to 128.91 from 96.89 in the prior year, owing largely to rise in stock market capitalization, due to the listing of Bahamas Registered Stock on the Securities Exchange. In addition, the financial soundness index strengthened to 115.18 from 114.18 in the preceding year, undergired by gains in the ratio of liquid assets to total assets. In contrast, the financial vulnerability sub-index fell to 99.0 from 99.93, due mainly to a notable rise in the total fiscal balance to GDP ratio. The positive movements in the majority of these indicators, suggested that the domestic financial sector remained stable and there is no stability concerns.

Chart 11

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



Source: Central Bank of The Bahamas

2.6.3. Stress Testing

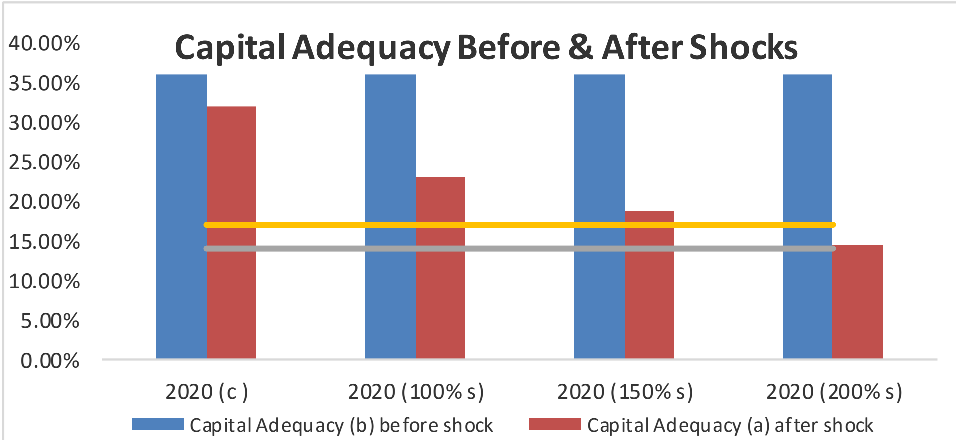
Stress tests continued to be conducted semi-annually and remained the primary tool to assess the resilience of the banking system, including capital adequacy or credit loss absorbing capacity. Credit risk assessments consider varying levels of non-performing loans (NPLs), which might be precipitated by economic or financial shocks. Interest rate shocks also consider loss absorbing capacity from market rate shifts, while liquidity shocks examine failure risks from potential surges in deposit withdrawals.

Credit Risk Stress Tests

During the year 2020, the stress scenarios used to assess the level of capital deficiency, if any, remained constant at NPL shocks of 100%, 150% and 200% for forecasted years 2020 and 2021; the overall impact of which affects the statement of income, through increases (or decreases) in expenses, driven mainly by foregone interest income and provision shortfalls for increases in impaired loans, ultimately impacting the level of banks' total eligible capital.

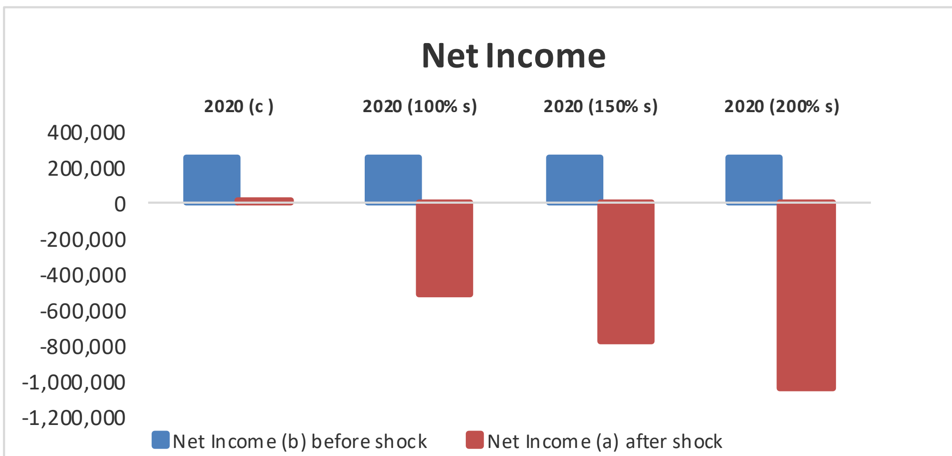
The results of consolidated credit risk stress tests conducted in 2020, consistently showed that, at all levels of shocks, no capital injection was required when assessed against the regulatory trigger ratio of 14.0%. The results also revealed, however, that capital injection would be required at the 200% shock level, when assessed against the regulatory target ratio of 17.0%. The post shock results reflected an average capital to risk-weighted assets ratio of 14.4% and 33.4% (see Chart 13). Although the Bank anticipates a rise in NPLs and reduced earnings during 2021, as COVID-19 related loan payments deferrals conclude, there are no immediate financial stability concerns, given the commercial banks' capital and provisioning levels.

Chart 12



Source: Central Bank of The Bahamas

Chart 13



Source: Central Bank of The Bahamas

The Central Bank anticipates that commercial banks' earning capacity will be negatively impacted due to increases in loan loss provisioning levels and the loss in interest income associated with varying levels of shocks to NPLs. In the meatime, banks are not expected to have significant scope to recoup net-interest losses, as other earnings sources are also expected to be constrained in the COVID-19 environment. Chart 14 illustrates the projected net income before any shock, at a net gain of around $225.0 million and reductions in net income of $1.0 billion, due to applied shocks.

