Financial Stability Report December, 2022

Issue No. 11

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

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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

During 2022, risks within the financial sector remained well contained, with the Central Bank retaining its risk-based approach to financial supervision as it monitored the recovery of Supervised Financial Institutions (SFIs) from the global pandemic. In this environment, the Bank heightened its efforts concerning the implementation of international risk-based supervisory standards for financial institutions, and the development of crisis management frameworks for Bahamian banks and credit unions.

Due to the increase in the domestic economy's absorption capacity, and the satisfactory outlook for external reserves, the Bank relaxed some prudential controls on credit policies. However, regulatory attention remained focused on SFIs' strategies to reduce the level of non-performing loans (NPLs).

No new concerns about financial stability arose within the banking system, given the commercial banks' robust capital buffers and satisfactory provisioning levels. The results of consolidated stress tests—which comprised credit, liquidity and interest rate risks—showed that Domestic Systemically Important Banks (DSIBs) remained resilient to sudden shocks, as banks' capital ratios continued to exceed the regulatory minimum of 17.0%. Specifically, the banking sector's average capital to risk-weighted assets ratio fluctuated between 29.1% and 32.8%. In addition, the Bank Stability Index (BSI) indicated that financial sector stability improved relative to 2021. Furthermore, the Aggregate Financial Stability Index (AFSI) suggested that overall financial stability returned to trend, reflecting the moderation in the pace of economic recovery, with indicators reverting to pre-pandemic levels.

Supervision of credit unions continued to focus on multiple risk-based outcomes around Anti-Money Laundering/Know Your Customer (AML/KYC), corporate governance and credit risk management frameworks, and remediation efforts against on-site examination findings. In particular, the Central Bank closely monitored the credit unions' management of delinquencies, given the sector's weakened capital and liquidity buffers, and the expiration of loan payment deferral programmes. In 2022, profitability indicators for credit unions improved, as asset quality and liquidity levels strengthened. Correspondingly, capital adequacy levels continued to surpass international benchmarks.

Performance indicators for the insurance sector remained buoyant for both the life and non-life portfolios, and in line with international targets. Specifically, profitability within the sector was sustained, albeit by a smaller margin when compared to 2021. Further, the sector maintained adequate financial stability ratios, reflecting its sound positioning.

Due to limited data, the securities industry is not covered in this report. However, from a financial stability perspective, the domestic sector is not a material source of risk, given the absence of sophisticated products and fairly narrow liquidity in the securities market. Anecdotally, non-bank money lenders, supervised by the Securities Commission, are an increasing source of private credit, but there is no evidence that this segment is even as significant as the credit union sector relative to the systemic, aggregate volume of lending within the economy.

In the payments space, the Bank made progress with respect to its key payments modernization objective to reduce heavy reliance on cash in the domestic market. As such, in April 2022, the Bank established two working groups—Public Education and Outreach and Legal and Regulatory—to aid in the advancement of the Bahamas Cheque Reduction and Elimination Strategy. The Public Education and Outreach Working Group is tasked with formulating the coordinated education and communications strategy—and its execution—for transformation of the payments space away from cheques. Meanwhile, the Legal and Regulatory Working Group would work closely with the Bank's appointed legal consultants to identify legal issues around the further transformation of the payments system, to address any impediments that might undermine the ease of reducing dependence on cheques. In terms of the consideration for new license applications for Payment Service Providers (PSPs) and Money Transmission Businesses (MTBs), effective October 31, 2022, the Bank lifted the suspension on new license applications, as pandemic conditions subsided, putting this sector in a better position to provide expanded services to the public.

Throughout the medium-term, the Central Bank will continue to undertake active and effective supervision of financial institutions, so as to safeguard the stability of the financial sector. In this vein, the Bank will continue to prioritize its focus on risk mitigation efforts regarding Anti-Money Laundering (AML) and Counter-Financing of Terrorists (CFT). In addition, the Bank will continue its work toward liquidity management, amid the ongoing recovery within the domestic economy and improved labour market conditions, with a view to alleviate the impact of a higher demand for credit on external reserves. Further, the ongoing work of the credit bureau is anticipated to assist with the pricing and quantification of lending, by providing information on borrowers' creditworthiness. Throughout 2022, credit bureau operations gained traction with the participation of domestic banks, credit unions, public utilities companies and other credit information providers. In particular, banks transitioned to the regular reporting of data and began using the credit reports generated by the bureau.

STRUCTURE OF THE REPORT

To the extent that domestic and international economic conditions affect financial stability, these are highlighted in Chapter 1 of this report. Meanwhile, Chapters 2 to 4 assess stability indicators, in the banking, credit unions and insurance sectors, respectively. This focus is limited to the domestic sector, as owing to exchange control regulations, a distinct separation is maintained between the balance sheets of the domestic and international sectors. Chapter 5 provides a general overview of the securities and non-bank money lenders, while Chapter 6, presents a summary of the overall assessment of risks, followed by the conclusion in Chapter 7. 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

The performance of the Bahamian economy remained largely impacted by global economic developments. In 2022, the International Monetary Fund (IMF) projected that the global economy grew by 3.4%, a moderation from the 6.3% growth in 2021, as economic activity return to trend, amid relaxed Novel Coronavirus (COVID-19) pandemic conditions. In this context, the expansion in the global economy is expected to slow further to 2.8% in 2023.

In the United States, the economy posted an annualized real GDP growth of 2.1%, lower than the 5.9% increase in 2021, owing to a decline in residential fixed investment and Government spending, along with a rise in imports (see Table 1). With regard to the labour market, the unemployment rate decreased by 1.8 percentage points to 3.6%, while the annual inflation rate softened to 6.5% from 7.0% in 2021. In this environment, the Federal Reserve, through several interventions, increased its target range for federal funds to 4.25%-4.50% from 0.00%-0.25%, in an effort to regulate economic activity, noting the adverse impact on inflation and overall economic activity of Russia's war against Ukraine and supply chain disruptions.

Developments in other major economies reflected the slowdown in economic growth. In the United Kingdom, real output tapered to 4.0%, from 7.6% in the prior year, underpinned by a falloff in the production sector. Similarly, real economic growth in the euro area slowed to 3.5% from 5.2% in previous year. Likewise, China's real economic output grew at a slower pace of 3.0% from the 8.5% expansion in the preceding year. Further, in Japan, real GDP expansion moderated to 0.4%, vis-à-vis 1.5% in 2021, amid a falloff in private consumption and public spending.

1.2. Regional Environment

In 2022, the Caribbean region registered positive growth, as most of the economies strengthened. However, unemployment rates remained above pre-pandemic levels, and elevated inflation levels persisted, on account of a rise in the price of imported goods, and supply-chain shortages, associated with the geopolitical tensions in Eastern Europe. Nonetheless, the regional financial sector remained stable and highly capitalized, making it resilient to external shocks. Meanwhile, risks to tourism-based economies remained, attributed to major central banks' counter-inflation policies, which could constrain the spending capacity of key source market consumers, while commodity-based economies could further be impacted by the volatility in international prices. Average real GDP for the region increased to 14.3% in 2022, from 7.3% in 2021 (see Table 2). The outturn was led by a notable expansion in real output in Guyana, which strengthened further to 62.3% from 20.1% in the prior year, owing mainly to oil gains. Similarly, economic growth recovered for Barbados, Trinidad & Tobago and Suriname to 10.0%, 2.5% and 1.3%, respectively, following contractions of 0.2%, 1.0% and 2.7% a year earlier. Further, real output in the Eastern Caribbean Currency Union (ECCU) moved higher to 8.9%, from 5.8% in the previous year. Meanwhile, real GDP in The Bahamas, Belize and Jamaica moderated to 14.4%, 11.4% and 4.0%, respectively, relative to 17.0%, 15.2% and 4.6% in 2021.

