Financial Stability Report December, 2013

Issue No. 2

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

The Manager
Research Department
Central Bank of The Bahamas
P.O. Box N-4868
Nassau, Bahamas

www.centralbankbahamas.com
email address: research@centralbankbahamas.com

TABLE OF CONTENTS

EXEUCTIVE SUMMARY

During 2013, the Central Bank of The Bahamas (the Bank) continued to pursue its mandate of maintaining a healthy and stable financial sector. As such, the Bank, in collaboration with the Securities Commission and Insurance Commission—who are responsible for regulating the securities market and insurance industry, respectively—worked to ensure that all facets of the financial services industry operated in accordance with sound principles and best practices. This semi-annual report provides a discussion of the macroeconomic environment, both domestic and global, a synopsis of pertinent developments within the various segments of the financial sector, identifies potential risks and reviews the financial system's ability to withstand potential shocks and vulnerabilities.

Over the period, the regulatory bodies mandated to oversee the financial system, continued to monitor and evaluate the soundness and resiliency of banking, insurance and securities industries, through onsite and offsite examination, risk assessments and stress testing to internal and external shocks. These exercises are framed and informed by current developments in the global supervisory and regulatory space. The regulators' overall assessment of the financial system was largely positive, as institutions remained highly liquid and well capitalized, thereby mitigating any near-term financial stability concerns.

The prevailing domestic economic context featured a continuation of relatively mild recovery momentum, with real output growth easing to 0.7% from 1.0% in 2012. Tourism sector performance was constrained by ongoing weakness within key source markets and competition from alternative destinations, as the high value-added air component registered a decline and gains in the dominant sea segment moderated. However, construction sector activity remained buoyant, benefitting mainly from foreign investment funded tourism-related projects within New Providence and several Family Islands. Nonetheless, the narrowness of the recovery, and persistent weakness in private sector business conditions limited growth in employment opportunities. In this environment, private sector credit was anemic, reflecting both demand and supply constraints, with banks retaining their conservative lending stance, as arrears and non-performing loans continued to increase—although at a slower pace of growth than in previous years.

Against this backdrop, banks augmented their bad debt provisions which, together with higher operating costs and a falloff in revenue inflows, negatively impacted annual profitability outcomes. However, banking system liquidity stayed at high levels and banks' capital adequacy indicators remained above the Bank's 17% benchmark. The overall performance of the insurance sector improved slightly during 2013, supported by a marginal increase in the assets of life insurance companies, as the portfolio for non-life insurance providers declined relative to 2012. Nonetheless, the majority of the financial stability indicators for both life and non-life companies improved over the review period.

Domestic credit unions continued to be an important vehicle for savings and credit—registering strong gains in deposit liabilities and assets during 2013, with the latter concentrated in total loans outstanding High levels of liquidity persisted, and capital adequacy ratios stayed above the level required by international guidelines.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

During 2013, the global recovery lost some momentum relative to the previous year, as growth within both emerging markets and developing economies—which accounts for two thirds of the global expansion—slowed by 0.3 of a percentage point to 4.7%, and real GDP in developed markets stabilized at a modest 1.3%. As a consequence, global growth tapered by 20 basis points to 3.0%, year-on-year. As depicted in Table 1, gains in real output for the United States softened to 1.9% from 2.8% in 2012, occasioned by a slow-down in consumer spending and a reduction in Government outlays. Europe's economic performance improved over the year, as the expansion in the United Kingdom strengthened to 1.8% from 0.3% in 2012, and the contraction in the euro area's economy eased slightly, to 0.5% from 0.7%. Within the Asian economies, China's upward trajectory steadied at 7.7%, supported by gains in factory output and investment spending, while higher fixed investments contributed to a slight firming in Japan's output growth, to 1.5% from 1.4% in 2012.

Within the Caribbean region, real output gains slowed by 0.2 of a percentage point to 1.7%, as the majority of the island states recorded growth rates of under 2.0%, and Barbados registering a 0.7% contraction. In contrast, increased exports of agricultural goods and other commodities underpinned relatively stable real GDP growth in Guyana and Suriname, of 4.8% and 4.7%, respectively (see Table 2).

In the context of improving growth fundamentals, unemployment rates narrowed in most of the major economies—although ongoing challenges within southern Europe contributed to an increase in the euro area jobless rate. On the prices front, lower energy costs dampened inflationary pressures across most economies, with the exception of Japan, as the Government's implementation of its fiscal stimulus programme, resulted in an increase in consumer prices, compared to a relatively flat performance in the prior year.

Given the challenging economic environment, most major central banks maintained their highly accommodative monetary stance, to support economic growth. In the United States, the Federal Reserve kept its key bank rate at a historic low and continued with its 'quantitative easing' programme. Similarly, the Bank of England held its benchmark rate at a record 0.5% and the size of its Asset Purchase Programme at £375 billion. Amid the persistent recession in several southern member states, the European Central Bank (ECB) lowered its refinancing rate, by a total of 50 basis points, and its marginal lending rate, by 75 basis points during the year. In Asia, the People's Bank of China injected additional liquidity into the banking system to support lending, while the Bank of Japan implemented a US$520 billion per year stimulus program, which consisted of purchases of Government bonds (JGB's) and exchange–traded funds (ETFs).

TABLE 1

Selected Indicators for Developed Economies (%)

	2008	2009	2010	2011	2012	2013
GDP Growth Rates						
United States	-0.3	-3.1	2.4	1.8	2.8	1.9
Euro Area	0.4	-4.4	2.0	1.6	-0.7	-0.5
United Kingdom	-0.8	-5.2	1.7	1.1	0.3	1.8
China	9.6	9.2	10.4	9.3	7.7	7.7
Japan	-1.0	-5.5	4.5	-0.5	1.4	1.5
Unemployment Rates						
United States	5.8	9.3	9.6	9.0	8.1	7.4
Euro Area	7.7	9.6	10.1	10.2	11.4	12.0
United Kingdom	5.7	7.6	7.9	8.1	8.0	7.2
China	4.1	4.3	4.1	4.1	4.1	4.1
Japan	4.0	5.1	5.1	4.6	4.4	3.4
Inflation Rates						
United States	3.8	-0.3	1.6	3.1	2.1	1.5
Euro Area	3.3	0.3	1.6	2.7	2.5	1.3
United Kingdom	3.6	2.1	3.3	4.5	2.8	2.6
China	5.9	-0.7	3.3	5.4	2.6	2.6
Japan	1.4	-1.3	-0.7	-0.3	0.0	0.4

Sources: IMF, Internaional Statistical Bureaus

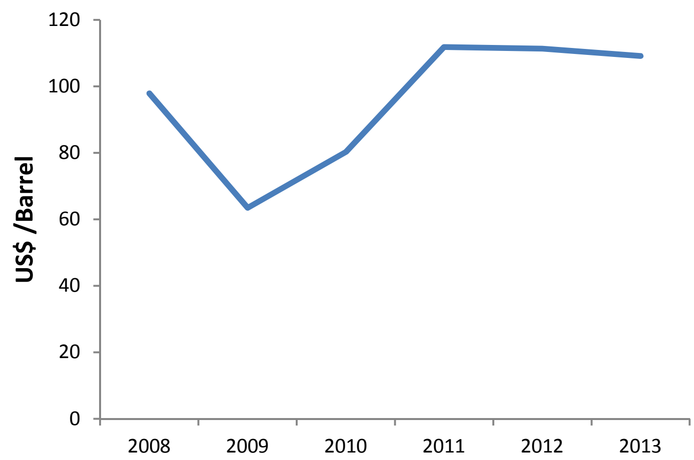
TABLE 2

Selectd Caribbean Countries GDP Growth Rates (%)

	2008	2009	2010	2011	2012	2013
Bahamas	-2.3	-4.2	1.5	1.1	1.0	0.7
Barbados	0.3	-4.1	0.2	0.8	0.0	-0.7
Belize	3.8	0.3	3.1	2.1	4.0	1.6
Eastern Caribbean	2.6	-5.2	-3.3	-0.1	0.2	0.7
Guyana	2.0	3.3	4.4	5.4	4.8	4.8
Jamaica	-0.8	-3.4	-1.4	1.4	-0.5	0.5
Suriname	4.1	3.0	4.2	5.3	4.8	4.7
Trinidad & Tobago	3.4	-4.4	0.2	-2.0	1.2	1.6

Sources: IMF, International Statistical Bureaus, Regional Central Banks

Chart 1
Oil Prices (Brent Crude Oil Index)



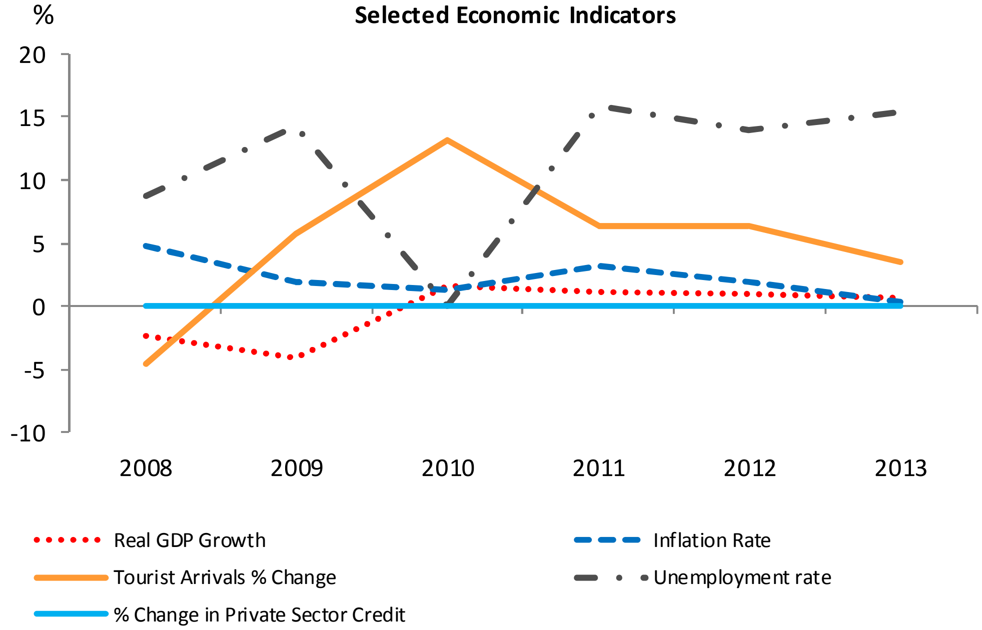
Source: Bloomberg

1.2. The Domestic Environment

During 2013, the pace of the domestic recovery slowed marginally, to 0.7% from 1.0% in 2012, reflecting the ongoing softness in tourism performance. Growth in overall tourist arrivals was markedly lower at 3.5% from the 6.3% rebound in the prior period, as the combination of sustained weakness in several key source markets, rising competition from other regional destinations and a modest decrease in room and airlift capacity led to a 5.7% contraction following a year-earlier gain of 7.1%. In contrast, the dominant sea segment—at 79.2% of the total—firmed by 6.3%, in line with the previous year's expansion. Construction sector output continued to benefit from foreign investment funded projects, dominated by the multi-billion dollar Baha Mar project in New Providence. However, domestic private sector construction activity remained weak, amid the generally anemic and narrow-based recovery. With business conditions remaining challenging, the unemployment rate firmed by 2.2 percentage points to 16.2% in the six months ending May 2013, before declining by 80 basis points to 15.4% at end-November. Domestic price conditions, however, were favorable, as average consumer price inflation slowed to 0.36% from 1.97% in 2012, in line with a falloff in global oil prices.