Interest and Liquidity Shocks

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

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

CHAPTER 3: CREDIT UNIONS

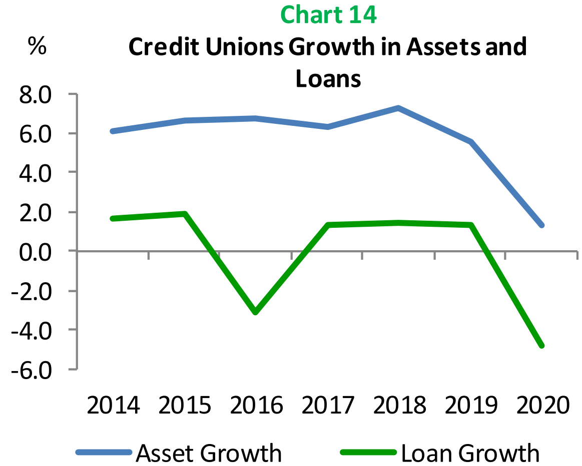
After commercial banks, credit unions remained the second largest deposit taking and loan granting institutions. In this context, the sector continues to be supervised and monitored by the Central Bank, where a risk-based approached has been adopted, inclusive of anti-money laundering/know your customer (AML/KYC), corporate governance and credit risk management. Prior to the pandemic, the sector operated with very narrow capital buffers in comparisons to banks, and also more concentrated exposures in some cases to the tourism industry. However, average liquidity ratio stayed comfortably above the minimum statutory thresholds. In the meantime, the sector received heightened protection from enrolment in the Deposit Insurance Scheme, and remained under enhanced prudential oversight.

3.1. Assets and Liabilities

With the total number of credit unions remaining at 10, total assets rose by 1.3% ($6.3 million) to $482.3 million in 2020, although lower than the 5.6% growth in the previous year. Underlying this outturn, deposits held with the league grew by 4.2% ($3.7 million) to $93.7 million, albeit below the 5.4% gain in 2019. Contrastingly, loans to members, which comprised a dominant 46.8% of total assets, decreased by 4.8% ($11.4 million) to $225.9 million, a reversal from a 1.3% increase last year. A breakdown of the loan portfolio showed that consumer purchases remained the main form of credit at 68.3%, followed by mortgages (30.4%), with lowered figures for SME development (0.7%), and other lines of credit (0.6%).

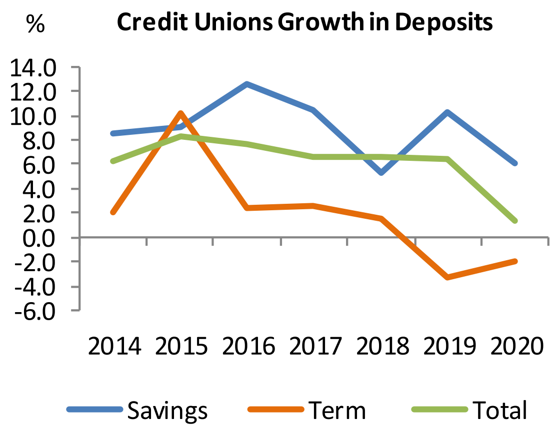
Total deposits within credit unions grew by 1.4% ($5.6 million) to $416.9 million, relative to a 6.5% increase in the prior year, as savings deposits—which accounted for 50.7% of the aggregate—rose by 6.1% ($14.1 million) to $244.5 million, vis-à-vis a 10.3% expansion a year earlier. Conversely, term deposits—at 28.4% of the total—reduced by 2.0% ($2.8 million) to $136.8 million, following a 3.2% falloff in 2019.

Chart 14
Credit Unions Growth in Assets and Loans



Source: Central Bank of The Bahamas

Chart 15
Credit Unions Growth in Deposits



Source: Central Bank of The Bahamas

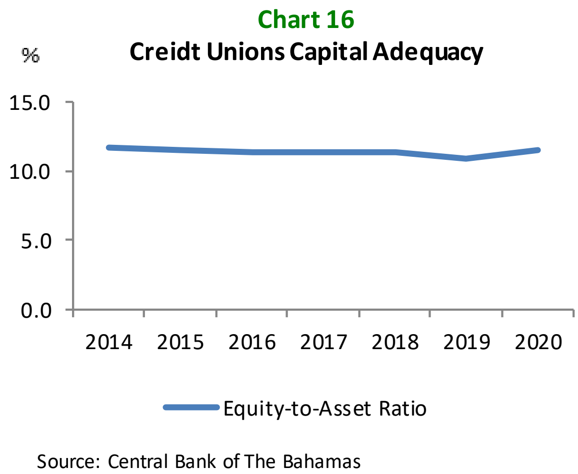
TABLE 5							
Selected Financials for Credit Unions (B$M)							
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total Assets	347.7	370.6	395.5	420.3	450.9	476.0	482.3
Total Gross Loans	230.9	235.3	227.9	230.8	234.2	237.3	225.9
Total Deposits	291.6	315.9	339.9	362.2	386.2	411.3	416.9
Liquid Assets	86.8	101.6	129.7	146.0	172.3	187.0	199.8
Savings	146.4	159.6	179.7	198.4	208.9	230.4	244.5
Term Deposits	122.8	135.3	138.5	142.0	144.3	139.6	136.8
Total Members' Equity	40.7	42.4	45.1	47.4	51.3	52.1	55.5
Non-Earning Assets	25.2	25.0	34.8	33.4	37.1	50.2	39.9
Allowance	11.8	14.1	9.9	7.4	7.5	8.0	7.2
Short-Term (ST) Payables	1.4	1.0	1.1	0.5	0.7	1.0	1.1
Capital & Surplus	20.5	19.0	20.0	17.5	19.7	16.4	16.0
Provisions	1.1	2.3	2.4	3.9	3.5	3.4	3.7
Net Income	2.8	1.3	1.4	1.7	1.8	1.9	3.8
Institutional Capital	14.3	11.9	12.8	9.4	9.4	7.8	7.2
# of Credit Unions	7	9	10	10	10	10	10
Financial Ratios (%)							
Equity-to-Asset Ratio	11.7	11.5	11.4	11.3	11.4	10.9	11.5
Return on Assets	0.8	0.3	0.3	0.4	0.4	0.4	0.8
Return on Equity	7.0	3.0	3.0	3.6	3.5	3.7	6.9
Provisions to Loans	0.5	1.0	1.0	1.7	1.5	1.4	1.6
Total Gross Loans to Total Assets	66.4	63.5	57.6	54.9	51.9	49.9	46.8
Liquid Assets to Total Assets	25.0	27.4	32.8	34.7	38.2	39.3	41.4
Non-Earning Assets/Total Assets	7.2	6.7	8.8	8.0	8.2	10.5	8.3
(Liquid Assets-ST Payables)/Total Deposit	29.3	31.9	37.8	40.2	44.4	45.2	47.7