TABLE 1

Selected Indicators for Developed Economies (%)	2016	2017	2018	2019	2020	2021	2022
GDP Growth Rates							
United States	1.7	2.2	2.9	2.3	(2.8)	5.9	2.1
Euro Area	2.0	2.4	1.8	1.2	(6.6)	5.2	3.5
United Kingdom	2.2	2.4	1.7	1.6	(11.0)	7.6	4.0
China	6.9	6.9	6.8	6.0	2.2	8.5	3.0
Japan	0.8	1.7	0.6	(0.4)	(4.3)	1.5	0.4
Unemployment Rates							
United States	4.9	4.4	3.9	3.7	8.1	5.4	3.6
Euro Area	10.0	8.6	7.9	7.6	7.9	7.7	6.6
United Kingdom	4.9	4.4	4.1	3.8	4.5	4.5	3.7
China	4.0	3.9	4.0	3.6	4.2	3.8	5.5
Japan	3.6	2.8	2.4	2.4	2.8	2.6	2.4
Inflation Rates							
United States	1.3	2.1	2.4	1.8	1.2	7.0	6.5
Euro Area	0.2	1.5	1.8	1.2	0.3	5.0	9.2
United Kingdom	0.7	2.7	2.5	1.8	0.9	5.4	10.5
China	1.6	0.8	2.0	3.3	4.2	0.9	2.0
Japan	(0.1)	0.5	1.0	0.5	(0.0)	0.8	4.0

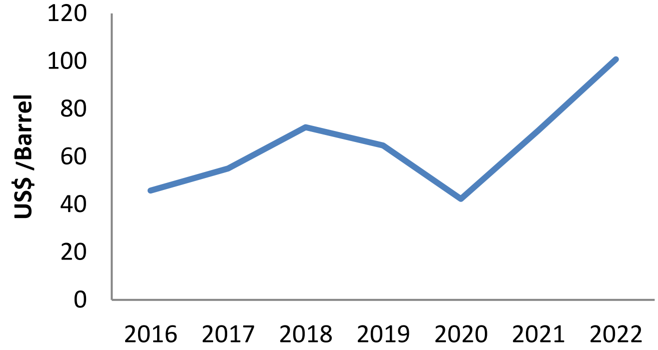
Sources: IMF, International Statistical Bureaus

TABLE 2

Selected Caribbean Countries' GDP Growth Rates (%)	2016	2017	2018	2019	2020	2021	2022
Bahamas	(0.8)	2.5	2.9	(0.7)	(23.5)	17.0	14.4
Barbados	2.3	(0.2)	(0.5)	(0.1)	(17.6)	(0.2)	10.0
Belize	(0.6)	1.4	3.0	0.3	(14.1)	15.2	11.4
Eastern Caribbean	2.7	1.2	3.0	2.8	(14.0)	5.8	8.9
Guyana	3.4	2.1	3.4	4.7	43.4	20.1	62.3
Jamaica	1.5	0.7	1.4	1.0	(10.2)	4.6	4.0
Suriname	(5.6)	1.7	2.0	2.3	(13.5)	(2.7)	1.3
Trinidad & Tobago	(6.5)	(2.0)	0.3	0.0	(7.8)	(1.0)	2.5
Average	**(0.5)**	**0.9**	**1.9**	**1.3**	**(7.2)**	**7.3**	**14.3**

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

Chart 1
Oil Prices (Brent Crude Oil Index)



Source: Bloomberg

1.3. The Domestic Environment

The recovery in the domestic economy was sustained in 2022, contributing to a reduction in non-performing loans (NPLs) and a corresponding improvement in commercial banks' balance sheets. In the review year, real GDP grew by 14.4%, albeit a moderation from the 17.0% expansion in 2021. The outturn was supported by gains in tourist arrivals, due to the rebound in the high-value air component and sea traffic. In particular, total visitors arrivals more than tripled to 7.0 million, from 2.1 million (17.1%) in 2021, as air arrivals expanded by 65.8% to 1.5 million, and sea passengers rebounded to 5.5 million, from 1.2 million in the preceding year. As it relates to the vacation rental market, positive trends were noted, as total room nights sold increased by 48.5%, albeit a moderation from the 62.8% growth in the preceding year.

In line with the rise in global oil prices, domestic inflationary pressures firmed during 2022. Specifically, the Retail Price Index (RPI) rose to 5.6% in 2022, from 2.9% in 2021, given average cost gains for most of the index's components.

During the FY2021/22, the overall fiscal deficit narrowed to $722.2 million, from $1,334.8 million in FY2020/21. Underlying this outturn, total revenue increased by $696.9 million (36.5%) to $2,605.7 million, outpacing the $84.3 million (2.6%) growth in aggregate expenditure to $3,327.9 million. Over the calendar year, the overall fiscal deficit moderated to $718.7 million in 2022 from $881.8 million in 2021, as aggregate revenue grew by $361.1 million (15.2%) to $2,730.3 million, outstripping the $198.1 million (6.1%) rise in total spending to $3,449.0 million.

Domestic monetary trends featured an expansion in bank liquidity in 2022, as the accumulation in the deposit base overshadowed the growth in domestic credit. Similarly, external reserves increased, supported by proceeds from Government's external borrowings and net foreign currency receipts from real sector activities. Further, bank's credit quality indicators improved during the year, underpinned by the sustained economic recovery and ongoing loan write-offs. In addition, the weighted average interest rate spread widened, on account of an increase in the average lending rate, while the corresponding deposit rate remained unchanged.

At end-2022, external reserves reached $2.6 billion, equivalent to an estimated 34.2 weeks of total merchandise imports, albeit lower than the 36.1 weeks at end-2021. The useable reserves, or balances after statutory provisions for 50.0% of the Central Bank's demand liabilities, decreased by $42.1 million (3.5%) to $1,174.1 million. Further, the improvement in the Central Bank's balance sheet continued in 2022, as the end-of-year external reserves to demand liabilities ratio remained above the 80.0% benchmark, at approximately 90.9% in December.

TABLE 3

The Bahamas: Macroeconomic Indicators

	2016	2017	2018	2019	2020	2021	2022
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	0.7	4.3	3.3	3.2	(25.3)	18.2	11.9
Real GDP Growth Rate (%)	(0.8)	2.5	2.9	(0.7)	(23.5)	17.0	14.4
Inflation Rate (Average chg in RPI)	(0.3)	1.5	2.3	2.5	0.0	2.9	5.6
Unemployment Rate (May)*	12.7	9.9	10.0	9.5	25.6	18.2	8.8
Overall Fiscal Balance (B$M)	(467.1)	(622.5)	(337.4)	(238.9)	(1,366.1)	(881.9)	(718.2)
% of GDP	(4.0)	(5.1)	(2.7)	(1.8)	(14.0)	(7.7)	(5.6)
Private Sector Credit (B$000)	6,170.8	5,982.9	5,886.2	5,891.6	5,766.1	5,680.7	5,661.6
Weighted Average Lending Rate (%)	12.5	11.8	11.3	10.5	10.4	10.0	11.0
Weighted Average Deposit Rate (%)	1.2	1.0	0.8	0.6	0.5	0.5	0.5
Treasury Bill Rate (%)	2.0	1.9	1.7	1.8	1.9	2.9	2.9
Gross Int'l Reserves (B$M)	904.0	1,417.4	1,196.3	1,758.1	2,382.2	2,432.8	2,611.0
Import Cover Ratio (Tot. Merch. (CIF) in weeks)	16.5	22.2	17.4	28.3	56.8	36.1	33.8
Current Balance (B$M)	(1,472.7)	(1,652.9)	(1,199.3)	(281.1)	(2,284.5)	(2,434.0)	(1,760.1)
as % of GDP	(12.5)	(13.5)	(9.5)	(2.2)	(23.4)	(21.1)	(13.6)
Total Public Sector Debt (B$M)	7,901.1	8,834.0	9,249.5	9,437.2	10,814.0	11,636.2	12,379.9
of which: External	2,373.0	3,233.9	3,171.8	3,123.1	4,478.0	4,760.8	5,225.0
Internal	5,528.1	5,600.1	6,077.7	6,314.1	6,335.9	6,875.4	7,154.9
Total Arrivals ('000s)	6,265.0	6,135.8	6,622.0	7,249.5	1,794.5	2,100.6	7,000.7
Tourist Expenditure (B$M)	2,725.9	2,930.2	3,727.6	4,125.5	967.4	N/A	N/A
Construction Number of Permits Issued	1,109.0	1,355.0	1,504.0	1,553.0	1,278.0	1,578.0	N/A
Value of Starts (B$M)	96.2	136.6	118.2	102.9	154.6	313.7	N/A
Value of Completions (B$M)	202.2	1,493.6	333.8	213.0	200.0	307.3	N/A
Average Oil Prices (Brent Crude Oil Index)	45.8	55.0	72.4	64.7	42.3	71.0	100.8

Source: Central Bank of The Bahamas, Bahamas National Statistical Institute, Bloomberg

*2020 and 2021 rates represent forecasts

N/A - Not Available

CHAPTER 2: BANKING SECTOR

Attributed to the imposed exchange control restrictions, banks are limited from undertaking domestic business activities other than through assets funded with domestic liabilities. Therefore, this prevents any direct connection or balance sheet flows from direct international to domestic banking operations. Consequently, the focus of this chapter is on the stability of the domestic banking sector.

2.1 Asset Trends

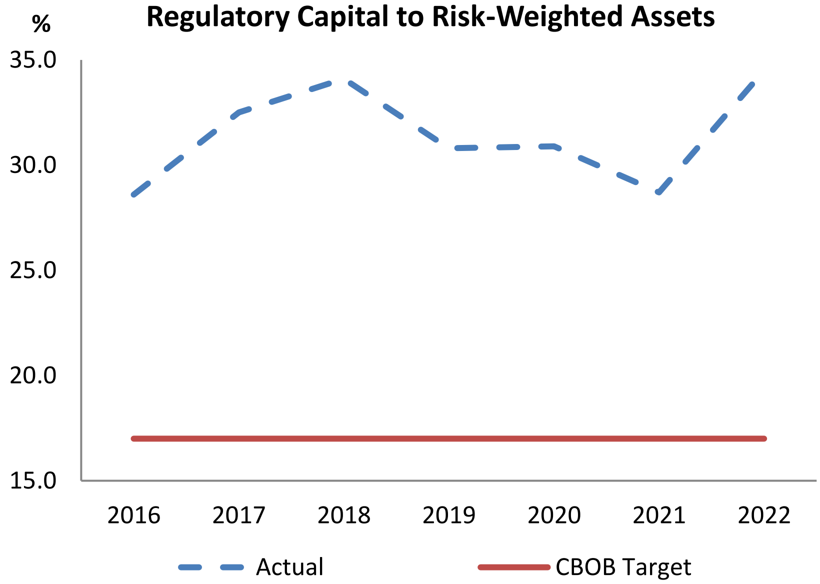
Total domestic assets of the banking system grew by 3.3% to $11.4 billion in 2022, extending the year-earlier 1.1% accumulation. As a share of the total asset portfolio, loans and advances comprised the largest segment at 56.4%, followed by securities (19.6%) and claims on the Central Bank, that is, cash and balances (19.9%). The expansion in asset growth was underpinned by an acceleration in banks' claims on the Central Bank, to 26.9% from 4.6% in 2021. Further, the decline in loans and advances slowed to 1.6% from 3.2%. Meanwhile, the increase in banks' holdings of securities moderated to 3.7% from 8.3% in 2021.