In fiscal developments, the overall deficit widened by 21.2% ($95.5 million) during FY2012/13 to $546.1 million, reflecting a 6.4% ($92.1 million) decline in revenue and a marginal 0.2% ($3.4 million) rise in total spending. The deficit was financed mainly from domestic sources, with external project loan financing accounting for the balance of the funding.

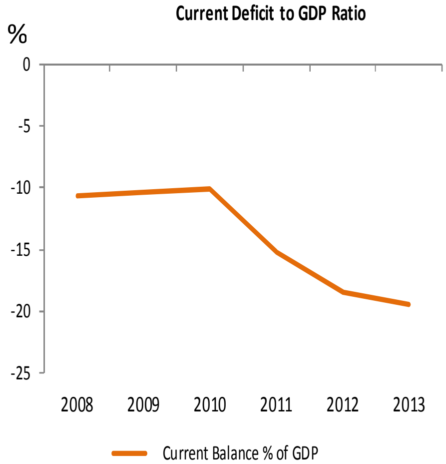
Chart 2
Selected Economic Indicators



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

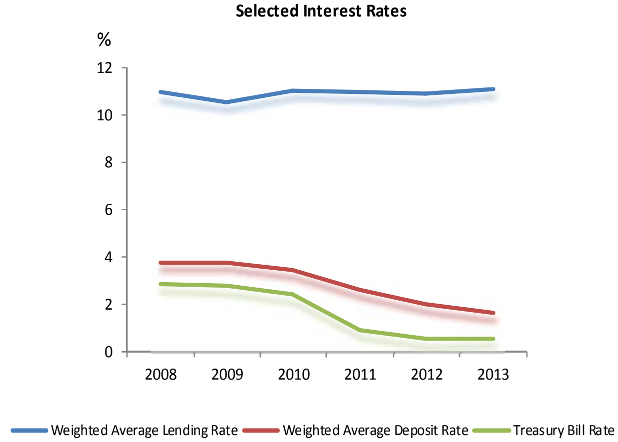
In the external sector, the estimated current account deficit for 2013 deteriorated by 8.8% ($131.9 million) to $1,636.7 million (see Chart 3). This outturn was mainly due to a surge in payments for foreign investment-related construction services, which curtailed the services account surplus; however, the merchandise trade deficit narrowed modestly. On the capital and financial account, a falloff in net foreign direct investment inflows and lower public sector external borrowings contributed to a $316.3 million reduction in the surplus to $990.0 million.

Chart 3
Current Deficit to GDP Ratio



Source: Central Bank of The Bahamas

Chart 4
Selected Interest Rates



Source: Central Bank of The Bahamas

Monetary developments featured a continuation of elevated banking sector liquidity, amid the softness in private sector demand and banks' conservative lending practices. In this context, the weighted average interest rate spread widened, as the average deposit rate declined while the average loan rate increased (see Chart 4). In contrast, banks' overall profitability contracted, due mainly to an expansion in staff outlays, as well as increased "miscellaneous" expenses, related to higher Government licenses fees, while revenue from interest income was reduced.

TABLE 3:

The Bahamas: Macroeconomic Indicators

	2008	2009	2010	2011	2012	2013
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	-0.9	-5.2	1.1	0.3	3.6	2.5
Real GDP Growth Rate (%)	-2.3	-4.2	1.5	1.1	1.0	0.7
Inflation Rate (Average chg in RPI)	4.7	1.9	1.3	3.2	2.0	0.4
Unemployment Rate	8.7	14.2	N/A	15.9	14.0	15.4
Overall Fiscal Balance (B$M)	-186.6	-403.1	-376.7	-319.8	-557.3	-484.9
as % of GDP	-2.3	-5.2	-4.8	-4.1	-6.8	-5.8
Private Sector Credit (B$000)	6536.8	6595.9	6572.7	6647.5	6629.3	6514.2
Weighted Average Lending Rate %	11.0	10.6	11.0	11.0	10.9	11.1
Weighted Average Deposit Rate %	3.8	3.8	3.4	2.6	2.0	1.7
Treasury Bill Rate %	2.9	2.8	2.4	1.0	0.6	0.7
Gross Int'l Reserve (B$M)	562.9	815.9	860.4	884.8	810.2	741.6
Import Cover Ratio (Non-Oil (CIF) in weeks)	13.1	20.8	21.6	19.7	16.0	15.5
Current Balance (B$M)	-871.7	-808.5	-796.8	-1192.7	-1504.8	-1634.5
as % of GDP	-10.6	-10.3	-10.1	-15.2	-18.5	-19.4
Total Public Sector Debt (B$M)	3634.5	4266.1	4799.7	4952.5	5765.9	6338.8
of which: External	443.7	767.3	915.9	1043.8	1460.0	1601.7
Internal	3190.9	3498.8	3883.8	3908.7	4314.1	4737.0
Total Arrivals ('000s)	4393.6	4645.1	5254.8	5587.6	5940.2	6150.8
Tourist Expenditure (B$M)	2501.0	2014.2	2163.2	2141.6	2311.4	2053.7
Construction Number of Permits Issued	3184.0	2416.0	1996.0	1966.0	N/A	N/A
Value of Starts (B$M)	399.6	360.9	154.2	131.1	N/A	N/A
Value of Completion's (B$M)	427.1	297.0	337.6	482.7	N/A	N/A
Oil Prices (Brent Crude Oil Index)	97.9	63.5	80.3	111.8	111.4	109.1

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

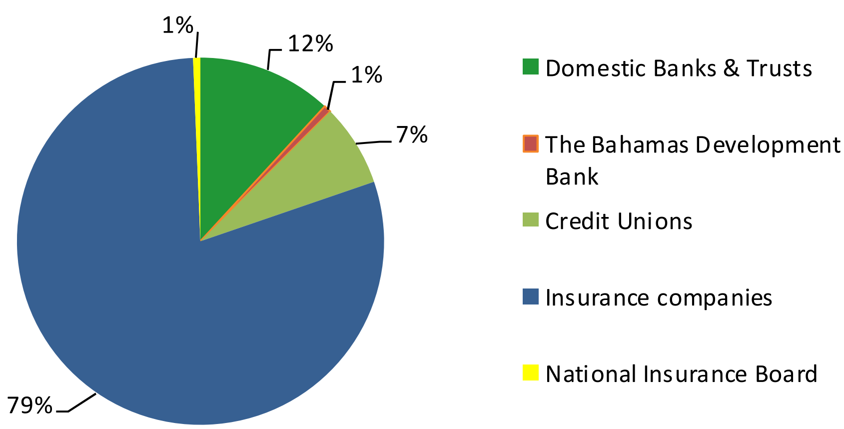
N/A - Not Available

CHAPTER 2: FINANCIAL SYSTEM OVERVIEW

2.1. Overview of The Financial System

The Bahamian financial sector, which is responsible for an estimated 15% of the country's GDP, has grown in significance over the last few decades. In terms of its structure, the financial sector includes domestic banks & trusts, the Bahamas Development Bank, money transmission businesses (MTBs), credit unions, insurance companies, financial and corporate service providers, capital market enterprises, and the National Insurance Board (see Chart 5). The sector has over 400 banks and non-banks, and an employment count in excess of 6,500 individuals. Comprising the international financial market are offshore banks and trust companies (249) mutual/investment funds (753), International Business Companies (IBCs) (169,575), and private trust companies (PTCs) (98), while domestic banks totalled 18 (see Table 4).

Chart 5
Domestic Banks & Non-banks (2013)



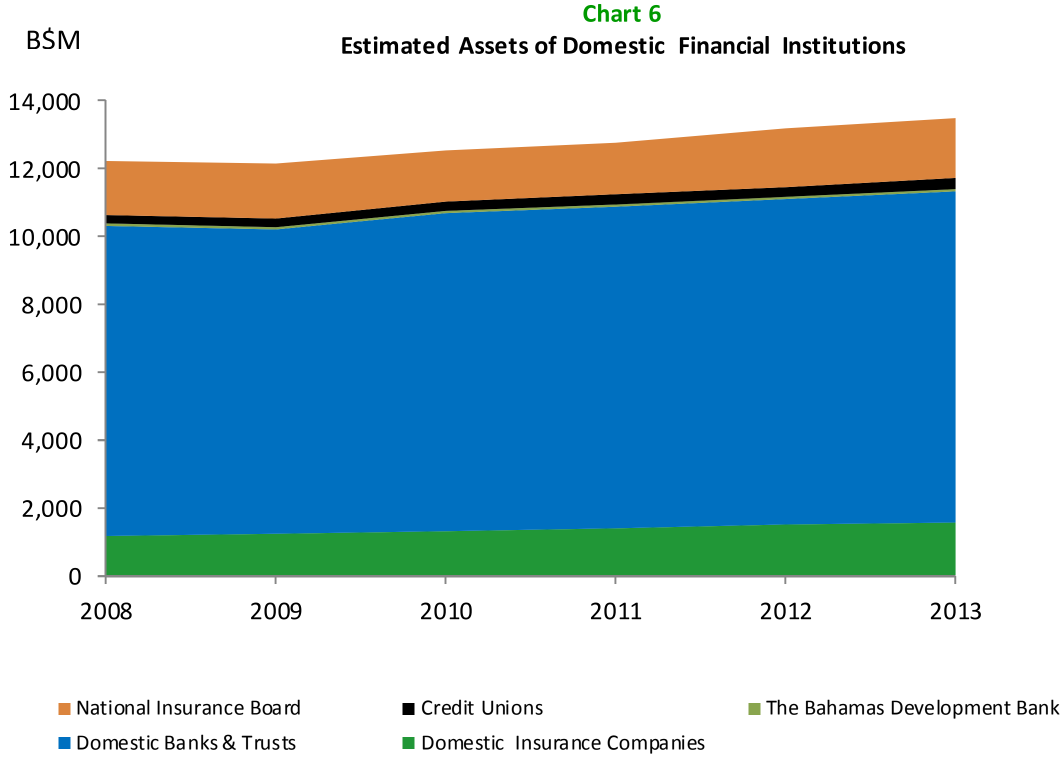
Source: Central Bank of The Bahamas

In total, the banking industry recorded approximately \$321.2 billion[1] in assets, the majority of which are held by offshore banks (\$243.8 billion), followed by domestic banks (\$76.8 billion), while The Bahamas Development Bank constitutes the smallest percentage (\$0.6 billion). Among non-banks, mutual funds command the bulk of the assets (\$127.9 billion); next were insurance companies (\$1.6 billion), and then credit unions (\$327.6 million).

Within the domestic sector, the dominant share of the assets are held by domestic banks and trusts, followed by the National Insurance Board and domestic insurers (see Chart 6).

[1] The Bahamian Dollar is equivalent to the U.S. Dollar.

Chart 6
Estimated Assets of Domestic Financial Institutions



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

2.2. Domestic Banks & Trusts

Banks and trust companies comprise commercial banks, other local financial institutions (OLFIs) and offshore banks, which are regulated by the Central Bank under the Banks and Trust Companies Regulations Act, 2000. During 2013, the number of banks and trust companies declined marginally, by 1 to 267 (see Table 4), as the offshore bank count declined by 1 to 248, while the domestic banks steadied at 19. Domestic banks and trust companies' assets advanced by $171.2 million (1.8%) to $9.8 billion at end-2013. Conversely, the assets of offshore banks contracted by 15.0% to $243.8 billion, owing to a reduction in the market placements held with entities domiciled outside The Bahamas, combined with individual licensees' decisions to alter their treasury funding models.