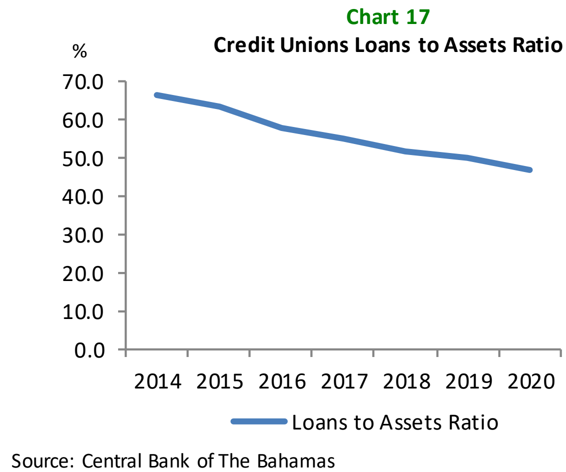
Source: Department of Cooperative Development & Central Bank of The Bahamas

3.2. Capital Adequacy

During the year, credit unions' capital ratio remained just above the 10.0% international PEARLS benchmark, though with greater negative exposure from reduced asset quality. The aggregate capital & surplus resources—held to cover unexpected losses—declined by 2.6% ($0.4 million) to $16.0 million, but was a moderation from the 16.6% contraction in 2019. In this context, the relevant ratio of total equity[3] to total assets (the gearing ratio) increased to 11.5% from 10.9% a year earlier.

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





3.3. Asset Quality

Credit unions' total impaired loans[4] increased by 17.3% ($4.9 million) to approximately $33.1 million in 2020, contrasting with a 0.7% decline in the preceding year. Correspondingly, the ratio of delinquencies to total loans firmed to 15.2% from 12.3% in 2019. In terms of the components, non-performing loans (NPLs)—which accounted for 72.4% of total delinquencies—grew by 4.3% ($1.0 million) to $24.0 million, extending the 12.7% increase a year earlier. In addition, short term delinquencies (31-90 days) rose by 31.8% ($1.7 million) to $7.0 million, in line with the 31.6% expansion in the previous year.

Given the rise in loan delinquencies, the collateral value of impaired facilities increased by 34.8% ($5.1 million) from the recorded $14.7 million in 2019. However, the value of uncollateralized exposures reduced by 1.6% ($0.2 million) to $13.3 million. Credit unions' total provisions for loan losses grew by 10.1% ($0.3 million) to $3.7 million, following a 3.4% decline a year earlier. As a result, the ratio of provisions to total gross loans firmed by 22 basis points to 1.6%, while the coverage ratio for short-term arrears remained unchanged at 35.0% and for NPLs, at 100%.

The value of non-earning assets—inclusive of land, buildings, vehicles, furniture and cash—contracted by 20.4% ($10.2 million) to $39.9 million, relative to a 35.1% expansion last year. Consequently, the relevant ratio of non-earning assets to total assets narrowed by 2.2 percentage points to 8.3%, vis-à-vis a 2.3 percentage point gain in 2019.

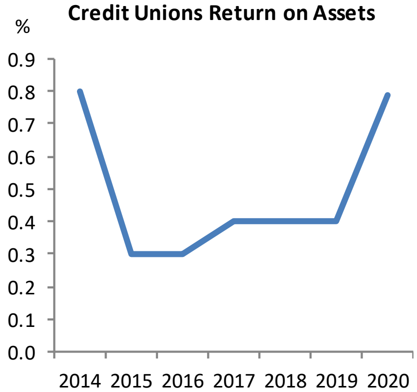
[4] An impaired loan is defined as one in which the full amount of principal or interest due is not collected on time, according to the contractual terms of the loan agreement.

3.4. Profitability

During 2020, largely attributed to a rise in interest income from deposits, credit Unions' overall profits doubled to $3.8 million, following a 7.2% gain last year. This improved the return on assets ratio by 40 basis points to 0.8%, while the return on equity rose by 3.1 percentage points to 6.9%.

Chart 18

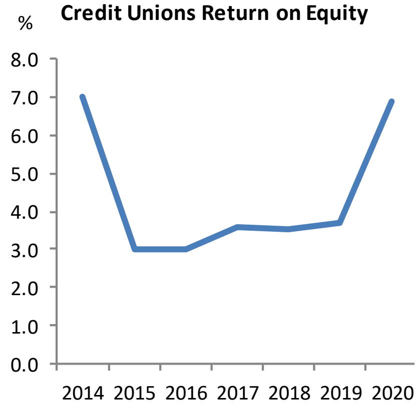
Credit Unions Return on Assets



Source: Central Bank of The Bahamas

Chart 19

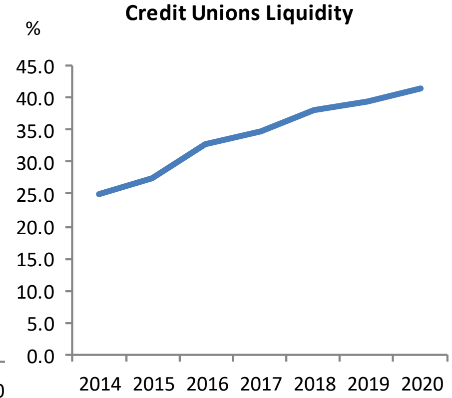
Credit Unions Return on Equity



Source: Central Bank of The Bahamas

Chart 20

Credit Unions Liquidity



Source: Central Bank of The Bahamas

3.5. Liquidity

Credit unions' liquidity stayed at robust levels during the year, underpinned by a notable rise in financial investments (32.2%) and in liquid investments (32.0%), which outweighed the 30.0% falloff in cash balances. As a result, ratio of liquid assets to total assets firmed by 2.1 percentage points to 41.4% in 2020, relative to 39.3% in the previous year. Similarly, the alternative indicator—the ratio of short-term payables to total deposits—moved higher by 2.4 percentage points to 47.7% at end-2020. Both ratios exceeded the minimum prudential standard of 15.0%, demonstrating that credit unions maintained healthy levels of liquidity.