2.2 Capital Adequacy

Domestic banks remained well capitalized in 2022. Specifically, the ratio of average capital to risk weighted assets firmed to 34.5% from 28.7% at end-December 2021, remaining above the Central Bank's required ratio of 17.0% of risk-weighted assets, and the international benchmark of 8.0%[1].

Chart 4

Regulatory Capital to Risk-Weighted Assets



Source: Central Bank of The Bahamas

[1] The Central Bank imposes a minimum regulatory required ratio of 17.0%, below which licensees would be required to implement measures to either reduce risk exposures or supplement their capital.

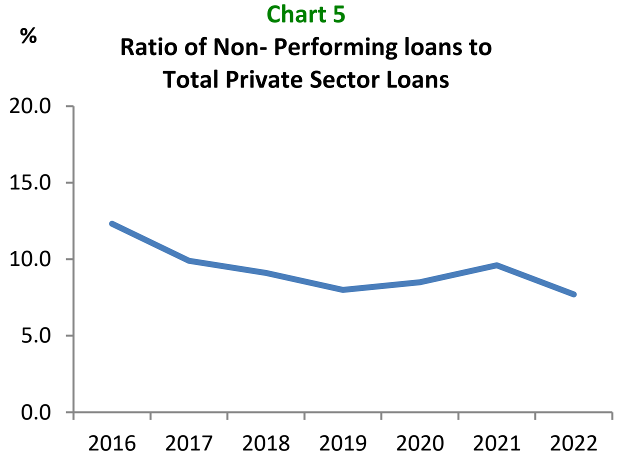
2.3 Asset Quality

Banks' credit quality indicators improved during the year, reflective of the ongoing recovery in the domestic economy, combined with ongoing loan write-offs. Specifically, total private sector loan arrears contracted by $169.6 million (21.8%) to $610.2 million at end-December 2022, a reversal from a growth of $6.7 million (0.9%) in the prior year. The decline was led by the reduction in consumer loan arrears, with more modest decreases reported for commercial delinquencies and mortgage arrears. Consequently, the ratio of arrears to total private sector loans fell by 2.9 percentage points to 11.4%, following a 42 basis point rise a year earlier.

A disaggregation of delinquencies by average age showed that, the NPL segment decreased by $113.0 million (21.4%) to $414.9 million, a switch from a $53.4 million (11.2%) gain in 2021. The outturn was occasioned by reductions for all loan types, with NPLs for consumer loans lower by $87.7 million (43.6%), mortgages, by $23.1 million (8.3%) and commercial arrears, by $2.2 million (4.7%). By comparison, short-term (31-90 days) arrears reduced by $56.6 million (22.5%) to $195.2 million, extending the year-earlier $46.6 million (15.6%) decline. In particular, mortgage delinquencies fell by $33.8 million (21.2%), while commercial and consumer arrears were lower by $14.1 million (59.0%) and by $8.8 million (12.7%), respectively. As a result, the NPL ratio against total private sector loans decreased by 1.9 percentage points to 7.7%; while the ratio of past due loans to total private sector loans narrowed by 1.0 percentage point to 3.6%.

Chart 5

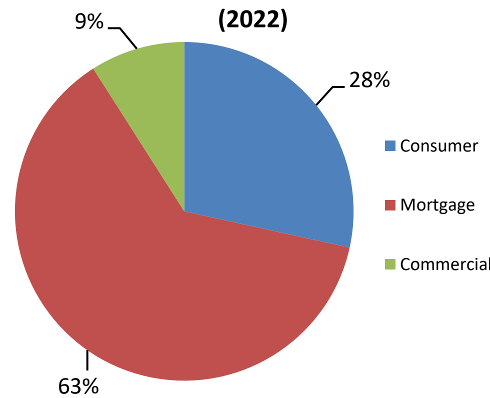
Ratio of Non- Performing loans to Total Private Sector Loans



Source: Central Bank of The Bahamas

Chart 6

Composition of Private Loan Arrears (2022)



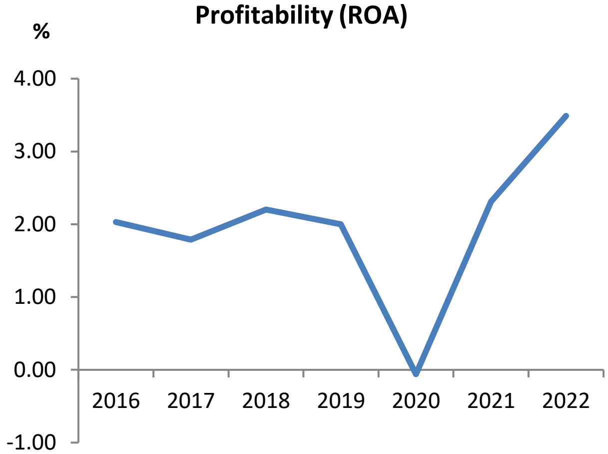
Source: Central Bank of The Bahamas

2.4 Profitability

Domestic banks reported net profits of $397.0 million in 2022, extending the previous year's $254.7 million net earnings. Contributing to this outturn was a decline in provisions for bad debts and reductions in staff and occupancy costs. Correspondingly, the ratios of net income to average monthly assets (ROA), and to equity (ROE) grew to 3.5% and 17.9%, respectively, from 2.3% and 10.9% in 2021.

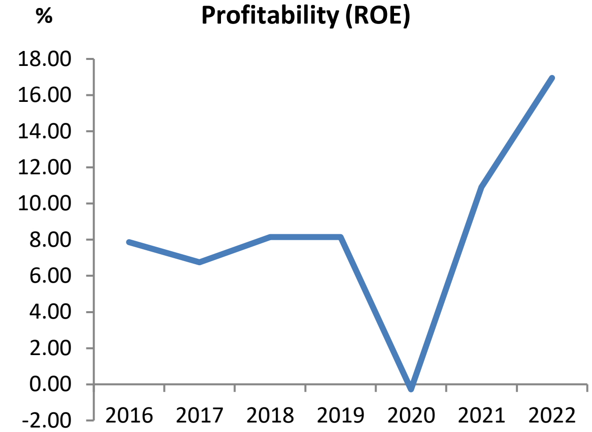
Total provisions for bad debts fell by $140.1 million (27.5%) to $371.8 million, extending the 10.9% decrease in the previous year. As a result, the attendant ratio to average assets declined by 1.2 percentage points to 3.2%. In addition, depreciation costs reduced by 4.6%, a turnaround from a 20.6% rise in 2021, with the attendant ratio lower by 1 basis point at 0.17%. In contrast, total operating costs increased by 2.3%, after an 11.6% reduction a year earlier, for an 8 basis points rise in the relevant ratio to 3.6%. Further, the ratio of net interest income to average assets firmed by 8 basis points to 4.7%, while the ratio of commission and foreign exchange income to average assets moved higher by 7 basis points to 0.5%.

Chart 7
Profitability (ROA)



Source: Central Bank of The Bahamas

Chart 8
Profitability (ROE)



Source: Central Bank of The Bahamas

2.5 Liquidity

Banking sector liquidity remained buoyant in 2022, supported by Government's foreign currency borrowings and receipts from real sector activities. As a share of total assets, banks' holdings of liquid assets grew by 3.5 percentage points to 37.3%, outpacing a year-earlier 1.4 percentage point gain. Further, the ratio of liquid assets to short-term liabilities rose by 2.1 percentage points to 48.8%, exceeding the previous year's 1.0 percentage point improvement.

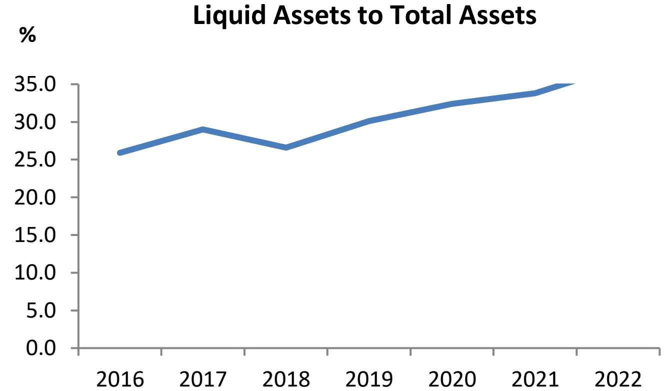
The ratio of deposits to total loans firmed by 13.3 percentage points to 135.5%, following a more modest 7.6 percentage point gain in 2021. Meanwhile, the ratio of demand deposits to total deposits strengthened by 3.0 percentage points to 50.6%, extending the 2.5 percentage point increase in 2021 (see Table 4).