TABLE 4 Structure of the Financial System						
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Banks &Trusts						
Offshore Banks	251	252	256	260	249	248
Domestic Banks	20	20	20	18	19	19
Total	**271**	**272**	**276**	**278**	**268**	**267**
The Bahamas Development Bank	1	1	1	1	1	1
Non-Bank Financial Institutions						
Mutual Funds	867	788	753	713	652	753
International Business Companies	157,703	160,383	160,793	163,499	166,342	169,575
Credit Unions	14	13	13	13	13	7
Insurance Companies	166	174	178	127	139	147
Domestic Companies & Agents	*143*	*154*	*157*	*114*	124	128
External Insurers	*23*	*20*	*21*	*13*	15	19
National Insurance Board	1	1	1	1	1	1

Source: Central Bank of The Bahamas

2.2.1. The Bahamas Development Bank

As the only state-owned lending institution[2], the Bahamas Development Bank is regulated by the Bahamas Development Bank Act, 1974. This entity provides funding for investments in agriculture, fisheries, tourism, manufacturing and transportation services, which have the potential to positively contribute to the growth and development of the domestic economy. In 2013, total assets declined by $3.7 million (5.7%) to approximately $61.7 million, year-on-year. This outcome was mainly due to a broad-based reduction in loans extended, by $2.1 million (5.2%) to $38.9 million, while balances held with Other Local Financial Institutions (OLFIS) were nearly halved to $2.6 million.

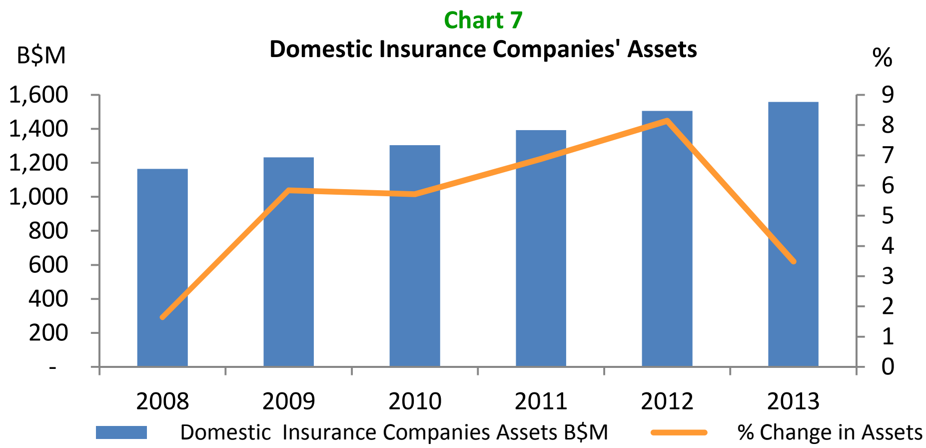
2.3. Non-Bank Financial Institutions

2.3.1. Insurance Companies

Insurance companies and insurance intermediaries are non-bank institutions regulated by the Insurance Commission of The Bahamas (ICB) and governed by the Insurance Act of 2005 and the External Insurance Act, 2010. At end-2013, the number of insurance companies and intermediaries stood at 147, an increase of eight (8) over the previous year, compared with 12 to 139 in 2012. The number of domestic insurers rose by two (2) to 26, and external insurers were higher by four (4) to 19. Provisional statistics for 2013

[2] The Central Government also holds shares in the Bank of The Bahamas International (BOB); however, it does not possess a controlling interest.

indicated that the value of domestic insurance companies' assets firmed by 3.5% ($52.5 million) to $1.56 billion, moderating from 2012's gain of 8.1% ($113.4 million) (see Chart 7). Correspondingly, total gross premiums advanced by $15.5 million (2.1%) to $745.0 million, markedly below the $43.6 million (6.4%) improvement for 2012, signalling that the market has reached a level of maturity.



Source: Insurance Commision of The Bahamas

2.3.2. The National Insurance Board (NIB)

The positive growth momentum in NIB's portfolio was sustained during 2013, as the value of total assets was higher by $39.6 million (2.3%) at $1.77 billion, extending the previous year's increase of $19.1 million (1.1%). The bulk of the assets are invested in Bahamas Government Registered Stock (BGRS), which decreased by $42.1 million (6.1%) over the review period, while holdings of equity securities rose by $48.1 million (70.1%) and net investments in finance leases, firmed by $32.6 million (34.3%).

2.3.3. Credit Unions

Governed by the Cooperatives Societies Act, 2005, credit unions continue to develop as an alternative to traditional commercial banks—currently offering a variety of saving and loan services to over 38,000 members. During 2013, credit unions' total assets grew more strongly, by 16.7% ($46.8 million), to $327.6 million, following 2012's gain of 3.8% ($10.2 million). Assets were concentrated in the loans category (69.3%), which firmed by 13.2% ($26.4 million) to $227.0 million—of which consumer loans comprised the largest component (72.5%), followed by mortgages (20.0%) and revolving lines of credit (7.3%).

Total deposits advanced by 16.7% ($39.4 million) to $274.7 million at end-2013, exceeding the 2.5% ($5.6 million) growth recorded in 2012. Extending the buffer against any potential losses, the capital & surplus position improved by 12.8% ($4.3 million) to $38.4 million.

Box 1: Credit Union Transition Project Update

The project to transition credit unions from the supervisory responsibility of the Department of Cooperative Development within the Ministry of Agriculture and Marine Resources to the Central Bank, gained momentum in 2013. The proposed legislative framework, that will govern the new prudential oversight regime for credit unions, took definitive shape in 2013, with the Central Bank issuing four (4) pieces of draft legislation for public consultation, namely the draft Cooperative Credit Unions Bill, the draft Cooperative Credit Unions Regulations, the draft Central Bank of The Bahamas (Amendment) Bill and the draft Cooperative Societies (Amendment) Bill.

Following extensive consultation with the industry, these documents were placed on the Bank's website for period of one month, to facilitate wider public consultation. Near year-end, the Central bank engaged the sector in a final review of the draft provisions, with a view to advancing the drafts through the final legislative approval process.

2.3.4. Other Non-Bank Institutions

The Securities Commission of The Bahamas has responsibility for the supervision of mutual funds, the domestic capital market and financial and corporate service providers—activities correspondingly governed by the Securities Industry Act, 2011, the Investment Funds Act, 2003 and the Financial and Corporate Service Providers Act, 2000. The Registrar General's Department oversees the activities of International Business Companies (IBCs) to ensure that they comply with the International Business Companies Act, 2000.

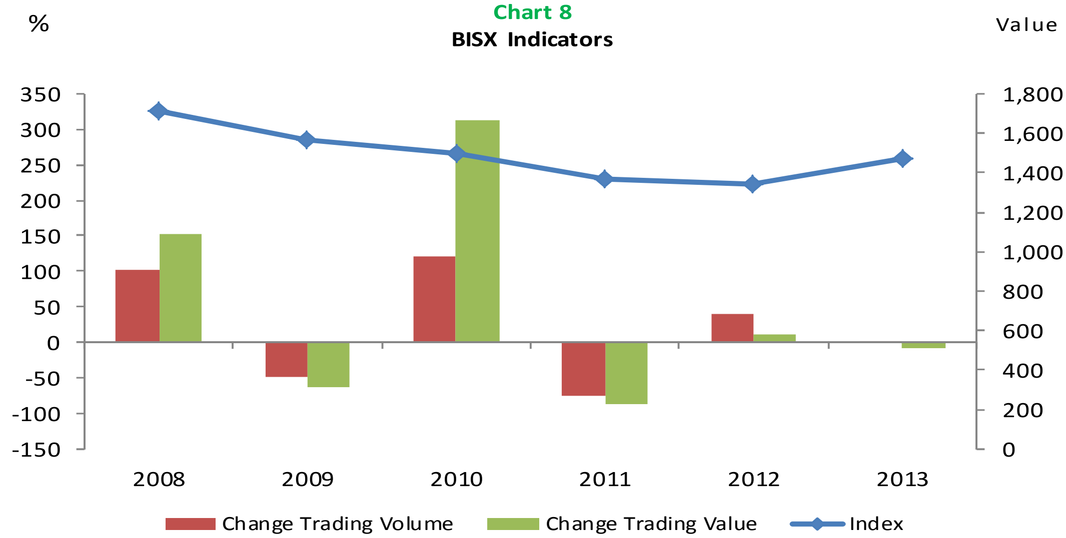
Second to offshore banking activity in terms of size, the mutual funds industry continued to positively impact the overall financial services sector—recording growth in both the number of entities registered and the sector's total assets. The number of active funds increased by 101 (15.5%) to 753 by end-2013, a reversal from a decline of 61 (8.6%) in 2012. Net asset values grew by 13.6% ($15.3 million) to $127.9 billion, although below the previous year's 29.6% ($25.7 million) gain, largely associated with the rebound in the number of fund registrants.

Data obtained for IBCs signal further growth in the number of registrants. The number of IBCs rose by 1.9% to 169,575 at end-2013, as an estimated 3,233 firms were registered compared with 2,843 (1.7%) in 2012.

The Bahamas International Securities Exchange (BISX) is the main market for the trade of domestic private sector securities, and second only to the Government debt market in terms of size. During 2013, the capitalization of all of the shares on the market firmed by $128.0 million (4.5%) to $3.0 billion, while the number of listings—which typically consists of common and preference shares and debt tranches—held steady at 27.

As shown in Chart 8, after four (4) consecutive years of decline, the BISX All Share Index[3] recovered by 9.1% to 1,468, largely attributed to broad-based share price appreciations. The volume and value of shares traded rose by 0.1% (3.2 million) to 4.1 million and by 7.8% ($1.5 million) to $17.4 million—moderating from year-earlier gains of 39.8% and 11.3%, respectively for 2012, which was linked to the listing of the shares of a major port development company and an insurer.

Chart 8
BISX Indicators



Source: Bahamas International Securities Exchange (BISX)

[3] This is a market capitalization weighted index that consists of all primary market listings, excluding debt securities.

CHAPTER 3: BANKING SECTOR

As a major center for international banking, the size of the offshore sector is significantly larger than the domestic side, given the predominance of private banking and wealth management activities for a global clientele. In contrast, domestic commercial banks cater almost exclusively to residents of The Bahamas, providing services such as deposit and credit facilities.

In line with this focus, the Bahamian banking sector, at end-December 2013, consisted of one-hundred and nine (109) public licensees, of which ninety-nine (99) were offshore banks with total assets of $232.9 billion, while the domestic component encompassed eight (8) commercial banks and eleven (11) OLFIs, with a combined $9.8 billion in total assets—less than 5% of the offshore component.

Given the country's Exchange Control regime, offshore banks are not permitted to undertake domestic business activities, including investments in Government securities. As a result, their operations are unlikely to have a direct impact on domestic financial stability and, therefore, this report focuses on the onshore banks.

3.1 Domestic Banking Sector

Of the eight (8) domestic banks, three (3) institutions are publicly listed on BISX, while the remaining five (5) are foreign-owned. During 2013, the sector continued to be dominated by the three (3) largest banks, which control two-thirds of the aggregate assets. Overall, these banks are very conservative in their operations, as they are funded primarily from deposits and provide predominately mortgage and consumer loan financing to their clients—although each institution tends to specialize in different segments of the market. On average, banks also maintain high levels of liquidity in the form of balances with the Central Bank and investments in Government paper.