CHAPTER 4: THE INSURANCE SECTOR

Given the country's exposures to natural disasters, such as hurricanes, insurance companies are very important to sustaining the stability of the financial sector. During the review year, the industry was forced to conduct business in a virtual arena, due to the COVID-19 pandemic and measures introduced to contain the spread. Further, directives from the Government in March 2020, led to the suspension of insurance premium payments to eligible policy holders, for 60 days upon expiration of the existing Emergency Powers Order. Notwithstanding, the industry was obligated to comply and remain within international standards. The sector stayed compliant with AML/CFT risk management standards, and adhered to newly introduced guidance policies,[5] which were released mid-2020. Despite the challenges, the domestic insurance sector remains conservative, with its focus on long-term stable investments, such as Government bonds, with minimal concerns regarding the sector's stability.

Information from the Insurance Commission of The Bahamas (ICB) revealed that in 2020 the number of companies remained unchanged at 30. These consisted of 12 life and health insurers, offering whole life, term life, as well as universal life, and 18 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—5 life insurers and 6 non-life insurers—which represented a combined market share of approximately 84.2% of total gross premiums written and the majority of insurance coverage.

The external insurance sector, which is registered under the External Insurance Act,[6] mainly provides self-insurance coverage for non-resident entities in other countries. In 2020, it comprised of 159 entities, of which 21 were insurance companies and 138 were captive cells. Therefore, external insurers' main impact on the domestic economy is through employment and the fees charged by local service providers. As their operations do not affect the local financial sector, the domestic insurance sector will be the major focus of this analysis.

Key performance indicators in the domestic insurance sector strengthened in 2020. The penetration ratio (total gross premiums to GDP[7]), extended by 0.8 percentage points to 4.3% over the prior year. Specifically, the dominant life insurance segment registered a profit, extending gains earned in the previous year. Likewise, the non-life sector also recorded an operating profit, overturning losses which were on account of a rise in claims associated with the passage of Hurricane Dorian in September, 2019. In this environment, the sector remained financially sound, as revealed by the adequacy of its financial stability ratios.

4.1 Life Insurance

Life insurance companies constituted 69.0% of aggregate assets and 55.6% of total gross premiums, representing the dominant segment of the market. According to provisional data, life insurers' total assets grew by 2.0% ($30.1 million) to $1.5 billion, due primarily to the dominant investments category—at 72.9% of total assets—which rose by 2.5% ($27.3 million) to $1.1 billion. An analysis of investments revealed broad

[5] Premiums Trust Accounts, and General Insurers and their Intermediaries on Minimum Due Diligence Requirements for Policy holders
[6] See website: http://www.ibc.gov.bs/home
[7] Based on Department of Statistics GDP figures.

based gains in mutual funds (84.8%), other “miscellaneous” investments (83.7%), government securities (7.3%) and investment property (1.0%), which overshadowed notable declines in non-listed corporate equities (91.7%), corporate securities (47.8%) and listed corporate equities (8.4%). Further, total assets registered gains in cash & deposits—the most liquid asset category—which moved higher by 17.9% to $197.1 million. In an offset, broad based declines were noted in intangibles ($7.9 million), receivables ($5.0 million), re-insurance recoveries ($4.8 million), other assets ($5.6 million) and fixed assets ($3.8 million).

In terms of funding, total liabilities decreased by 0.8% ($8.7 million) to $1.0 billion, explained by a 4.6% falloff in technical reserves—which finance policyholders' claims and future benefits—to $871.9 million. In contrast, other liabilities grew by 26.8% to $159.3 million. Further, aggregate equity levels expanded by 8.6% to $495.423 million, attributed mainly to a 24.1% growth in retained earnings with some offset provided in other “miscellaneous” reserves that contracted by $26.9 million to $103.2 million.

In terms of earnings, the net income of domestic insurers more than double to $57.5 million from $24.7 million in the previous year. Underpinning this development was a 4.6% increase in total income to $494.8 million, while total expenses declined by 2.4% to $437.3 million. As a result, the respective return on equity (ROE) and return on assets (ROA) ratios strengthened by 6.2 percentage points to 11.6% and by 2.1 percentage points, to 3.8%, respectively. Likewise, the investment yield ratio rose by 90 basis points to 7.4%, as investment income grew. Conversely, the expense ratio firmed by 2.6 percentage points to 33.5%.

During 2020, financial soundness indicators for the life insurance industry registered mixed performances, although remaining above international benchmarks. As a measure of the liquidity of insurance companies, the real estate plus unquoted equities and receivables to total assets ratio, moderated by 2.3 percentage points to 14.6%, while the value of equities as a proportion of total assets—which are considered relatively higher risk—declined by 1.8 percentage points to 3.6%. Likewise, the real estate-to-total assets ratio fell by 10 basis points to 5.8%.

With regard to capital ratios, the net premium-to-capital ratio narrowed by 5.0 percentage points to 85.4%. In contrast, capital to total assets ratio firmed by 2.0 percentage points to 32.0%, while the capital-to-technical reserves ratio increased by 6.9 percentage points to 55.6% (see Table 6), remaining above the international benchmark of 7.0%-10.0%.