TABLE 4

Key Domestic Banks Financial Stability Indicators (%)	2016	2017	2018	2019	2020	2021	2022
Liquidity Indicators							
Loan to Deposit Ratio	100.9	95.4	96.4	87.5	87.2	81.8	73.8
Deposits to Loan Ratio	99.1	104.8	103.7	114.3	114.7	122.2	135.5
Demand Deposits to Total deposits	37.2	39.0	40.7	45.2	45.1	47.6	50.6
Liquid Assets to Total Assets	25.9	29.0	26.6	30.1	32.4	33.8	37.3
Liquid Assets to Short-Term Liabilities	37.8	42.7	38.3	41.6	45.7	46.7	48.8
Credit Risk Indicators							
NPL to Total Private Sector Loans	12.3	9.9	9.1	8.0	8.5	9.6	7.7
Total Assets Growth rate	1.6	2.3	(2.4)	7.4	2.0	1.1	3.3
Loans & Advances Growth rate	(0.6)	(4.1)	0.9	1.4	(0.3)	(3.2)	(1.6)
Capital Adequacy							
Regulatory capital to risk-weighted assets (avg)	28.6	32.5	34.1	30.8	30.9	28.7	34.5
Trigger Ratio	14.0	14.0	14.0	14.0	14.0	14.0	17.0
Target Ratio	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Profitability Indicators							
ROAA (annualized)	2.0	1.8	2.3	2.4	(0.1)	2.3	3.5
ROAE (annualized)	7.9	6.8	8.8	10.7	(0.3)	10.9	17.9
Net interest income to average earning assets (annualized)	5.3	5.1	5.1	5.0	4.8	4.6	4.7
Net interest income to gross income	69.4	69.4	68.5	67.4	70.1	65.0	63.1
Non interest expenses to gross income	48.4	52.1	49.7	50.5	62.9	52.7	51.3
Personnel expenses to non interest expenses	44.0	40.8	41.2	39.0	32.7	38.1	36.0
Trading and fee income to total income	3.2	3.8	3.8	4.7	5.4	6.2	6.8
Effective Interest Rate Spread	7.2	7.1	7.1	6.8	7.0	6.9	6.9

Source: Central Bank of The Bahamas

Chart 9
Liquid Assets to Total Assets



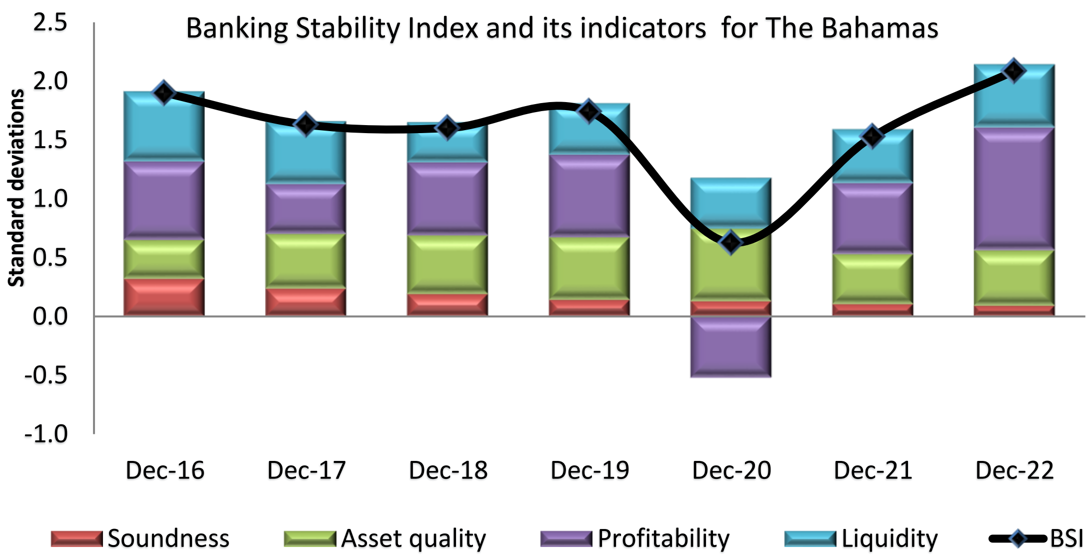
Source: Central Bank of The Bahamas

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 (DTI) 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 2022, the BSI—which measures the soundness of DTIs in The Bahamas—continued to improve, underpinned by the ongoing strengthening in the domestic economy. The index increased to 2.01 from 1.53 in 2021, signalling that the sector remained sound. Specifically, the normalized profitability indicator rose to 1.04, higher than the 0.61 firming in the previous year, reflective of an increase in profitability, as returns on both assets and equity sustained its positive trend in 2022, extending the gains in the preceding year. In addition, the liquidity indicator firmed to 0.53 from 0.46 in 2021, as banking sector liquidity maintained robust levels. The normalized asset quality indicator also moved higher to 0.47 from 0.42 in the prior year. Further, indicators of respective capital adequacy and interest rate were relatively stable at 0.1 and 0.0. Overall, the BSI increased on a standard deviation of 1.1 in December 2022, from 0.9 in 2021, indicating that liquidity levels within the sector remained at healthy levels, as the share of liquid assets to total assets expanded.

Chart 10



2.6.2. Aggregate Financial Stability Index

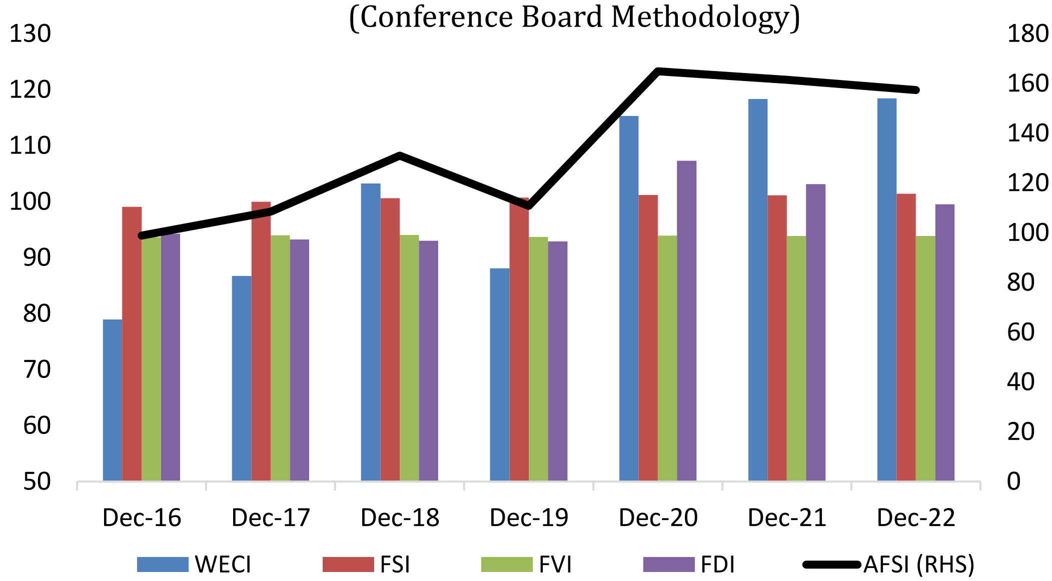
The Aggregate Financial Stability Index (AFSI) produces a single measure of financial stability from microeconomic, macroeconomic and international factors. It is comprised of sub-components such as the financial development index, the financial soundness index, the financial vulnerability index and the world economic climate index. A higher AFSI value suggests increased financial sector stability, while a lower value signals a decline in stability. That said, the 2020-2021 trends were distorted by the large reduction in the

GDP base. Consequently, as at 2022 with normalisation, indices showed improvement against the pre-pandemic assessments.

An analysis of the AFSI showed that the overall index normalised to 120.0 in 2022 from 121.8 in 2021; an indication that it is returning to trend, as GDP continued to recover. A breakdown by the components revealed that the financial development index narrowed to 111.4 vis-à-vis 119.6 in the prior year, with both the stock market capitalization and domestic credit ratios re-sized against the recovered nominal GDP. Meanwhile, the world economic climate sub-index rose to 154.0 from 153.7 in the previous year, underpinned by the ongoing strengthening in the global economy. Further, the financial soundness index firmed to 115.7 in 2022 from 115.1 in 2021, attributed to a rise in the ratio of liquid assets to total assets and capital to total assets, combined with a decline in the non-performing loans ratio. Meanwhile, the financial vulnerability sub-index was unchanged at 98.7 in 2022 relative to 2021, on account of an improvement in the total fiscal balance to GDP ratio.