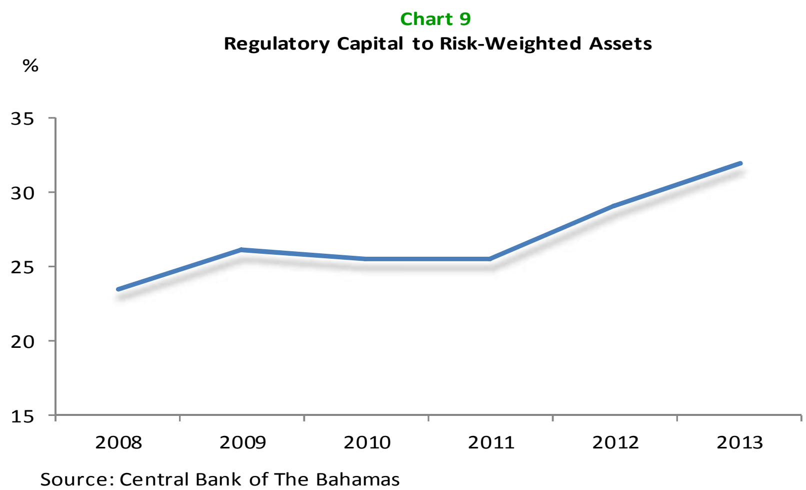
3.1.1 Capital Adequacy

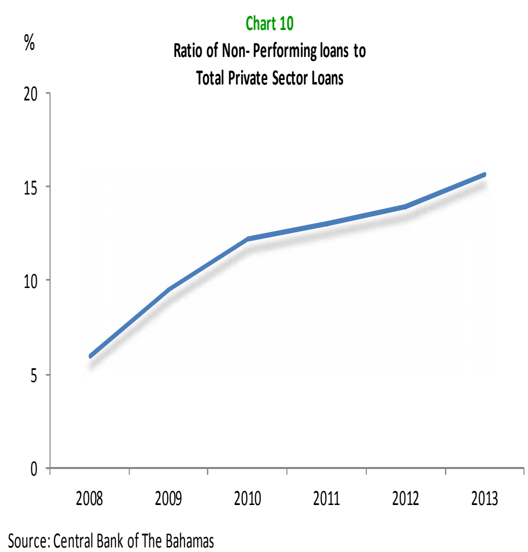
As depicted in Chart 9, banks remained well capitalized in 2013, with their aggregate Tier 1 ratios rising by 2.9 percentage points to 32.0%, significantly above the Bank's target and minimum requirement ratios of 17% and 14%, respectively, and well in excess of the 8% international benchmark.

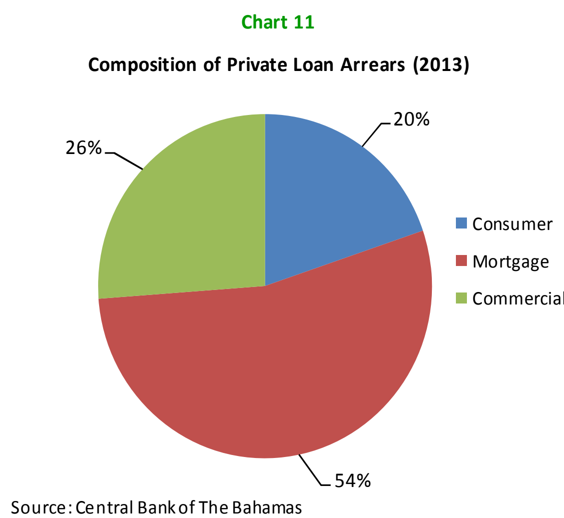
3.1.2 Asset Quality

Banks' credit quality indicators worsened in 2013, due mainly to the deterioration in one entity's loan portfolio. Total private sector loan arrears rose by $101.7 million (8.1%) to $1,352.2 million, outpacing the previous year's 3.5% expansion (see Chart 10). Consequently, arrears firmed by 1.9 percentage points to 21.9% of total private sector loans. In particular, non-performing loans (NPLs) grew by $98.4 million (11.4%) to $966.0 million, extending the year-earlier 6.3% growth, while the short-term (31-90 day) component advanced by $3.2 million (0.8%) to $386.2 million, in contrast to 2012's 2.3% reduction. As a result, at end-December, short-term arrears and non-performing loans comprised 28.6% and 71.4% of total private sector arrears, respectively.

The deterioration in overall credit quality was led by commercial arrears, which surged by $83.1 million (30.7%) to $353.9 million, extending the previous year's 5.5% contraction—in line with the observed weakness in business conditions. The dominant mortgage component—at 54% of the total[4]—also rose by $31.4 million (4.5%) to $730.9 million, whereas consumer delinquencies fell by $12.9 million (4.6%) to $267.4 million.







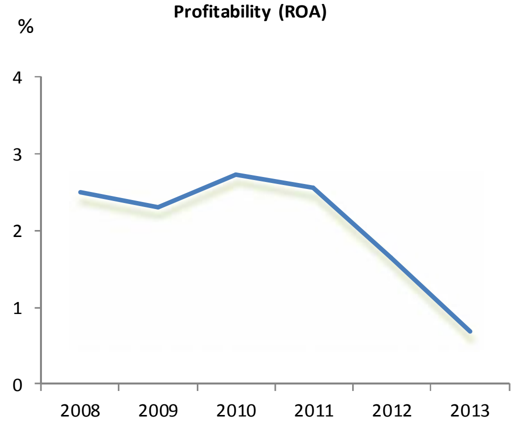
[4] See Chart 11

3.1.3 Profitability

Banking sector profitability declined modestly in 2013, mainly reflecting higher operating costs. On the revenue side, interest income—which accounts for the bulk of the sector's revenue—decreased by $21.0 million (3.1%) to $646.1 million, although eclipsing the $27.1 million (18.7%) reduction in interest expense to $117.8 million. Operating costs rose by $40.5 million (13.3%) to $344.5 million, on account of expansions in "miscellaneous" operating costs (18.4%) and staff outlays (12.0%). Providing some offset, the losses from "non-core" operations—which include fees & charges—moderated by $25.1 million (27.0%) to $68.1 million, owing primarily to a decrease in the level of provisioning for bad debt, which outpaced the rise in depreciation expenses and fee-based income (see Charts 12 & 13).

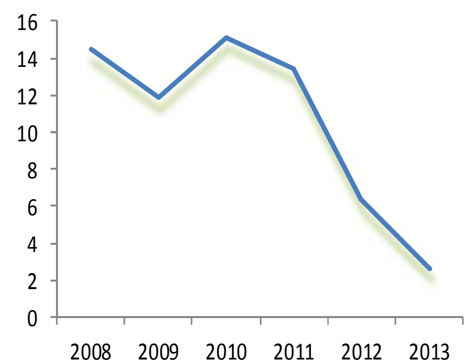
For the year, banks' net income decreased by $9.0 million (6.1%) to $139.0 million, with the interest rate spread and return on assets (ROA) ratios softening, by 48 and 10 basis points, to 6.85% and 1.43%, respectively.

Chart 12
Profitability (ROA)



Source: Central Bank of The Bahamas

Chart 13
Profitability (ROE)



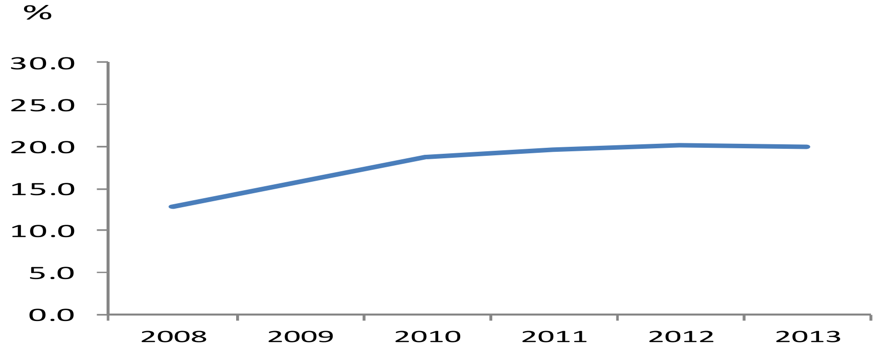
Source: Central Bank of The Bahamas

3.1.4 Liquidity

As shown in Chart 14, bank liquidity levels remained buoyant in 2013, reflecting a combination of Government's foreign currency borrowing proceeds and subdued lending conditions, as consumers continued to repair their balance sheets. Banks' excess reserves—a narrow measure of liquidity—averaged $380.3 million in 2013, a gain of 5.3% over 2012 and, at end-December, stood 26.2% higher at $407.4 million.

The broader excess liquid assets—which include holdings of Government securities—averaged $1.1 billion per month, 17.5% in excess of 2012 levels. At year-end, excess liquid assets stood at $1.1 billion, an increase of 17.6% over 2012, to constitute approximately 115.1% of the statutory requirement.

Chart 14
Liquid Assets to Total Assets

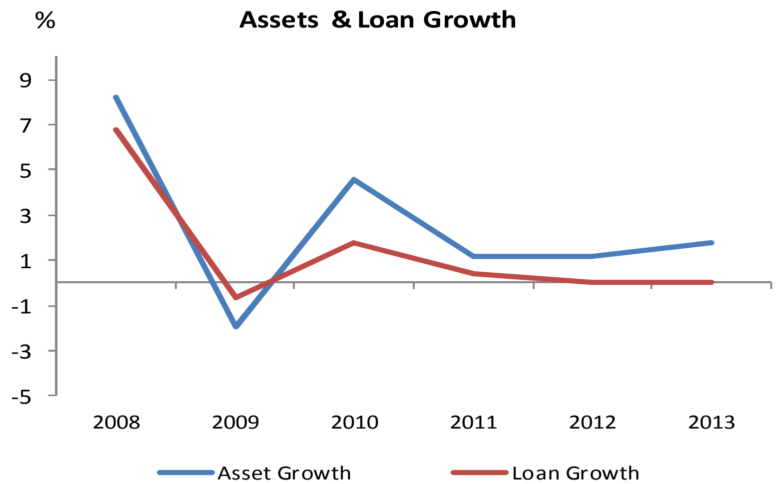


Source: Central Bank of The Bahamas

3.1.5. Growth in Assets

Total domestic assets of the banking system firmed by 1.8% in 2013, following a 1.2% rise in the prior year. In the underlying developments, security holdings advanced by 13.4% ($176.6 million), extending the year-earlier 4.6% increase, owing to gains in Central Government and private sector security holdings, of 14.8% ($174.2 million) and 17.2% ($2.4 million), respectively. Similarly, loans and advances were 0.2% ($12.8 million) higher, as the 66.4% ($101.2 million) expansion in Government loans and advances, offset the 2.6% ($8.7 million) reduction in public corporations' loans and the 1.2% ($79.8 million) decline in the private sector segment. Further, other assets and till cash rose by 4.2% ($20.8 million) and 8.4% ($10.7 million), while balances with the Central Bank were lower by 8.8% ($49.7 million).

Chart 15
Assets & Loan Growth



Source: The Central Bank of The Bahamas

At end-2013, the domestic banking system's assets were dominated by loans and advances (72.8%), followed by securities (15.3%), balances with the Central Bank (5.3%), "other" assets (5.2%) and till cash (1.4%) (see Table 5).