Table 6

Life Insurance: Financial Soundness Indicators (%)

	2014	2015	2016	2017	2018	2019	2020p
Capital Adequacy							
Capital/Total Assets	29.8	29.5	29.3	30.0	30.1	30.0	32.0
Capital/Technical Reserves	48.3	48.9	48.0	49.1	49.1	48.7	55.6
Net Premium/Capital	104.5	104.2	99.5	88.7	90.5	90.4	85.4
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	14.4	14.8	17.4	14.8	15.4	16.9	14.6
Equities/Total Assets	6.4	6.3	6.0	5.8	5.3	5.4	3.6
Real Estates/Total Assets	7.2	6.8	6.5	5.7	5.9	5.9	5.8
Earnings & Profitability							
Expense Ratio (expense/net premium)	29.3	29.6	29.5	28.5	30.4	30.9	33.5
Investment Yield (investment income/investment assets)	6.4	6.3	5.6	5.2	5.2	6.5	7.4
Return on Equity (ROE)	12.2	11.6	10.8	9.3	7.3	5.5	11.9
Return on Assets (ROA)	3.6	3.4	3.2	2.8	2.2	1.7	3.8

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

p = provisional

4.2. Non-Life Insurance

The less dominant non-life insurance segment reverted to trend in 2020. Specifically, non-life insurance assets reduced considerably to $682.3 million from $1.9 billion in 2019, occasioned to a sharp fall in re-insurance recoveries to $178.3 million (84.5%), which surged in the prior year to $1.1 billion, following claims settlement inflows for policy holders who were affected by Hurricane Dorian. Further, cash and deposits—which constituted 22.0% of the total—scaled back by $48.0 million (24.3%) to $149.9 million. Similarly, receivables—which represented 31.3% of total assets—decreased markedly to $213.8 million from $404.5 million a year earlier. Conversely, investments advanced by $12.3 million (11.5%) to $119.1 million, on account of a significant rise in preference shares, other "miscellaneous" investments and mutual funds, which outstripped reductions in government and corporate securities.

The sector's total liabilities decreased notably to $462.4 million (73.2%) from $1.7 billion in 2019, mirroring a significant contraction in "other" liabilities and technical reserves to $160.8 million and $301.6 million, from $310.3 million and $1.4 billion, respectively in 2019, which was associated with the temporary rise related to the major storm. In this environment, balance sheet equity advanced by 33.9% to $220.0 million, reflective of a surge in "other" reserves ($50.6 million) and higher retained earnings (27.4%), which outweighed the downturn in share capital (23.4%).

As a result, non-life insurance companies recorded an estimated net gain of $17.2 million in 2020, relative to a net loss of $27.1 million in the preceding year. Underlying this outturn, total expenses reduced by $60.0 million (39.5%) to $91.8 million, relative to a 44.5% accumulation a year earlier. Further, total income fell by $15.7 million (12.6%) to $109.0 million, a reversal from a 2.4% increase in 2019.

Financial soundness indicators were mostly positive for the non-life insurance sector in 2020 (see Table 7). As it relates to asset composition, the equities to total assets ratio more than doubled to 5.2% in 2020 from 2.0% in 2019. Similarly, other indicators improved, as the loss ratio—which measures whether net claims paid-out exceed net premiums collected—narrowed sharply to 12.6% from 61.8% in the prior year, while the expense ratio moderated by 2.5 percentage points to 73.8%. In addition, the ROA and the ROE recovered to 2.5% and 7.8%, following respective losses of 1.4% and 16.5%, in 2019. In an offset, the investment yield ratio recorded a loss of 0.6%, contrasting with a 6.7% increase in the preceding year.

Table 7

Non-Life Insurance: Financial Soundness Indicators (%)

	2014	2015	2016	2017	2018	2019	2020p
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	51.2	52.5	72.7	67.5	59.4	82.6	59.7
Reinsurance and Technical Reserves							
Risk Retention Ratio (net premiums /total gross premiums)	33.2	31.8	32.2	30.8	30.2	26.2	27.8
Technical Reserves/Net Claims	720.1	693.6	1110.5	1332.1	1241.3	2078.0	2259.2
Technical Reserves/Net Premiums	191.1	210.0	618.2	443.3	288.2	1285.1	284.0
Earnings & Profitability							
Expense Ratio (expense/net premium)	61.9	62.8	66.3	66.4	71.0	76.3	73.8
Loss Ratio (net claims/net premium)	26.5	30.3	55.7	33.3	23.2	61.8	12.6
Investment Yield (investment income/investment assets)	7.6	7.0	9.6	9.4	1.7	6.7	-0.6
Investment income/net premium	6.1	7.0	10.0	9.2	1.6	6.5	-0.7
Return on Equity (ROE)	12.9	8.9	-3.8	8.2	7.5	-16.5	7.8
Return on Assets (ROA)	5.3	4.0	-0.8	2.3	2.7	-1.4	2.5

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

p= provisional

Reinsurance ratios generally reflect the appropriateness of risk-minimizing policies in relation to negative events. In 2020, the risk retention ratio[8] increased by 1.6 percentage points to 27.8%. However, the ratio of capital to technical reserves returned to trend to around 137.1% from 859.3% in 2019, when hurricane proceeds influenced the notable rise in the ratio. Similarly, the technical reserves to net premiums ratio reverted to trend to 284.0%, from 1,285.1% a year earlier. Overall, the sector maintained adequate reserves to mitigate against the risk of significant negative shocks.

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

CHAPTER 5: ASSESSMENT OF RISKS

Despite the COVID-19 global pandemic, financial risks within The Bahamas remained contained in 2020, without material immediate nor medium-term threat to the stability of the sector. During the review year, SFIs had to adjust operations to comply with the Emergency Powers (COVID-19) Order, 2020 and regulations issued under the Order as a result of the pandemic.