Chart 11

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



2.6.3. Stress Testing

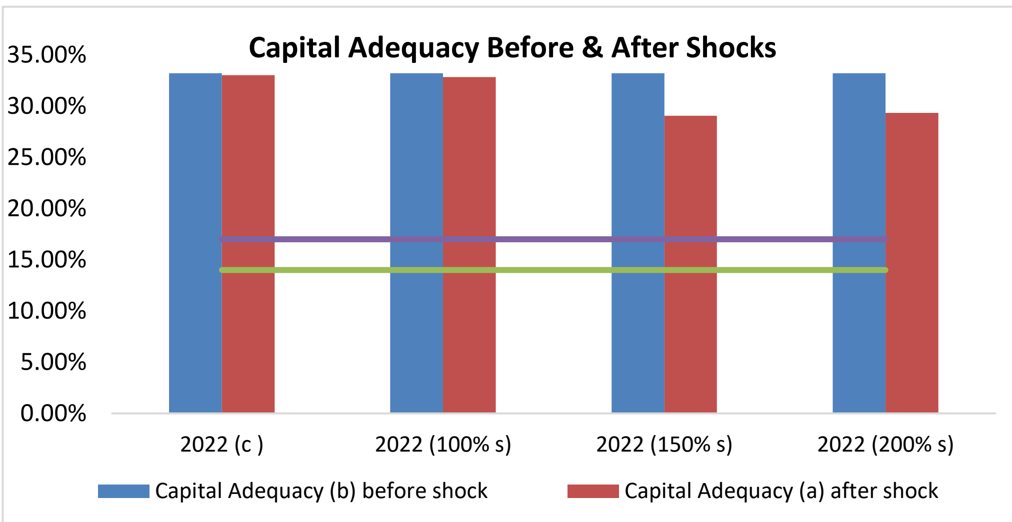
Stress tests remained the primary tool to assess the resilience of the banking system, including capital adequacy or credit loss absorbing capacity. Credit risk assessments consider varying levels of non-performing loans (NPLs), which might be precipitated by economic or financial shocks. Interest rate 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

The credit risk stress test uses extreme, but credible, scenarios to assess whether the Domestic Systemically Important Banks (DSIBs) have sufficient capital to absorb losses and withstand varying levels of predicted losses from probable economic or financial crises.

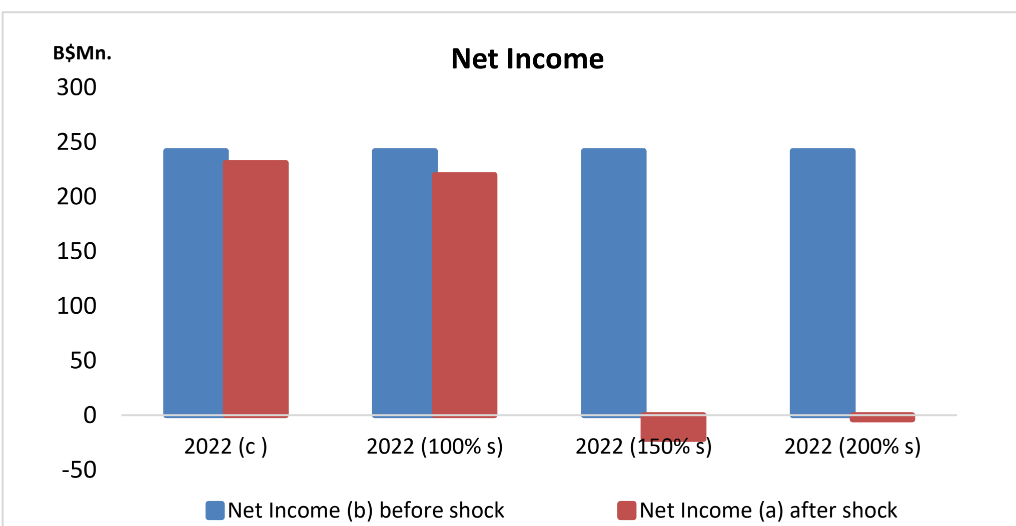
Given the commercial banks' high capital buffers and satisfactory provisioning levels, there are no immediate financial stability concerns. The credit stress scenarios examined shocks to NPLs of 100%, 150% and 200%, and the consequent impact of these on income and capital. The consolidated results, which produced simulated declines in banks' capital levels of up to 4.6%, consistently yielded no capital injection requirement. At all levels of shocks, capital remained above the established regulatory ratio of 17.0%. In particular, the banking sector's average capital to risk-weighted assets ratio fluctuated between 29.1% and 32.8% during the year (see Chart 12).

Chart 12



Source: Central Bank of The Bahamas

Chart 13



Source: Central Bank of The Bahamas

Interest and Liquidity Shocks

Stress test results showed that commercial banks are less vulnerable to interest rate risks, due to the persistent robust levels of eligible capital, among other reasons. Simulations further indicated that the risk to near-term depletion of liquidity was negligible, owing to the high level of liquidity across the banking system, supported by banks' continued cautious lending posture.

CHAPTER 3: CREDIT UNIONS

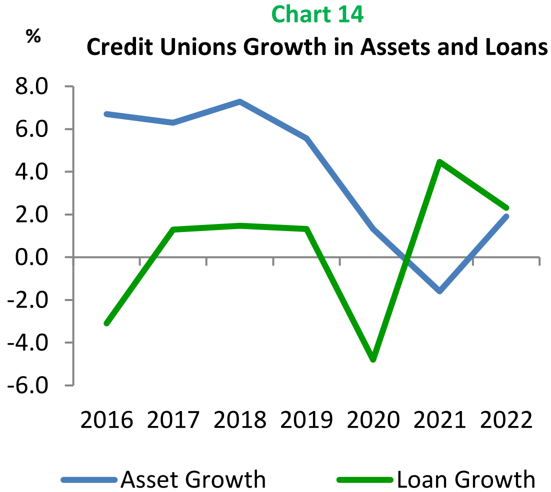
After commercial banks, credit unions are the second largest group of deposit taking and lending institutions. In this context, the sector remains under the supervision of the Central Bank, where a risk-based approach has been implemented, inclusive of Anti-Money Laundering/Know Your Customer (AML/KYC), corporate governance and credit risk management. The sector functioned with capital buffers below that of banks, and exposures were mainly, to workers in the tourism industry. Nonetheless, the average liquidity ratio stayed comfortably above the minimum statutory thresholds. Further, the sector continued to receive protection from enrolment in the deposit insurance scheme, and remained under improved prudential oversight.

3.1. Assets and Liabilities

During the review period, total assets within credit unions expanded by 1.9% ($9.0 million) to $483.6 million in 2022, a switch from a 1.6% reduction in 2021, although the total number of credit unions decreased to 8, from 10 in the previous year. Reflective of this outturn, deposits held with the league grew by 7.2% ($6.9 million) to $103.0 million, exceeding the 2.5% growth in 2021. In like manner, loans to members, which represented a dominant 49.9% of total assets, increased by 2.3% ($5.4 million) to $241.4 million, albeit lower than the 4.5% expansion in the prior year. A breakdown by the loan portfolio revealed that consumer purchases remained the main form of credit, at 56.9%, followed by mortgages, at 42.5%, with SME development (0.3%) and other lines of credit (0.3%), accounting for the remainder.

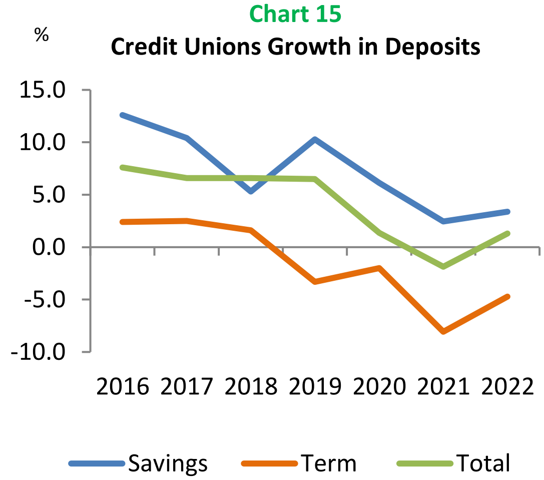
Total deposits within credit unions rose by 1.3% ($5.3 million) to $414.4 million, vis-à-vis a 1.9% decrease in the previous year, as savings deposits—which accounted for 62.5% of the total—grew by 3.4% ($8.5 million) to $259.0 million, extending the 2.5% gain a year earlier. Conversely, term deposits—at 28.9% of the total—reduced by 4.7% ($5.9 million) to $119.9 million, albeit lower than the 8.1% falloff in the preceding year.