TABLE 5

Summary of Total Domestic Assets of the Banking System (B$M)

	2008	2009	2010	2011	2012	2013
Total Domestic Assets	**9,147.3**	**8,970.8**	**9,382.6**	**9,489.0**	**9,602.1**	**9,774.9**
Loans and Advances	**6,997.3**	**6,951.1**	**7,075.5**	**7,103.7**	**7,106.0**	**7,120.4**
Government	145.8	76.5	180.3	145.7	152.4	253.6
Public Corp.	343.5	305.9	339.8	326.8	338.5	369.2
Other	6,508.0	6,568.7	6,555.3	6,631.1	6,615.2	6,497.7
Other Assets	**870.1**	**479.4**	**449.0**	**441.6**	**491.6**	**512.3**
Till Cash	**117.6**	**111.8**	**113.2**	**126.9**	**127.4**	**138.1**
Balance with Central Bank	**322.3**	**375.6**	**518.7**	**560.1**	**563.3**	**513.6**
Securities	**840.0**	**1,052.9**	**1,226.3**	**1,256.7**	**1,313.9**	**1,490.5**
Central Government	713.6	918.6	1,093.3	1,123.0	1,180.4	1,354.6
Rest of Public Sector	97.5	107.0	115.6	117.4	119.4	119.4
Private Sector	28.8	27.2	17.4	16.4	14.1	16.6

Source: Central Bank of The Bahamas

3.1.6. Loan Rates

Banks' weighted average loan rate increased by 22 basis points to 11.1% in 2013 (see Table 6). This outturn was due solely to an equivalent rise in the dominant consumer loan segment, to 13.65%, while average interest rates on residential and commercial mortgages fell, by 24 and 8 basis points, to 7.26% and 8.21%, respectively.

TABLE 6

Banking System Loan Rates (%)

	2008	2009	2010	2011	2012	2013
Weighted Average Rate	11.0	10.6	11.0	11.0	10.9	11.1
Consumer Loans	13.0	12.7	13.2	13.4	13.4	13.7
Residential Mortgages	8.4	8.3	8.1	7.8	7.5	7.3
Commercial Mortgages	8.7	8.6	8.8	8.4	8.3	8.2

Source: Central Bank of The Bahamas

3.1.7. Deposit Rates

Amid the high levels of liquidity in the banking system, the weighted average deposit rate fell by 34 basis points to 1.68% in 2013 (see Table 7), reflecting broad-based declines in the various categories. Average rates on savings deposits decreased by 56 basis points to 0.97%, and by 14 basis points on demand deposits to 0.31%. In addition, the average range of rates on fixed balances narrowed, to 1.35% - 2.20%, from 1.60% - 2.65% in 2012.

TABLE 7

Banking System Deposit Rates (%)

	2008	2009	2010	2011	2012	2013
Weighted Average Rate	3.8	3.8	3.4	2.6	2.0	1.7
Savings Deposits	2.2	2.1	1.9	1.7	1.6	1.0
Fixed Deposits						
Up to 3 Months	3.7	3.6	3.2	2.3	1.6	1.4
Up to 6 Months	4.1	3.9	3.6	2.7	1.9	1.4
Up to 12 Months	4.6	4.3	4.0	3.2	2.5	2.2
Over 12 Months	4.4	4.4	4.0	3.2	2.7	2.2

Source: Central Bank of The Bahamas

3.1.8 Stress Testing Analysis

During 2013, the Bank continued to conduct top-down stress tests to assess the resilience of the banking sector to adverse shocks, inclusive of credit, domestic interest rate and liquidity risks, using prudential returns submitted by the domestic commercial banks and quarterly real economic forecasts for the years 2013 through 2015. The stress testing framework model showed predominately positive results for the years reviewed.

Credit Risk Stress Tests: The continuing framework for the credit risk stress test model applied shocks of 100%, 200% and 300% to the forecasted non-performing loan (NPL) rates, with the provisioning rate held constant from year-to-year. From a systemic perspective, the credit risk stress test results indicated that banks remained resilient to the shocked NPL level of 100%, which is based on the forecasted levels, despite negative earnings, which will be impacted by increased provisions and continued loss of interest income. With weak economic conditions and subdued growth, NPL levels are expected to remain over $900.0 million—the current level. However, under a scenario where NPL levels increase by 200% and 300%, respectively, owing to severely weakened economic conditions, the model predicts that banks will need to inject additional capital resources. Chart 16 shows that at the current (c) levels, the capital adequacy ratio (CAR) remains above or at 30%; however, with the decreasing levels of net income over the period, at various shocks—due to anticipated deterioration of loans—the CAR decreased to around 10.0%, which is below the trigger/target ratios of 14%/17%.

Chart 16

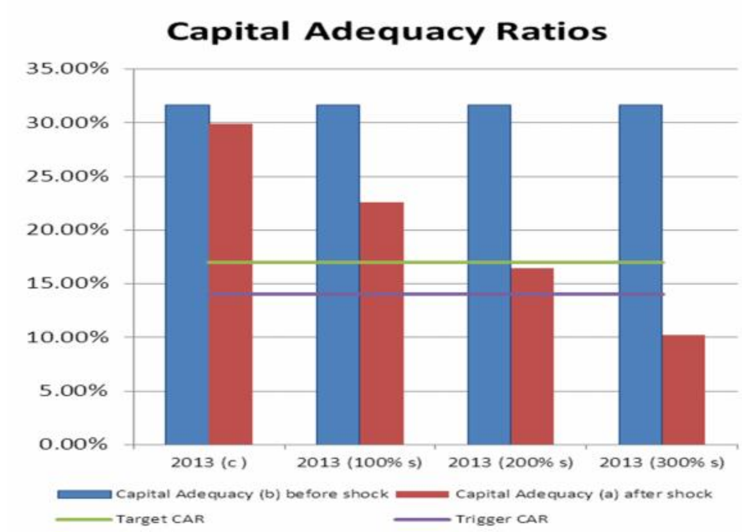
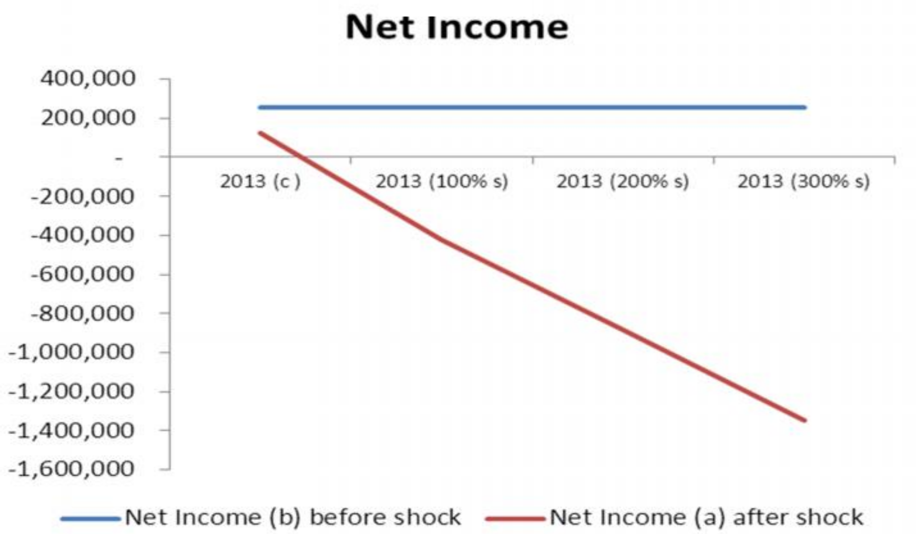


Chart 17



As depicted in Chart 17, while projected net income before any shock is at levels of around $200.0 million, net income steadily declines when shocks of 100%, 200% and 300% are applied to given levels of NPLs, due to shortfalls in provisions and loss in interest income. However, the impact on individual banks will vary.

Interest Rate Risk Stress Tests*:* The interest rate stress test model continues to utilize the duration method in computing the impact interest rate changes, in both local and foreign currency, will have on commercial banks. However, due to the stability of the Bahamian Prime Rate, there is no material impact on banks' capital levels. As tested, assumed changes in the yield curve of 100 basis points for Bahamian currency and 200 basis points for foreign currency have a mere $7.1 million impact on banks' estimated capital levels, which stand at $2.1 billion.

Liquidity Risk Stress Tests*:* The liquidity risk stress tests model looks at projecting the solvency of a bank, should there be a significant short-term increase in demand for deposits. The model uses a cash flow baseline, focuses on liabilities which are due within a 30-day period or less, and long-term assets which can be quickly converted into cash to meet the obligations of the depositors. Using data reported quarterly to the Bank, various assumptions were made relative to the inflows and outflows ranging from 0.0% - 80%. The results from the test suggested that the gap of the system's maturities within the short-term bucket (i.e., less than 1 month) can possibly be shortened by some $11.2 million, which can comfortably be covered by long-term, highly liquid assets. From an aggregate system level, therefore, banks will be able to meet short-term liabilities should they fall due—although the results will differ at the individual bank level.

In summary, the banking system continues to remain resilient to shocks assumed by all three (3) stress testing models, attesting to the overall stability of the financial system. However, with the persistent weakness in economic growth, and strains on businesses and households to meet debt servicing obligations, NPLs are poised to remain elevated.

CHAPTER 4: THE INSURANCE SECTOR

4.1 Overview

The domestic insurance sector, which is regulated by the Insurance Commission of The Bahamas (ICB), consisted of twenty-six (26) companies as at end-2013—eleven (11) life insurers, offering whole life, term life and universal life; and fifteen (15) non-life insurers, comprised of companies providing, *inter alia,* insurance for automobiles, houses and other property. The sector is relatively concentrated, with a few large firms—four (4) life insurers and six (6) non-life insurers—accounting for more than 85% of total gross premiums written and thereby providing the majority share of insurance coverage. Of the 103 entities registered under the External Insurance Act, there were fifteen (15) insurance companies, eighty (80) captive cells and eight (8) insurance managers.

External insurers domiciled in The Bahamas mainly provide self-insurance coverage for non-resident entities in other countries. As their activities are not significant from a domestic financial stability perspective, the remainder of the analysis of the insurance sector is focused on domestic insurers' operations.

The domestic insurance sector maintained its importance in relation to the size of the economy. With a current penetration ratio (total gross premiums to nominal gross domestic product) of 9.0%, the sector expanded over the year, with higher levels of assets, equity and net income recorded for both the life and non-life insurance segments. The sector also remained financially sound in 2013, as shown by the adequacy of its financial soundness indicators.

4.2 Life Insurance

Life insurance companies comprise the dominant segment of the market, representing 72.8% of aggregate assets and 53% of aggregate gross premiums of the insurance sector. Based on provisional data, life insurers' total assets increased by 5.1% to $1.1 billion, led by an 8.1% expansion in their investment portfolios, to $819.1 million. A further breakdown showed cash & deposits—the most liquid asset class—growing by 7.4% to $189.7 million. The sector's exposure to the private corporate sector broadened, as holdings of corporate securities and preference shares—some of which are listed on the BISX—were higher at $56.1 million, while some $5.4 million was invested in mutual funds. In addition, holdings of properties, mortgages and Government securities grew, by 9.1%, 1.9% and 2.0%, to $86.3 million, $164.3 million and $358.1 million, respectively. Providing some offset, investments in corporate non-listed equity securities contracted by 4.4%, to $12.7 million and receivables declined by 24.3% to $48.4 million. The smaller asset categories also contracted, with the relatively illiquid other "miscellaneous" assets, intangibles and fixed assets decreasing, by 6.6%, 6.9% and 0.8%, to $18.6 million, $9.1 million and $41.2 million, respectively.