The Central Bank remained focused on safeguarding and strengthening the resilience of the sector, with its release of the COVID-19 Guidance Notes, which provided certain temporary relaxed accommodations to SFIs to alleviate some of the difficulties presented by COVID-19. Focus was also on endorsing prudentially sound credit risk management policies, alongside a policy of leniency for domestic borrowers who were displaced from their jobs and unable to service their debt. In addition, owing to the uncertainty surrounding the severity of the impact of the pandemic, domestic banks maintained healthy capital buffers to absorb any credit losses.

Broad observations from consolidated results indicated that the domestic systemically important banks (DSIBs) remained resilient, despite the challenges posed by the pandemic. COVID-19 related credit exposures were well contained, as domestic banks and credit unions moved quickly to introduce loan payment deferral schemes to assist borrowers whose debt servicing capacity were adversely impacted. As deferment schemes conclude, it is expected that there will be a rise in NPLs in 2021, albeit posing no threat to financial stability, and with expanded provisioning already anticipating such adversity. In this context, the Central Bank will sustain it direct aggressive supervisory intervention to oversee the expansion of NPLs, through loss recognition, the enforcement of collateral (via foreclosures and asset sales) and debt restructuring where still feasible. Further, heightened oversight will also be on credit unions, which operate with very minimal excess capital.

Interest rate risks remained low for banks. Meanwhile, risks to near-term depletion of liquidity were negligible, in view of the high surplus of resources, sustained cautious lending posture and limited investment opportunities for surpluses. Given the potential for the liquidity overhang to fuel future credit expansion, the Central Bank's medium-term strategy continue to focus on some absorption of the excess, through a measured reduction in the Bank's holdings of Government securities.

Meanwhile, the medium-term framework for credit risk management strengthened, as the credit bureau operator, CRIF Information Services Bahamas Limited (CRIF Bahamas) initiated outreach activities in January, 2020. The operator also began testing of the reporting infrastructure with banks, with a target to go on-stream with live data during the second half of 2021. The credit bureau, strengthens the outlook for financial stability, as lending institutions will be able to better assess the creditworthiness of borrowers and to establish, both pricing and supply of credit by risk profiles.

The statutory underpinning of the crisis management and financial stability frameworks also strengthened in 2020, with a compendium of legislation to reform the Central Bank's governance structure, the approach to bank resolution and expansion of the deposit insurance safety net. In particular, the revamped Central Bank of The Bahamas Act, 2020, and the Banks and Trust Companies Regulation Act, 2020 establish a more comprehensive bank resolution and crisis management framework for The Bahamas. The framework mandates that SFIs must develop formal plans to resolve or liquidate their operations in the event of extreme crisis; and the Central Bank is also empowered to take an administrative approach in intervening to resolve trouble institutions. In addition, the Protection for Depositors (Amendment) Act 2020, further asserts the rights of the Deposit Insurance Corporation (DIC) regarding enhanced engagement and oversight of troubled domestic member institutions, including the ability of the DIC to exercise certain supervisory intervention, acting through the Central Bank. DIC was also expanded for the first time to domestic credit unions.

There is also modernized scope under the Central Bank of The Bahamas Act, 2020 to develop new monetary policy instruments. This would expand the Bank's capacity to develop market-based liquidity management tools and strengthen approaches to macro-prudential polices that promote financial stability.

The Bank also worked to define the regulatory framework for the digital currency, addressing key policy priorities, inter alia, for financial inclusion, interoperability, cyber security resilience and financial stability. Overlap with the government's digitization and cashless transactions initiative gained focus, as the Bank deepened its collaboration and preparation for the Government to use the Sand Dollar as its method for collections and disbursement of payments, especially in Family Island cash districts, where commercial banking services were absent or on a decline.

The near-term outlook is for continued gradual increase in financial sector liquidity as lending institutions maintain very conservative lending policies. The downside risk to the external reserves and riskier credit exposures are located more towards the medium to longer-term horizon, when lending policies are more likely to be relaxed. In the near-term, stress test results indicated that systemic risk of depletion of liquidity is negligible. Over the medium-term, it therefore remains important to sustain the strategy of measured reductions in the Central Bank's holdings of Government securities, through sales in the secondary market, to absorb significant portions of the surplus liquidity. Support for restrained holdings of Government debt has been enhanced, given the passage of the revised Central Bank Act, which places comprehensive limits on the Bank's financing to the Government, as well as the Public Debt Management Bill, which support the prudent management of the public debt[9]. These initiatives, will serve to further enhance and strengthen the supervisory regime in place to ensure the continued stability of the financial sector.

[9] The Public Debt Management Bill, 2020, enactment set for second quarter 2021.

CHAPTER 6: CONCLUSION

The Bahamas' domestic financial system remains sound and stable, in both the current assessment and the outlook. Therefore, the Central Bank will continue to pursue policies and reforms aimed at mitigating any potential risks to supervised financial institutions and strengthening of the regulatory environment. As vaccination efforts continue and the macroeconomic environment rebounds, efforts will persist to upgrade and complete the risk-based supervisory framework (Basel III) for banks and trust companies, while strengthening credit unions risk and governance systems. These measures entail an emphasis on increased buffers against risk, over the course of the business cycle for D-SIBs and maturity mismatches.

In addition, efforts will be sustained to improve oversight frameworks for the assessment and suppression of risks related to money laundering, terrorism financing, proliferation and other financial crimes, ensuring internationally compliant systems within SFIs. Further, the Bank will continue to strengthen the prudential oversight for domestic credit unions, as the enrolment in the deposit insurance scheme is expected to boost confidence in the sector. The credit bureau will also provide support for credit risk management. The Bank will also remain equally focused on the sustainability of the exchange rate arrangements, given the diverse channels through which this impacts financial stability prospects. The overall goal of the Bank is to maintain a financially sound and compliant financial sector, ensuring that prudent risk management practices are in place and economic growth is sustained.