Chart 14



Source: Central Bank of The Bahamas

Chart 15



Source: Central Bank of The Bahamas

TABLE 5

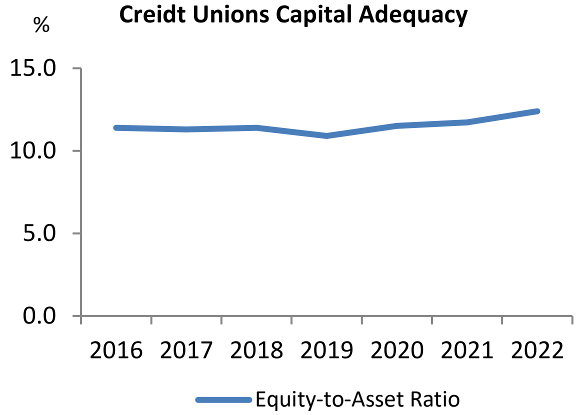
Selected Financials for Credit Unions (B$M)	2016	2017	2018	2019	2020	2021	2022
Total Assets	395.5	420.3	450.9	476.0	482.3	474.6	483.6
Total Gross Loans	227.9	230.8	234.2	237.3	225.9	236.0	241.4
Total Deposits	339.9	362.2	386.2	411.3	416.9	409.1	414.4
Liquid Assets	129.7	146.0	172.3	195.9	209.5	197.1	201.8
Savings	179.7	198.4	208.9	230.4	244.5	250.5	259.0
Term Deposits	138.5	142.0	144.3	139.6	136.8	125.8	119.9
Total Members' Equity	45.1	47.4	51.3	52.1	55.6	55.6	60.0
Non-Earning Assets	34.8	33.4	37.1	50.2	39.9	36.8	43.0
Total Allowance (Provisions)	9.9	7.4	7.5	8.0	7.2	8.2	9.0
Short-Term (ST) Payables	1.1	0.5	0.7	1.0	1.1	1.2	0.9
Capital & Surplus	20.0	17.5	19.7	16.4	16.0	14.3	19.5
Provision Expense	2.4	3.9	3.5	3.4	3.7	2.6	1.5
Net Income	1.4	1.7	1.8	1.9	3.8	2.3	2.9
Institutional Capital	12.8	9.4	9.4	7.8	7.2	5.2	9.9
# of Credit Unions	10.0	10.0	10	10	10	10	8
Financial Ratios (%)							
Equity-to-Asset Ratio	11.4	11.3	11.4	10.9	11.5	11.7	12.4
Return on Assets	0.3	0.4	0.4	0.4	0.8	0.5	0.6
Return on Equity	3.0	3.6	3.5	3.7	6.9	4.2	4.8
Provisions to Loans	4.4	3.2	3.2	3.4	3.2	3.5	3.7
Total Gross Loans to Total Assets	57.6	54.9	51.9	49.9	46.8	49.7	49.9
Liquid Assets to Total Assets	32.8	34.7	38.2	41.2	43.4	41.5	41.7
Non-Earning Assets/Total Assets	8.8	8.0	8.2	10.5	8.3	7.8	8.9
(Liquid Assets-ST Payables)/Total Deposits	37.8	40.2	44.4	47.4	50.0	47.9	48.5

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

3.2. Capital Adequacy

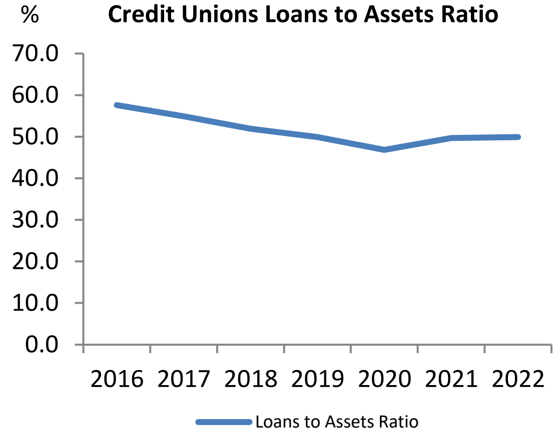
During the review period, credit unions' capital ratio remained above the 10.0% international PEARLS benchmark at 12.4%. The aggregate capital & surplus resources—held to cover unexpected losses—expanded by 36.2% ($5.2 million) to $19.5 million, a reversal from a 10.3% contraction a year earlier. Similarly, the corresponding ratio of total equity to total assets (the gearing ratio) increased to 12.4% from 11.7% in 2021.

Chart 16
Creidt Unions Capital Adequacy



Source: Central Bank of The Bahamas

Chart 18
Credit Unions Loans to Assets Ratio



3.3. Asset Quality

Credit unions' total impaired loans[2] decreased by 14.8% ($5.8 million) to approximately $33.5 million in 2022, vis-à-vis an 18.6% growth in 2021. As a result, the ratio of delinquencies to total loans narrowed to 14.5% from 17.4% in the prior year. An analysis by the average age of delinquency showed that, non-performing loans (NPLs)—which accounted for 83.8% of total delinquencies—declined by 4.9% ($1.4 million) to $28.1 million, a turnaround from a 23.0% rise in the preceding year. Further, short-term delinquencies (31-90 days) fell by 44.7% ($4.4 million) to $5.4 million, a reversal from a 7.3% increase a year earlier.

Given the reduction in loan delinquencies, the collateral value of impaired facilities decreased by 20.1% ($4.5 million) to $17.9 million in 2022. In addition, the value of uncollateralized exposures reduced by 7.6% ($1.3 million) to $15.6 million. Meanwhile, credit unions' total provisions for loan losses rose by 9.7% ($0.8 million) to $9.0 million, lower than the 13.3% increase in the previous year. Consequently, the ratio of provisions to total gross loans firmed to 3.7% from 3.5% in 2021, 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—rose by 16.8% ($6.2 million) to $43.0 million, a switch from a 7.8% contraction in 2021. As a result, the relevant ratio of non-earning assets to total assets grew by 1.1 percentage points to 8.9%, a reversal from a 0.5 percentage points decrease in the prior year.

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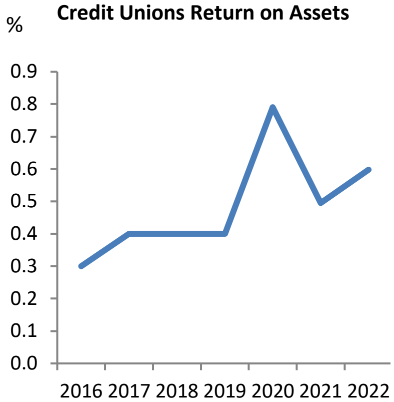
[2] An impaired loan is defined as one in which the full amount of principal or interest due is not collected on time, according to the contractual terms of the loan agreement.

3.4. Profitability

During 2022, credit unions' overall profit rose by $0.5 million (23.0%) to $2.9 million, relative to the previous year. As a result, the ROA moved higher by 10 basis points to 0.6% and the ROE by 60 basis points to 4.8%.

Chart 18

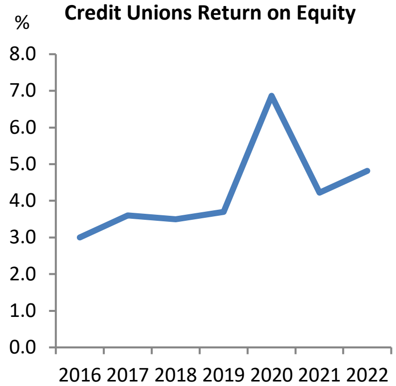
Credit Unions Return on Assets



Source: Central Bank of The Bahamas

Chart 19

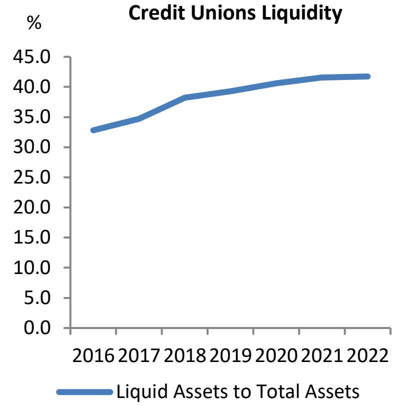
Credit Unions Return on Equity



Source: Central Bank of The Bahamas

Chart 20

Credit Unions Liquidity



Source: Central Bank of The Bahamas

3.5. Liquidity

Credit unions' liquidity strengthened over the year, reflective of a rise in cash balances (23.5%), combined with a falloff in liquid investments (9.8%) and financial investments (7.6%). Underlying this development, the ratio of liquid assets to total assets moved higher by 0.5 percentage points to 41.7%, relative to 41.5% in the preceding year. Similarly, the alternative indicator—the ratio of liquid assets net of short-term payables to total deposits—rose by 0.6 percentage points to 48.5% at end-2022. Both ratios exceeded the minimum prudential standard of 15.0%, demonstrating that credit unions maintained healthy levels of liquidity.

CHAPTER 4: THE INSURANCE SECTOR

The insurance industry is vital to maintaining the stability of the financial sector, given the country's exposures to natural disasters, such as hurricanes and floods. During 2022, the domestic insurance sector maintained its conservative stance with its preference to long-term stable investments, such as Government bonds. Against this backdrop, there has been minimal concerns regarding the sector's stability.

Information from the Insurance Commission of The Bahamas (ICB) showed that in 2022, the number of domestic insurers remained unchanged at 32. These consisted of 12 life and health insurers, offering whole life, term life, as well as universal life, and 19 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—4 life insurers and 6 non-life insurers—which represented a combined market share of approximately 89.7% of total gross premiums written, and the majority of insurance coverage, as at end-December 2022.