Total liabilities expanded by 2.3% to $823.2 million, with the 4.0% rise in technical reserves—which are used for the payment of policyholders' claims and future benefits—outpacing the 8.7% falloff in other liabilities, including items such as payables and accrued expenses. Domestic insurance companies' aggregate equity position increased by 13.2% to $323.6 million, as shareholders augmented their share capital by 5.3% to $92.6 million and higher profitability contributed to gains in retained earnings and other reserves, of 10.8% and 33.7%, to $162.6 million and $68.4 million, respectively.

The life insurance sector maintained its positive profitability profile, as net income expanded by 12.5% to $40.1 million—equivalent to 10.0% of revenues. The 2.9% premium-related gain in total receipts to $401.8 million, outstripped the 1.9% rise in total expenses to $361.7 million.

Aggregate financial soundness indicators for life insurance companies remained at healthy levels, although a number of indicators declined slightly, on a year-on-year basis. Specifically, the risk profile of these entities' assets increased moderately; the proportion of equities and real estate in their portfolios firmed as a percentage of total assets, by 1.0 percentage points to 6.0% and by 0.2 of a percentage point to 7.5%, respectively. Capital adequacy improved over the review period, as the ratio of capital to both total assets and technical reserves firmed by 2.0 and 3.7 percentage points, to 28.2% and 44.9%, respectively, while the net premiums-to-capital ratio fell by 10.3% to 108.7% (see Table 8). The expense ratio narrowed by 1.0 percentage point to 30.0%, and the investment yield ratio was lowered by 0.6 of a percentage point to 6.1%, as a result of a downtrend in investment-related revenue. The return-on-equity ratio also narrowed by 0.1 of a percentage point to 12.4%.

Table 8:
Life Insurance: Financial Soundness Indicators (%)

	2008	2009	2010	2011	2012^R	2013^P
Capital Adequacy						
Capital/Total Assets	22.4	24.0	25.0	26.2	26.2	28.2
Capital/Technical Reserves	32.2	36.0	37.4	40.1	41.2	44.9
Net Premium/Capital	180.3	148.6	126.4	128.5	119.0	108.7
Asset Quality						
Real Estate + unquoted equities + receivables)/Total Assets	15.0	23.2	19.3	16.4	16.3	14.7
Equities/Total Assets	n/a	5.4	5.5	531.0	5.0	6.0
Real Estates/Total Assets	n/a	8.0	7.8	7.6	7.3	7.5
Earnings & Profitability						
Expense Ratio (expense/net premium)	39.8	35.6	41.6	31.4	31.0	30.0
Investment Yield (investment income/investment assets)	10.4	10.9	10.9	7.3	6.7	6.1
Return on Equity (ROE)	7.9	15.1	14.5	10.9	12.5	12.4

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

^R = revised

4.3. Non-Life Insurance

Preliminary data for the non-life insurance sector showed gross premiums increased by 4.1% to $356.6 million, while net premiums grew 6.6% to $122.6 million; the asset portfolio expanded by 3.4% to $429.8

million. The value of cash and deposits increased by 18.8% to $108.6 million, while fixed assets advanced by almost two-thirds, to $29.1 million, due to the acquisition of land and buildings. Total investments rose by 8.7% to $76.8 million, supported by gains in Government securities, properties held for investment purposes and corporate equity listed securities, of 12.9%, 54.7% and 6.6%, to $31.3 million, $3.7 million and $20.3 million, respectively. In a modest offset, declines were noted for reinsurance recoveries, of 27.0% to $32.4 million, and receivables, of 7.5% to $173.2 million.

Total liabilities increased marginally, by 0.1%, to $258.3 million, due to a 5.5% reduction in technical reserves, which overshadowed the 29.8% rise in other "miscellaneous" liabilities. In addition, an 8.9% build-up in retained earnings from the sector's profits, alongside gains in share capital and other reserves, of 3.6% and 2.7%, respectively, underpinned the 6.0% increase in the total capital stock to $167.0 million.

Regarding profitability, net income strengthened by more than two-thirds to $9.4 million, approximately 14.2% of total income. The improvement was associated with the combination of a 6.4% advance in total revenue to $134.9 million, resulting from a 39.0% and 6.6% rise in investment income and net premiums, respectively, and a 1.0% decline in total expenses to $115.6 million, owing to lower claims costs in the absence of any major hurricane during 2013.

Table 9:
Non-Life Insurance: Financial Soundness Indicators (%)

	2008	2009	2010	2011	2012[R]	2013[P]
Asset Quality						
(Real Estate + unquoted equities + receivables)/Total Assets	51.8	44.9	40.6	56.9	58.4	50.8
Reinsurance and Technical Reserves						
Risk Retention Ratio (net premiums /total gross premiums)	40.7	37.2	35.4	29.2	29.9	28.7
Technical Reserves/Net Claims	360.6	302.2	380.6	554.1	500.0	463.8
Technical Reserves/Net Premiums	125.5	135.1	153.3	207.3	213.8	202.0
Earnings & Profitability						
Expense Ratio (expense/net premium)	48.3	45.7	50.5	63.8	72.1	70.2
Loss Ratio (net claims/net premium)	34.8	44.7	40.3	37.4	42.8	43.6
Investment income/net premium	4.0	5.0	5.5	8.4	5.3	7.3
Return on Equity (ROE)	23.1	12.7	10.9	4.5	6.4	11.3
Return on Assets (ROA)	11.1	5.5	4.9	1.7	2.4	4.5

Source: Insurance Commission of The Bahamas & Central Bank of The Bahamas
R = revised
P = provisional

The majority of financial soundness indicators for the non-life insurance sector improved in 2013 (see Table 9). In particular, a decrease in receivables led to a 7.4 percentage point reduction in the ratio of real estate plus unquoted equities and receivables to total assets, to 50.8%—signaling a move to more conservative portfolios. Given the increase in profitability levels, broad-based improvements were noted for all of the indicators linked to income. Specifically, the investment yield firmed by 2.0 percentage points to 9.7% and the investment income ratio rose by 0.8 of a percentage point to 6.1%. Further, the return on asset ratio increased by 2.1 percentage points to 4.5% and the return on equity ratio widened by 3.9 percentage points to 11.3%. The expense ratio declined by 3.5 percentage points to 58.2%, signaling lower costs per net premiums earned, and the loss ratio, which measures net claims to net premiums, fell by 1.7 percentage points to 36.4%.

Reinsurance ratios generally reflect the appropriateness of risk-minimizing polices in relation to the risk bearing capacity of the sector and, in 2013, the risk retention ratio steadied at 34.7%. In contrast, a decline in net technical reserves resulted in the ratio of this category to both net claims and average premiums, narrowing, by 36.2 and 21.5 percentage points, to 463.8% and 167.4%, respectively.

In line with international best practices, and to enhance the ICB's capacity to safeguard the safety and soundness of the domestic insurance sector, the regulators made progress on implementing a risk-based supervisory approach for the insurance sector and other measures aimed at providing more insight into the risk management and corporate governance controls, i.e. risk profile, of insurance companies. In addition, a quarterly financial reporting system was introduced for both the life and the general insurance companies. Now in its third phase, the Commission formally shared its Risk Based Supervisory Framework (RBSF) for consultation with the industry, and guidance was issued to life insurers on their stress testing programmes, as it relates to the ICB's solvency stress tests.

CHAPTER 5: CREDIT UNIONS

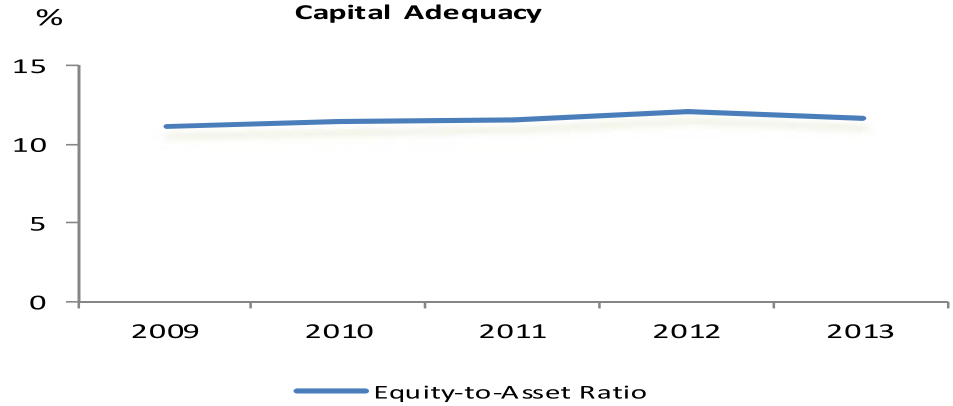
After the commercial banks, credit unions represent the second largest group of domestic deposit taking and loan granting institutions in The Bahamas. Under the philosophy of *"People Helping People,"* these entities were established under the Cooperative Societies Act of 1974, which was later replaced by the Cooperative Societies Act, 2005. Currently, plans are at an advanced stage to transition the supervision of credit unions from the Department of Cooperative Development within the Ministry of Agriculture and Marine Resources, to the Central Bank.

At end-2013, there were seven (7) credit unions in operation, with one (1) firm dominating the market—accounting for 52.5% of total assets—and the remaining six (6) entities holding smaller shares, ranging from 4.0% to 15.0% of the aggregate. During 2013, the sector continued to expand, reflecting broad-based balance sheet gains. However, in an environment of mild economic growth, the sector's performance indicators related to asset quality, profitability and capital adequacy, showed signs of weakening.

5.1. Capital Adequacy

Credit unions' capital & surplus resources were augmented by 12.8% ($4.3 million), to stand at $38.4 million at end-2013; providing a larger buffer against potential losses. On an aggregate level, the adequacy of the sector's capital stock, as measured by the ratio of total equity[5] to total assets (the gearing ratio), softened slightly, to 11.7%, from 12.1% at end-2012, as the growth in assets outpaced the build-up in capital. However, the ratio remained above the international PEARLS[6] benchmark of 10% (see Chart 18).

Chart 18
Capital Adequacy



Source: Bahamas Department of Cooperatives

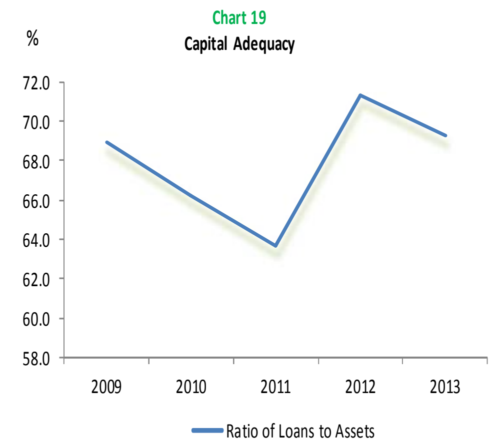
---

[5] Total equity includes members' capital, institutional capital and the reserve fund.