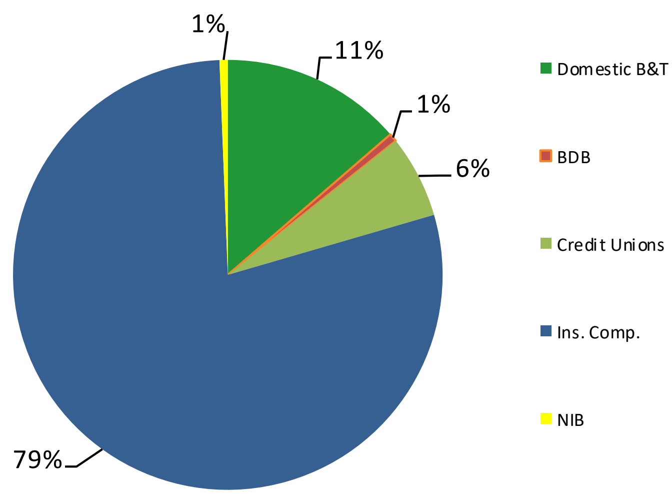
APPENDICES

Appendix 1

Structure of the Bahamian Financial System –Selected Highlights

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

Chart 1
Domestic Banks & Non-banks (Dec-20)



At end-2020, there were 217 banks and trust companies (see: Table 1, Appendix), which employed approximately 3,843 persons, with the largest single concentration in the 22 local domestic banks and trust companies[10] (3,124 persons). Other entities within the sector included 5 money transmission businesses (MTBs), 3 payment service providers, 10 local credit unions, 53 insurance companies, 340 financial & corporate service providers and 48 investment fund administrators. Within these operations, 8 of the banks and trust corporations operate either fully or in part within the domestic space, as well as 31 insurance companies. In addition, Government controlled public sector financial entities include: the Bahamas Development Bank (BDB), the National Insurance Board (NIB) and the Bahamas Mortgage Corporation

[10] There were 8 commercial banks in this total, representing the majority of the domestic assets.

(BMC)[11]. The Bahamas International Securities Exchange (BISX) is also an important component of the domestic financial sector; but with relatively small trading volumes and the absence of complex derivatives or other sophisticated instruments.

TABLE 1

Structure of the Financial System

	2014	2015r	2016r	2017r	2018r	2019	2020
Banks & Trusts							
International	237	233	232	225	211	199	195
Domestic	17	16	16	17	20	22	22
Total	**254**	**249**	**248**	**242**	**231**	**221**	**217**
Non-Bank Financial Institutions							
Investment Funds	830	885	859	783	748	725	713
Credit Unions	7	9	10	10	10	10	10
Insurance companies	143	148	142	144	151	160	159
Domestic Companies & Agents	122	116	112	115	118	127	127
External Insurers	21	32	30	29	33	33	32

r - revised

Source: Central Bank of The Bahamas

Banking Sector

At end-2020, the banking sector's balance sheet approximated $173.2 billion, of which international exposures dominated, accounting for $153.2 billion (90.5%) of the total. Domestic licensees (8 commercial banks and 14 mostly trust entities) held the remaining $19.6 billion (9.5%) of assets—which decreased by 8.6% in 2020—divided between domestic ($10.9 billion) and foreign ($8.7 billion) assets. Deposits served as banks' most significant source of funds, while the majority share of domestic assets (52.7%) consisted of credit to the private sector in the form of commercial, consumer and residential mortgages. In addition, holdings of Government and public sector debt securities accounted for respective shares of 15.9% and 2.1%. The majority of the sector's assets—in excess of two-thirds—were concentrated in the 3 largest banks.

Fiduciary assets under the care of trust companies were estimated at $223.2 billion and were almost exclusively held by international financial firms.

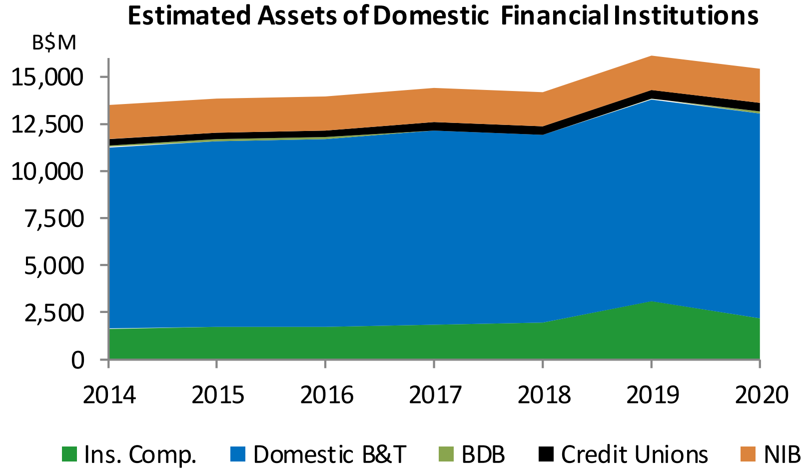
State Owned Enterprises

Major state-owned enterprises in the financial system include: the National Insurance Board (NIB or The Board), the Bahamas Mortgage Corporation (BMC) and the Bahamas Development Bank (BDB). NIB is

[11] There have also been a few Special Purpose Vehicles (SPVs) established within the last three years, to acquire a variety of financial assets, including: Bahamas Resolve Limited and Poinciana Limited.

considered systemically important for financial institutions' liquidity management practices. While NIB generally comprises sizable deposit holdings, the COVID-19 pandemic which led to a surge in unemployment claims by displaced workers, contributed to a significant drawdown in liquidity. Notwithstanding, neither BDB nor the BMC attract deposit funding for their lending operations and neither represent a systemically important source of credit expansion on an annual basis. BDB—which provides financing for small and medium-sized enterprises—recorded a 1.8% reduction in its assets base, to $34.4 million in 2020, largely reflecting a tightening of its balance of outstanding credit. At BMC, mortgages outstanding remained at an estimated $167.2 million for the year.