The external insurance sector, which is registered under the External Insurance Act,[3] mainly provides self-insurance coverage for non-resident entities. In 2022, the sector consisted of 152 entities, of which 21 were insurance companies and 131 were captive cells. Therefore, external insurers' main impact on the domestic economy was through employment and the fees charged by local service providers. As their operations do not impact the local financial sector, the domestic insurance sector will be the major focus of this analysis.

Table 6

Life Insurance: Financial Soundness Indicators (%)

	2016	2017	2018	2019	2020	2021	2022p
Capital Adequacy							
Capital/Total Assets	29.3	30.0	30.1	29.2	32.4	29.7	30.5
Capital/Technical Reserves	48.0	49.1	49.1	48.9	55.4	49.6	50.8
Net Premium/Capital	99.5	88.7	90.5	95.3	81.0	93.3	90.4
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	17.4	14.8	15.4	15.8	14.4	18.9	13.4
Equities/Total Assets	6.0	5.8	5.3	3.9	3.3	3.1	3.0
Real Estates/Total Assets	6.5	5.7	5.9	6.1	5.9	6.1	5.9
Earnings & Profitability							
Expense Ratio (expense/net premium)	29.5	28.5	30.4	34.1	34.4	34.1	33.7
Investment Yield (investment income/investment assets)	5.6	5.2	5.2	8.1	3.7	5.2	4.5
Return on Equity (ROE)	10.8	9.3	7.3	7.0	11.8	7.4	7.6
Return on Assets (ROA)	3.2	2.8	2.2	2.1	3.8	2.2	2.3

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

p = provisional

According to key indicators, in 2022, the domestic insurance sector continued to recover from the falloff of the COVID-19 pandemic. In particular, the life insurance component—the dominant segment—registered a profit (9.5%), a reversal from a reduction in the prior year. The non-life sector also recorded a strengthening in operating profit (17.5%), extending cumulative gains earned in 2021. However, the penetration ratio (total gross premiums to GDP)[4] declined by 50 basis points to 3.8% over the previous year. Nevertheless, the sector remained financially sound, as revealed by the adequacy of its financial stability ratios.

4.1 Life Insurance

The life insurers held 72.4% of aggregate assets, and 50.3% of total gross premiums, representing the dominant segment of the market. Based on preliminary data, life insurers' total assets grew by 3.6% ($54.7 million) to $1.6 billion, attributed to the dominant investments category—at 75.9% of total assets—which rose by 6.0% ($68.4 million) to $1.2 billion. The expansion in investments was underpinned by a rise in Government securities (18.1%), corporate equities listed (7.7%) and corporate securities (5.1%). In addition, muted gains were registered for investment property (0.2%), while non-listed corporate equities remained unchanged. Conversely, notable declines were recorded for other 'miscellaneous' investments (80.6%), mutual funds (13.1%), preference shares (8.0%), mortgage loans (3.6%) and policy loans (1.6%), respectively.

Further, total assets registered growth in the cash & deposits segment—the most liquid asset category—which expanded by $62.3 million (54.0%) to $177.7 million. In addition, fixed assets moved higher by $2.0 million (2.9%) to $69.1 million. In contrast, receivables and re-insurance recoveries declined by 48.7% and by 16.5%, respectively, while other assets and intangibles fell by 5.0% and by 2.4%, respectively.

In terms of funding, life insurers' total liabilities increased by 2.4% ($25.7 million) to $1.1 billion, as the $35.4 million (3.9%) rise in technical reserves—which finance policyholders' claims and future benefits—outstripped the $9.7 million (6.1%) falloff in other liabilities. Further, aggregate equity levels advanced by $28.9 million (6.3%) to $484.3 million, explained by broad-based gains for other 'miscellaneous' reserves (11.4%), retained earnings (5.1%) and share capital (3.1%).

With regard to earnings, the net income of domestic insurers grew by $3.2 million (9.5%) to $36.7 million, a reversal from a 42.9% reduction in the previous year. Contributing to this outturn, total expenses declined by $6.0 million (1.3%) to $469.0 million, a switch from a 19.2% growth in 2021. Consequently, the return on equity (ROE) and the return on assets (ROA) ratios firmed to 7.6% and 2.3%, respectively, from 7.4% and 2.2% in 2021. In addition, the expense ratio narrowed by 40 basis points to 33.7%. In contrast, the investment yield ratio fell to 4.5% from 5.2% in the preceding year, as investment income contracted.

During 2022, 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 to 13.4% from 18.9% in the previous year, while the real estate-to-total assets ratio fell by 20 basis points to 5.9%. Likewise, the

[4] Based on Bahamas National Statistical Institute GDP figures.

value of equities as a proportion of total assets—which are considered relatively higher risk—narrowed by 10 basis points to 3.0% in 2022.

In terms of capital ratios, the net premium-to-capital ratio fell to 90.4% from 93.3% in 2021, while the capital to total assets ratio firmed to 30.5% from 29.7%. Further, the capital-to-technical reserves ratio edged up to 50.8% from 49.6% in the preceding year; remaining above the international benchmark of 7.0%-10.0% (see Table 6).

4.2. Non-Life Insurance

Non-life insurance assets reduced by $1.7 million to $605.7 million in 2022, as re-insurance recoveries continued to revert to trend, declining to $77.4 million from $99.4 million in 2021, which had included residual hurricane claims settlements for policy holders who were affected by Hurricane Dorian. Further, receivables—which comprised 37.9% of total assets—decreased by $4.7 million (2.0%) to $229.5 million, while, fixed assets reduced, by $2.0 million (8.7%) to $21.3 million. In an offset, cash and deposits—which represented 24.9% of the total—rose by $22.1 million (17.2%) to $151.1 million. Investments also grew by $4.3 million (3.6%) to $122.3 million, on account of a rise in other "miscellaneous" investments (33.5%), mutual funds (16.5%), corporate equities listed (6.2%), corporate securities (6.2%) and investment property (1.3%), which overshadowed the falloff in Government securities (5.1%) and preference shares (6.7%).

The sector's total liabilities contracted by $20.8 million (5.6%) to $350.0 million in 2022, underpinned by a reduction in technical reserves, by $13.9 million (6.3%) to $206.7 million and "other" liabilities, by $6.9 million (4.6%) to $143.2 million. In this environment, balance sheet equity rose by $19.0 million (8.0%) to $255.7 million, on account of an increase in retained earnings (8.2%), "other" reserves (11.0%), and share capital (3.8%).

In terms of earnings, non-life insurance companies posted an estimated net gain of $16.5 million in 2022, exceeding the prior year's net gain of $14.0 million. Contributing to this outturn, total income grew by $15.4 million (13.0%) to $133.9 million, surpassing the 8.0% growth in 2021. Providing some offset, total expenses increased by $12.9 million (12.4%) to $117.4 million.

Financial soundness indicators were mixed for the non-life insurance sector in 2022. A disaggregation by asset composition revealed that capital to total assets rose by 3.3 percentage points to 42.2%, while the investment yield ratio moved higher to 6.4% from 1.5% in the previous year. In addition, the risk retention ratio[5] reduced by 0.9 percentage points to 25.2%, while the expense ratio narrowed by 2.7 percentage points to 70.6%. Conversely, the equities to total assets ratio decreased by 10 basis points to 6.1%, while the loss ratio—which measures whether net claims paid-out exceed net premiums collected—increased to 26.8% from 19.9% in the preceding year. Further, the ratio of capital to technical reserves reverted to trend to 80.8% from 93.2% in 2021, which had included proceeds from the major 2019 storm. Similarly, the technical reserves to net premiums ratio tapered to 171.6% from 197.0% in the prior year (see Table 7).

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

Against this backdrop, the respective ROA and ROE ratios firmed to 2.7% and 6.5% in 2022, from 2.3% and 5.9% in 2021. As a result, adequate reserve levels were maintained in order to mitigate against the risk of adverse shocks.

Table 7

Non-Life Insurance: Financial Soundness Indicators (%)

	2016	2017	2018	2019	2020	2021	2022p
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	72.7	67.5	59.4	82.6	59.7	57.8	53.6
Reinsurance and Technical Reserves							
Risk Retention Ratio (net premiums /total gross premiums)	32.2	30.8	30.2	27.6	28.2	26.1	25.2
Technical Reserves/Net Claims	1110.5	1332.1	1241.3	902.0	2259.2	992.2	641.2
Technical Reserves/Net Premiums	618.2	443.3	288.2	555.8	284.0	197.0	171.6
Earnings & Profitability							
Expense Ratio (expense/net premium)	66.3	66.4	71.0	71.2	73.8	73.4	70.6
Loss Ratio (net claims/net premium)	55.7	33.3	23.2	61.6	12.6	19.9	26.8
Investment Yield (investment income/investment assets)	9.6	9.4	1.7	3.6	-0.6	1.5	6.4
Investment income/net premium	10.0	9.2	1.6	5.3	-0.7	1.6	6.5
Return on Equity (ROE)	-3.8	8.2	7.5	-14.2	7.8	5.9	6.5
Return on Assets (ROA)	-0.8	2.3	2.7	-1.4	2.5	2.3	2.7

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

p= provisional

CHAPTER 5: SECURTIES AND NON-BANK MONEY LENDERS

The Central Bank's efforts are ongoing to improve the data coverage of the securities industry and non-bank money lenders. However, activities in both sectors are not expected, yet, to pose any financial stability concerns. While in the domestic securities markets, market capitalisation relative to GDP is 78.0%, only debt and equity instruments are traded in a very illiquid or low-turnover setting. Derivative assets are not yet employed on any of the trading platform. From a contagion point of view, the markets have limited connectivity to the banking sector, beyond low-volume shifts in liquidity during episodes of initial public offerings of securities. In the meantime, the non-bank money lenders are an emergent sector expected to be materially smaller in size than the consolidated balance sheet of credit unions. To the extent that regulated entities are enrolled in the credit bureau reporting regime, even with competition vis-à-vis systemically important lending institutions, the framework now permits more enhanced market imposed discipline and aggregate monitoring of domestic credit risk.