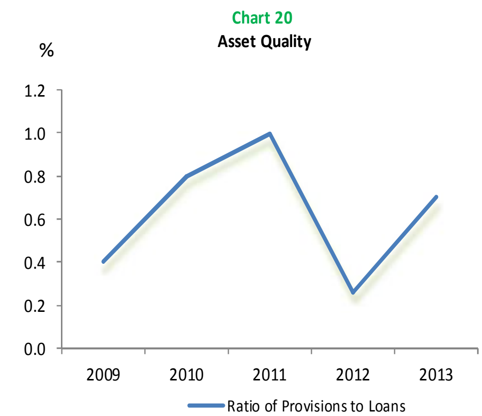
[6] PEARLS is a financial performance monitoring system, which consists, *inter alia*, of a series of financial ratios which provide an assessment of an institution's performance in the areas of: protection, effective financial structure, asset quality, rate of return and cost, liquidity and size of growth.

5.2. Asset Quality

Given that loans extended to members by credit unions are the largest category of assets, any deterioration in the quality could significantly impact the stability of the sector. In 2013, the ratio of loans to assets softened to 69.3% from 71.4% in the prior year (see Chart 19). In assessing the quality of assets, the delinquency ratio for the credit union sector stood at 7.0% in 2013, which is above the 5.0% international benchmark[7], while the ratio of loan loss allowances to gross loans increased to 4.9% from 4.2% in 2012—indicating a slight rise in loan delinquency levels. In this environment, the ratio of provisions to total loans strengthened to 0.7% from 0.3% in 2012 (see Chart 20).



Source: Central Bank of The Bahamas



Source: The Central Bank of The Bahamas

To further assess asset quality, the ratio of non-earning assets to total assets was analyzed over the past two (2) years. Non-earning assets, inclusive of holdings of land, buildings, vehicles, furniture and cash, grew by 47.9% ($5.6 million) to $17.2 million in 2013, reflecting gains in cash and land & buildings. As a percentage of total assets, the non-earning asset ratio rose by 1.1 percentage points to 5.2% at end-December, slightly above the prudential norm of 5.0%.

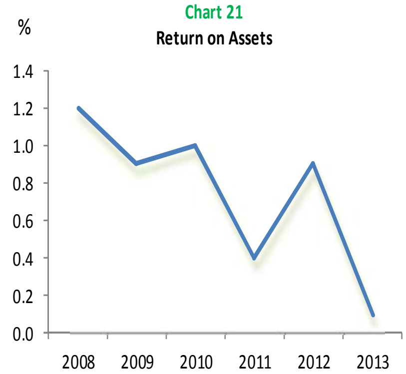
5.3. Profitability

Reflective of gains in interest income, combined with a decline in operating expenses, the credit union sector's overall profitability improved by 53.3% to $6.9 million. With gains in net income, the sector's profitability ratios trended upwards, as shown in Charts 21 and 22, with the return on assets ratio (ROA) and the return on equity ratio (ROE) firming, by 0.5 and 4.7 percentage points, to 2.1% and 17.9%, respectively.

---

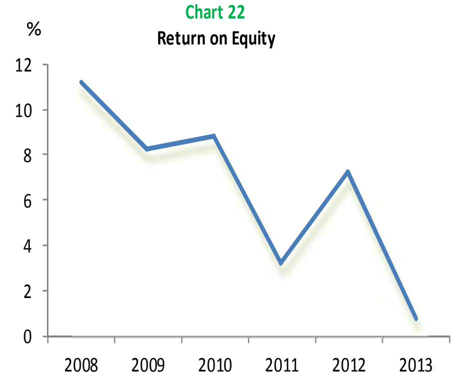
[7] It is important to note that under the PEARLS system, a delinquency ratio of up to 5.0% is considered to be excellent.

Chart 21
Return on Assets



Source: The Central Bank of The Bahamas

Chart 22
Return on Equity

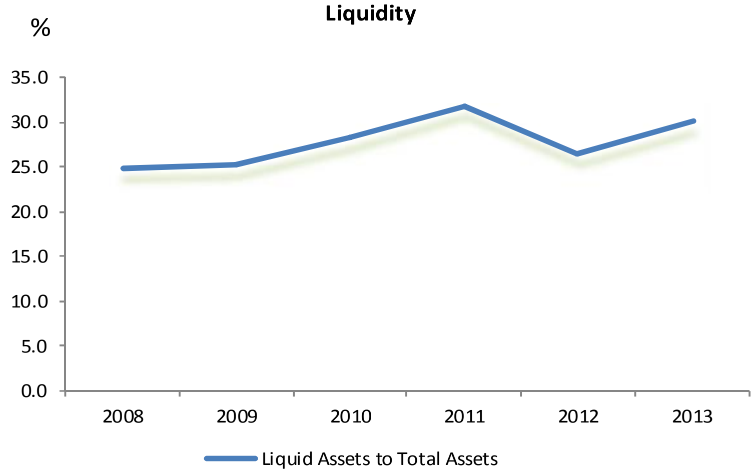


Source: Central Bank of The Bahamas

5.4. Liquidity

During 2013, liquidity in the credit unions (as measured by the ratio of liquid assets[8] to total assets) expanded by 3.5 percentage points to 30.1% at end-2013, occasioned by a more than three-fold increase in cash balances. The alternative liquidity indicator, the ratio of short-term payables to total deposits, also increased, from 31.4%, to 35.5% by year-end. Both ratios exceeded the minimum prudential standard of 15.0%, signifying that credit unions continued to hold robust levels of liquidity, to support their day-to-day operations (see Chart 23).

Chart 23
Liquidity

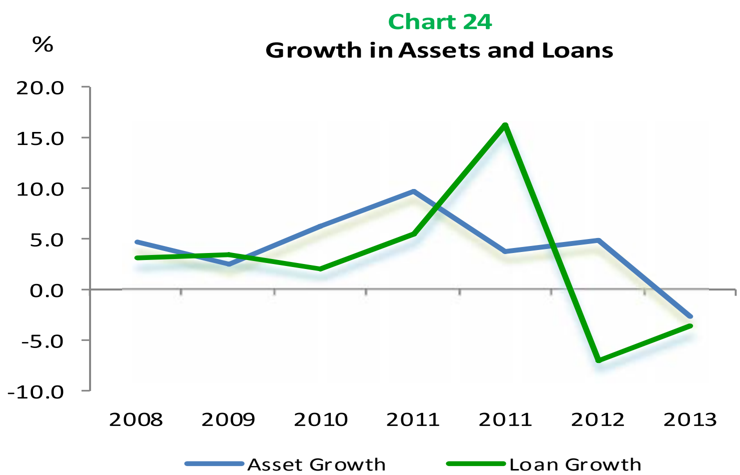


Source: Central Bank of The Bahamas

[8] Liquid assets are defined as cash plus investments.

5.5. Growth in Assets

Credit unions' total assets advanced by 16.7% ($46.8 million) to $327.6 million at end-2013, outpacing the preceding year's gain of 3.8% ($10.2 million). Growth was driven by the expansion in loans to members—which represented 69.3% of the total asset base—by 13.2% ($26.4 million) to $227.0 million, after a 16.3% ($28.2 million) gain in 2012. In addition, holdings of liquid assets, which comprise 30.1% of the total, expanded by 32.1% ($23.9 million) to $98.6 million, to reverse the year-earlier 13.4% ($11.6 million) contraction (see Chart 24).

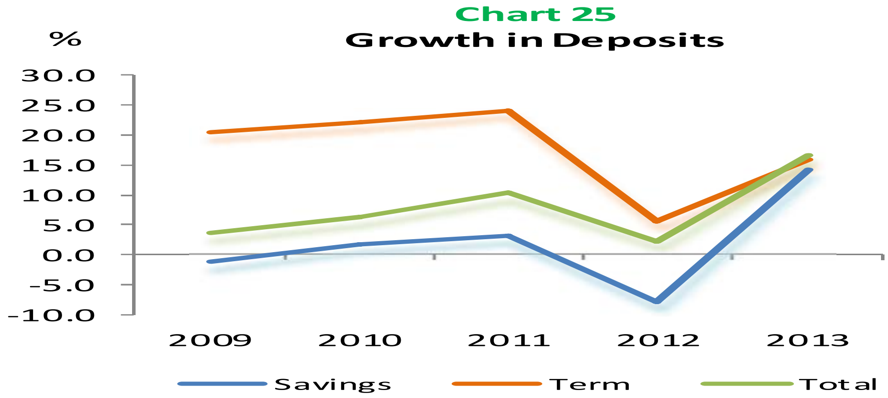


Source: The Central Bank of The Bahamas

A further disaggregation of the loan portfolio revealed that, as a proportion of the total, the majority of the credit was extended for small-scale consumer purchases (72.5%), while mortgages/land purchases and revolving lines of credit, accounted for smaller shares of the credit extended, at 20% and 7.3%, respectively; with agriculture, education, SME development and other "miscellaneous" loans holding the remaining 0.2%.

5.6. Growth in Deposit Liabilities

Reflecting the continued growth in the sector's membership, total deposits surged by 16.7% ($39.4 million), after a 2.5% ($5.6 million) hike a year earlier, to stand at $274.7 million at end-December. The expansion was led by a rebound in savings, by 14.4% ($17.0 million) to $134.8 million, following a 7.7% ($9.8 million) drawdown a year earlier. Term deposits, which typically offer higher interest rates than other deposit taking institutions, firmed by 16.0% ($16.6 million) to $120.4 million, extending 2012's 5.7% ($5.6 million) expansion (see Chart 25 and Table 10).



Source: Central Bank of The Bahamas

TABLE 10

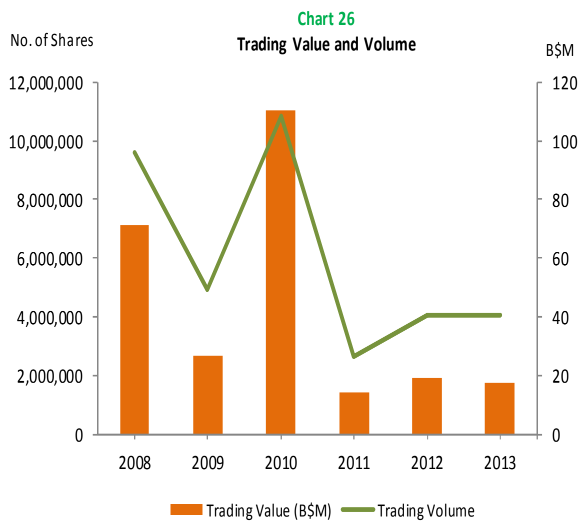
Selected Financials for Credit Unions (B$M)

	2008P	2009P	2010P	2011P	2012P	2013P
Assets	226.0	231.9	246.5	270.6	280.9	327.6
Loans	154.8	160.1	163.5	172.4	200.6	227.0
Deposits	188.8	195.9	208.2	229.7	235.3	274.7
Liquid Assets	56.4	58.6	69.8	86.2	74.7	98.6
Savings	122.5	121.1	123.4	127.6	117.8	134.8
Term Deposits	53.8	64.8	79.1	98.2	103.8	120.4
Total Deposits	188.8	195.9	208.2	229.7	235.3	274.7
Total Cash Balance	12.7	10.8	15.8	12.7	11.6	17.2
Allowance	9.1	6.3	6.7	7.5	8.5	11.2
Short-Term (ST) Payables	n/a	n/a	6.5	6.4	0.7	1.2
Capital & Surplus	24.1	26.0	28.1	31.3	34.1	38.4
Provisions	-2.0	-0.6	-1.3	-1.7	0.5	-0.01
Net Income	2.7	2.1	2.5	1.0	4.5	6.9
# of Credit Unions	14.0	13.0	13.0	13.0	13.0	7.0
Financial Ratios (%)						
Equity-to-Asset Ratio	10.7	11.2	11.4	11.6	12.1	11.7
Return on Assets	1.2	0.9	1.0	0.4	1.6	2.1
Return on Equity	11.2	8.2	8.8	3.2	13.2	17.9
Provisions to Loans	1.3	0.4	0.8	1.0	0.3	0.7
Loans to Total Assets	68.5	69.0	66.3	63.7	71.4	69.3
Liquid Assets to Total Assets	25.0	25.3	28.3	31.9	26.6	30.1
Non-Earning Assets/Total Assets	5.6	4.7	6.4	4.7	4.1	5.2
Allow. for Loan Losses-to-Gross Loans	5.9	4.0	4.1	4.4	4.2	4.9
(Liquid Asses-ST Payables)/Total Dep.	29.9	29.9	30.4	34.7	31.4	35.5