Chart 2
Estimated Assets of Domestic Financial Institutions



Source: Central Bank of The Bahamas

Credit Unions

Aside from commercial banks, credit unions are the only other deposit taking and loan granting institutions with an asset base of $482.3 million in December, 2020. At end-2020, the total membership of these cooperatives stood at an estimated 45,467 individuals. In 2020, the number of active credit unions—inclusive of the Co-operative League—was unchanged at 10. The market continued to be dominated by one institution, which represented approximately 46.5% of the sector's total assets, while smaller entities comprised more modest market shares, ranging from 0.3% to 14.9%.

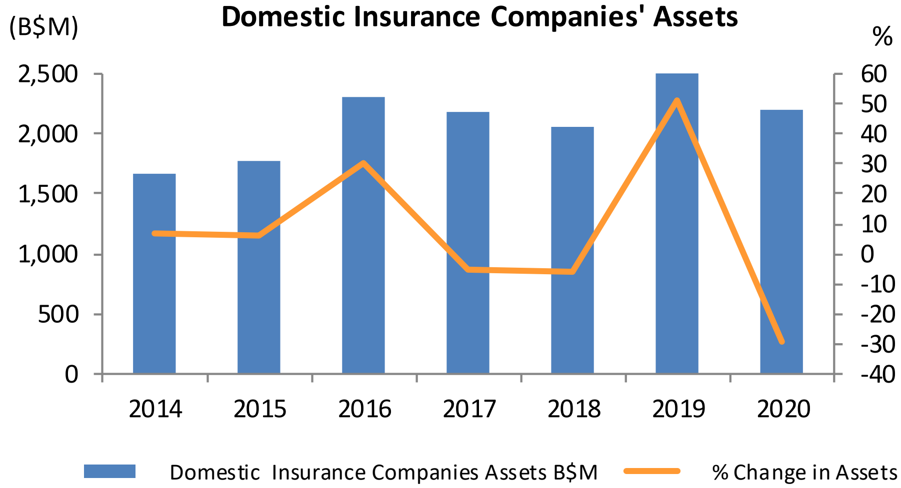
Insurance Companies

The Insurance Commission of The Bahamas (ICB) reported that operators within the sector consisted of 11 life and health insurers, offering whole life, term life and universal life; and 18 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—5 life insurers and 6 non-life insurers—which represent a combined market share of approximately 84.2% of total gross premiums written and the majority of insurance coverage as at December, 2020. The external insurance sector, which is registered under the External Insurance Act[12], mainly provides

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

self-insurance coverage for non-resident entities in other countries. In 2020, it comprised 38 entities, of which 21 were insurance companies and 17 were captive cells. The total asset base of the sector stood at $2.2 billion at end-2020.

Chart 3
Domestic Insurance Companies' Assets



Source: Insurance Commision of The Bahamas

Capital Markets

Although small, the domestic capital market is an important part of the financial landscape of the country. The Bahamas International Securities Exchange (BISX) lists and enables the trading of securities of local public companies, and Government's domestic bonds, which commenced listing in 2020.

While there are currently no financial stability concerns associated with the domestic capital market, performance indicators for the local equity market trended downward during the year, reflecting the contracted economic performance and uncertainty linked to the COVID-19 pandemic. The BISX All-Share Price Index decreased by 6.2% to 2092.46 points, contrasting with a 5.8% increase in the preceding year (see Chart 4). In addition, the volume of shares traded on BISX declined by 37.2% to 5.6 million, after a 3.9% growth in 2019. Correspondingly, the total value of shares traded reduced, by 34.8% to $27.9 million, following the 2.2% rise a year earlier.

In 2020, the index's market capitalization almost doubled to $8.8 billion, following a 2.6% uptick a year earlier and was due to the listing of Bahamas Registered Stock (BRS) on the Exchange (see Chart 5). The number of securities listed on the Exchange, excluding public debt instruments, fell by 1 to 37, and comprised 20 common shares, 7 preference shares and 10 debt tranches. However, inclusive of the 210 BRS, the debt tranches totalled 220, bringing the number of publicly traded securities on the exchange to 247. The five largest companies listed on the Exchange accounted for a dominant 81.4% of total market capitalization; up from 78.9% in 2019.

Payments System

With respect to the payment settlements infrastructure, the Real Time Gross Settlement System (RTGS) is owned and operated by the Central Bank and processes large value transactions (greater than $150,000). Smaller transactions are channelled through the Bahamas Automated Clearing House Association (BACH), which is owned by the clearing banks. During 2020, the total value of transactions processed through the RTGS advanced to $42.2 billion, from 32.2 billion in 2019. However, retail payments processed through the Bahamas Automated Clearing House (BACH) contracted to $4.6 billion, from $7.2 billion in the previous year.

In terms of other electronic-based payment instruments, the value of debit card transactions decreased by 7.8% to $1.8 billion in 2020. Similarly, credit card usage declined by 30.9% to $614.0 million. Additionally, the volume of ATM transactions was lower, by 28.0% at $8.0 billion, while the corresponding value fell by 2.9% to $2.0 billion. The reduction observed in electronic payments usage over the review period, was largely influenced by the COVID-19 pandemic, as a significant number of individuals in the tourism and retail sectors were furloughed or laid off, which impacted earnings and bank account balances. Thus, transactions levels were notably reduced. However, as the country slowly progresses toward a path of recovery, it is anticipated that payments activity will rebound.

Appendix 2

The Banking Stability Index

The Banking Stability Index (BSI) is an aggregate indicator of the soundness of the Deposit-Taking Institution sector. It was calculated as a normalized weighted average of key performance indicators, namely capital adequacy, asset quality, profitability and liquidity. Each variable was normalized using statistical standardization, which allows for the different variables to be on the same scale. The normalized range of values are from 0.0 to 1.0. An increase in the index value shows greater stability. The BSI is measured in standard deviations from the 8-year average.

The Aggregate Financial Stability Index

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

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