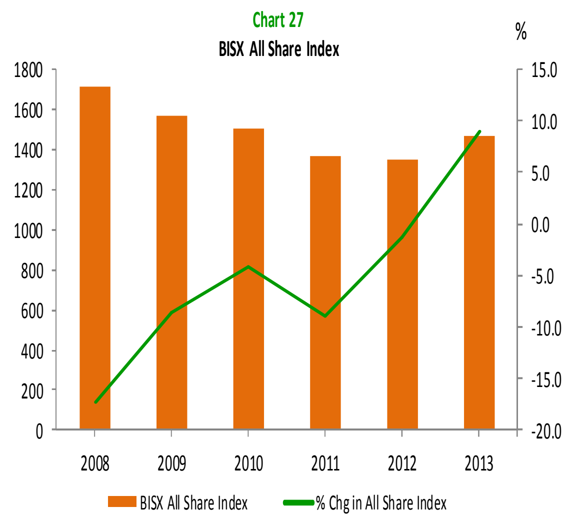
Source: Department of Cooperative Development

CHAPTER 6: CAPITAL MARKETS

Local capital market activity was relatively subdued in 2013, reflecting the mildly positive domestic economic conditions and investors' conservative posture. In particular, the total volume of securities traded on BISX firmed marginally, by 0.1%, to 4.1 million, following the previous year's 39.8% expansion (see Chart 26); however, the corresponding trading value decreased by 7.8% to $17.4 million, to reverse the 11.3% growth registered in 2012. During the year, the average daily trading volume declined by 0.6% to 17,428 shares, in contrast to the prior year's 24.0% gain.



Source: Central Bank of The Bahamas & BISX



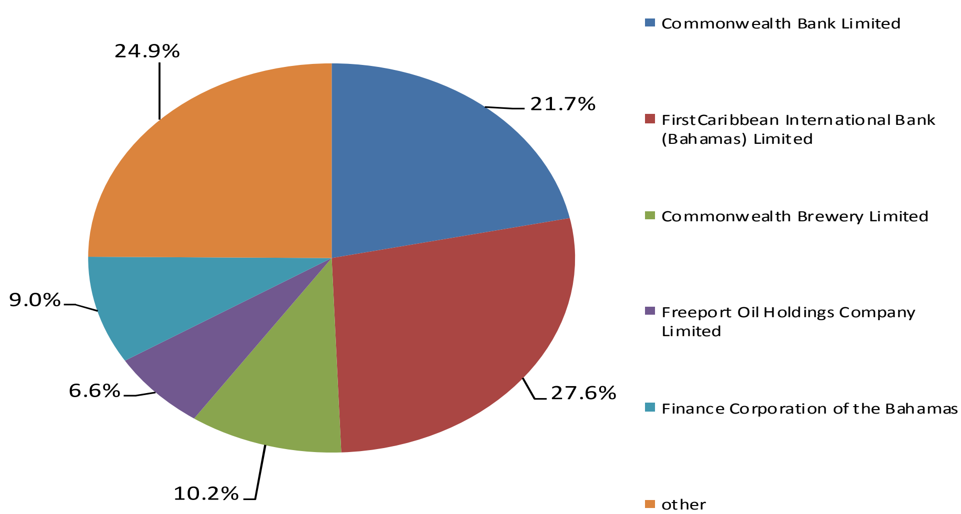
Source: Central Bank of The Bahamas & BISX

Other market indicators improved over the period. Supported by an overall gain in share prices, the BISX All Share Index rose by an estimated 9.1% to 1,468.2 points in 2013, a turnaround from the 1.4% reduction a year earlier (see Chart 27).

During 2013, market capitalisation firmed by 4.5% to $2,998.1 million, a reversal from the prior year's 1.2% contraction. The five largest companies comprised a dominant 75.1% of the Index's total market capitalisation, an increase of 9.8% over the previous year (see Chart 28). Meanwhile, the number of securities listed on the Exchange steadied at 27 at end-2013[9].

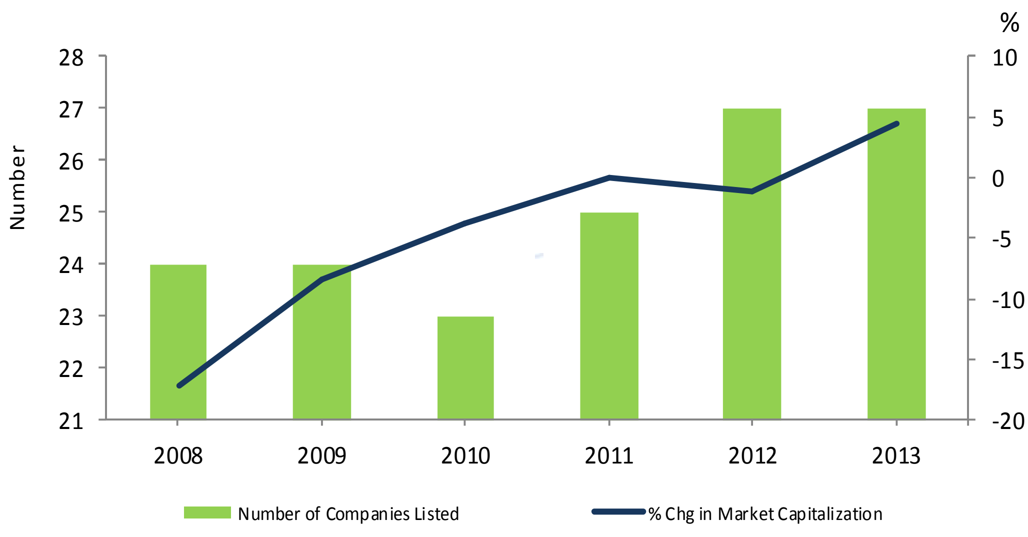
[9] See Chart 29

Chart 28
Share of Total Market Capitalization at End-December 2013



Source: Central Bank of The Bahamas & BISX

Chart 29
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Chapter 7: PAYMENT SYSTEMS

The nation's payment system is an important component of the overall infrastructure of the financial services sector in The Bahamas, and facilitates the settlement of capital and money market transactions in an efficient and effective manner. In this regard, the Central Bank sustained its efforts to further develop the payments environment, including the establishment of the National Payments Committee (NPC[10]), which held its first meeting in January. The Bank also implemented measures aimed at improving its offsite and onsite monitoring of systemically important payments systems, while also supporting initiatives which focused on increasing the domestic utilization of non-cash methods of payment, such as debit cards.

7.1. Real Time Gross Settlement (RTGS)

The RTGS system is owned and operated by the Bank, and processes large value transactions (greater than B$250,000). During the year, the volume of transactions processed through the system grew by 1.4% to 56,017, a slowdown from the 6.4% gain to 55,223 transactions in 2012. However, the value of transactions decreased slightly by 0.3% to $13.0 billion, compared to an increase of 7.1% in the prior year.

7.2. Payment Instruments

7.2.1. Cash

Although cash remains the dominant method of making payments, the utilization of other types of electronic mediums has been on an upward trajectory. As a consequence, at end-2013 the value of currency in active circulation contracted marginally by 0.1% to $214.4 million, relative to a 10.0% gain noted in 2012, while its share, relative to the more encompassing broad money (M2), steadied at 3.6%.

7.2.2. Automated Teller Machines (ATMs)

Consistent with banks' efforts to facilitate the delivery of more services to customers conveniently, the number of ATM machines throughout the country rose by 19.6% to 310. Of this number, approximately 91.6% (284) were configured to dispense only Bahamian currency, while the remaining 8.4% (26) provide both local currency and US Dollars.

7.2.3. Cheques and Nacha Payments

Although decreasing in relative importance in recent years, cheques remain the dominant form of non-cash payment for goods and services. During the year, the volume and value of cheques cleared through the Automated Clearing House (ACH) fell by 2.6% to 2,891,742 items, extending the 1.9% contraction in 2012. However, the corresponding value rose by 1.3% to $6.3 billion, following a 1.0% advance a year earlier. In

[10] The NPC is an advisory body, which is chaired by the Central Bank and comprises representatives from, *inter alia,* the Clearing Banks Association, the Government, the Credit Union League, and the major utilities. It is charged with assisting the Bank in ensuring the availability of efficient and cost effective payment products and services to the public.

addition, the number of NACHA[11] direct debit transactions—such as payroll payments—processed by BACH, was higher by 11.4% at 1.66 million, and the corresponding value, by 19.5% at $1,132 million.

7.2.4. Debit Cards

In recent years, debit cards have been increasing in their popularity, due to their convenience and security as a means of payment. Nevertheless, widespread use of these cards is limited by the relatively high fees and charges that are incurred and the small number of point-of-sale terminals which are available. However, initiatives by both the private and public sector during the year, including the removal of stamp taxes on debit card transactions, are expected to lead to an increase in their acceptance by retailers.

[11] National Automated Clearing House Association

CHAPTER 8: ASSESSMENT OF RISKS

A key function of the Central Bank's mandate is to promote the stability of the domestic financial sector, which is accomplished through the continuous monitoring of banks' key risks, mainly on the credit side, which can potentially impact the soundness of commercial banks and the system as a whole, while also ensuring that banks comply with all requisite regulations.

In an effort to further mitigate the risks to the banking sector, the Bank commenced, during the fourth quarter of 2013, the formal rollout of the Basel II and III Implementation Programmes, which are slated to be executed in three (3) phases over a 30-month timeline. In addition, the Bank's RBSF became fully operational in 2013, after four (4) initial rounds of assessments over a four-year period.

Although a 2012 Financial Sector Assessment Programme (FSAP) revealed that there were no significant risks to the financial system, domestic regulators acknowledged the need to prepare a comprehensive crisis management framework, to address any adverse developments in the sector. In this regard, the major regulators continued to collaborate on a National Financial Crisis Management Plan and also received assistance from the IMF in the form of a technical assistance mission on crisis resolution powers—including the creation of a roadmap for establishing a legal and regulatory framework for bank resolution.

In 2014, further progress is expected to be made in a number of these initiatives, which are designed to improve the ability of regulators to identify potential risks to the system. This includes the Bank's plans to enhance its stress testing framework by using other plausible scenarios, as well as work towards the prospective introduction of a credit reporting framework, which will assist lending institutions in determining the credit risk of individual clients. The ICB's moves to fully institute its RBSF for its licenses, will also be an important feature of their risk mitigation programme.

CENTRAL BANK OF THE BAHAMAS

Issue No. 2