CHAPTER 6: ASSESSMENT OF RISKS

Risks to financial stability remained within manageable limits in The Bahamas, with no immediate or medium-term threat to the stability of the sector. During 2022, the Central Bank continued to monitor the activities of Supervised Financial Institutions (SFIs) as the Emergency Orders related to the COVID-19 pandemic concluded. Further, domestic entities worked to improve efficiency through the digitisation of service platforms, although business growth remained subdued given the ongoing emphasis on reducing credit risks.

During the review year, financial institutions returned to pre-pandemic operations, although many maintained hybrid working arrangement for employees. The Central Bank continued to monitor developments with domestic financial institutions' loan portfolio, as commercial banks persisted with their write-offs of bad loans and provisioning posture. Further, in August 2022, the Bank relaxed the minimum qualification standards for personal loans, increasing the total debt service ratio (TDSR) to 50.0% from within a range of 40.0%-45.0%. In addition, with the exception of residential mortgages, the Central Bank removed the minimum equity or down payment requirement on loans, allowing lenders to grant facilities of up to 100% of the borrower's financing requirement. These measures allowed financial institutions to capture opportunities for new lending, while maintaining prudent and sound internal risk management policies.

In June 2022, the Central Bank relaxed its lending rules/guidelines to domestic banks and credit unions around the qualification criteria for the provision of domestic credit, against the backdrop of the domestic economy's increased capacity to sustainably absorb more credit expansion and the favourable outlook for external reserves. Despite this relaxation, regulatory focus remained on ensuring that the domestic banks were deploying effective strategies to reduce the level of non-performing loans (NPLs) in the banking system.

The banking system's credit risk management framework remained under close surveillance. As such, in 2022, there was a notable reduction in the number and value of credit facilities on deferral in the banking system representing near zero of the credit in the private sector by end-December, 2022. In the meantime, the industry's NPL rate declined to 7.7% at end-2022 from 9.6% in 2021.

Further, as the Bank's regulatory agenda remained focused on strengthening risk management policies, the Bank finalized its Basel Capital Regulations, 2022 which took a more proportionate measure based on the size and complexity of SFIs and operationalizing aspects of the recovery and resolution framework emanating from the reforms set out in the Banks and Trust Companies Regulation Act, 2020. Additionally, the Bank made progress on its policy position on the prudential treatment of digital assets, adopting the earlier stance of the Basel Committee, of "same risk, same activity, same treatment", with more conservative measures for unbacked crypto assets and algorithmic stablecoins. The Basel Committee continued to explore the prudential treatment of banks' crypto asset exposures, with the release of a second public consultation paper in June, 2022 which underscored the need for banks to deploy sound risk management policies and procedures in this area.

The supervision of AML and TF risks is also a sustained focus for the Central Bank. During 2022, the Bank reviewed the self-assessments of SFIs to gain a current view of SFIs' ML/TF risks and controls. In addition, the Bank completed updated assessments of several domestic and international banks and trust companies, as well as interviews with Money Laundering Reporting Officers and Compliance Officers from the various sectors. In addition, the annual AML Data Return submissions by SFIs remained an important input to the Bank's supervisory oversight, identifying trends and emerging risks. In 2022, Electronic Money Service Providers (EMSP) submitted these returns for the first time. The Bank also implemented an automated tool to monitor SWIFT inbound and outbound wire transfers. The tool is expected to provide new insights on the characteristics of Bahamian cross-border payments and identify patterns of relevance, in the sectors, jurisdictions and institutions of counterparties and intermediaries.

The results of the Central Bank's stress testing indicated that the financial sector remained resilient to detrimental macro-financial shocks, particularly around credit and liquidity risks. Domestic Systemically Important Banks (DSIBs) were stressed under extreme, but credible scenarios, which determined that they have sufficient capital to absorb losses and withstand varying levels of predicted losses from probable economic or financial crises. Given the commercial banks' high capital buffers and satisfactory provisioning levels, there were no immediate financial stability concerns. Stress test results also showed that commercial banks were less vulnerable to interest rate risks, due to the persistent robust levels of eligible capital, among other reasons. Simulations further indicated that the risk to near-term depletion of liquidity was negligible, owing to the high level of liquidity across the banking system, supported by banks' continued cautious lending posture.

Given the collaborative efforts of the Bahamas' Identified Risk Framework Steering Committee (IRFSC), the Office of the Attorney General and the National Identified Risk Framework Coordinator (NIRFC), the Caribbean Financial Action Task Force (CFATF) confirmed the re-rating of The Bahamas' technical rating, due to the completion of two of the FATF Recommendations. With this re-rating, in 2022, The Bahamas became compliant or largely compliant with all 40 of the FATF recommendations.

These initiatives, combined with the measures being employed by the Securities and Insurance Commissions, will serve to further enhance and strengthen the robustness of the supervisory regime in place to ensure the sustained stability of the financial sector.

CHAPTER 7: CONCLUSION

The domestic financial system remained stable and resilient in 2022, albeit with risks that must be managed. Indications for the outlook suggest that the financial system will maintain its soundness, though continued efforts to mitigate existing and potential risks will be required. In this context, the Central Bank will continue to pursue policies that will help to mitigate risks to supervised financial institutions, including operationalizing the Basel capital rules, and strengthening its policy stance and associated guidelines for digital assets. In addition, the Bank will continue to monitor its domestic licensees to ensure they are maintaining prudent and sound internal risk management policies. More broadly, the Bank will continue to collaborate with other supervisory and regulatory bodies to ensure a holistic approach is taken to safeguarding financial stability.

APPENDICES

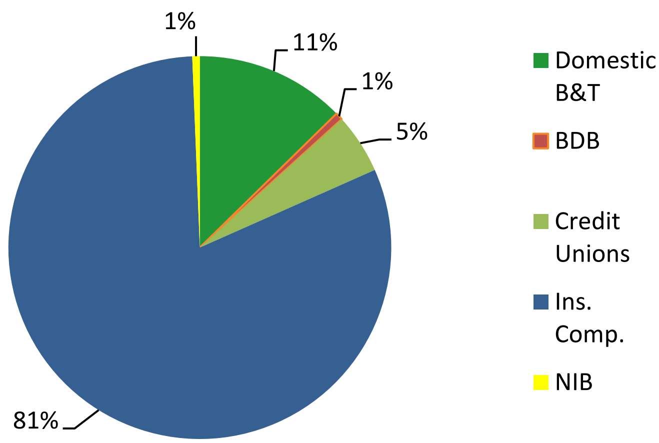
Appendix 1

Structure of the Bahamian Financial System –Selected Highlights

The Bahamas' financial system comprises operations under three key regulators, whose mandate is to ensure a stable financial system. 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, with responsibility 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-22)



At end-2022, there were 202 banks and trust companies (see Table 1, Appendix), which employed approximately 3,664 persons, with the largest single concentration in the 20 local domestic banks and trust companies[6] (3,008 persons). Other entities within the sector included 5 Money Transmission Businesses (MTBs), 3 payment service providers, 8 local credit unions, 158 insurance companies, 238 financial & corporate service providers and 46 investment fund administrators. Within these operations, 10 of the banks and trust corporations operate either fully or in part within the domestic space, as well as 32 insurance companies. In addition, the Government controlled public sector financial entities include: the Bahamas Development Bank (BDB), the National Insurance Board (NIB) and the Bahamas Mortgage Corporation (BMC)[7]. The Bahamas International Securities Exchange (BISX) is also an important component of the

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

domestic financial sector; but with relatively small trading volumes and the absence of complex derivatives or other sophisticated instruments.

Banking Sector

TABLE 1

Structure of the Financial System

	2016	2017	2018	2019	2020	2021	2022
Banks & Trusts							
International	232	225	211	199	195	193	182
Domestic	16	17	20	22	22	21	20
Total	**248**	**242**	**231**	**221**	**217**	**214**	**202**
Non-Bank Financial Institutions							
Investment Funds	859	783	748	742	712	677	682
Credit Unions	10	10	10	10	10	10	8
Insurance companies	142	144	151	160	159	152	158
Domestic Companies & Agents	112	115	118	127	127	122	128
External Insurers	30	29	33	33	32	30	30

r - revised

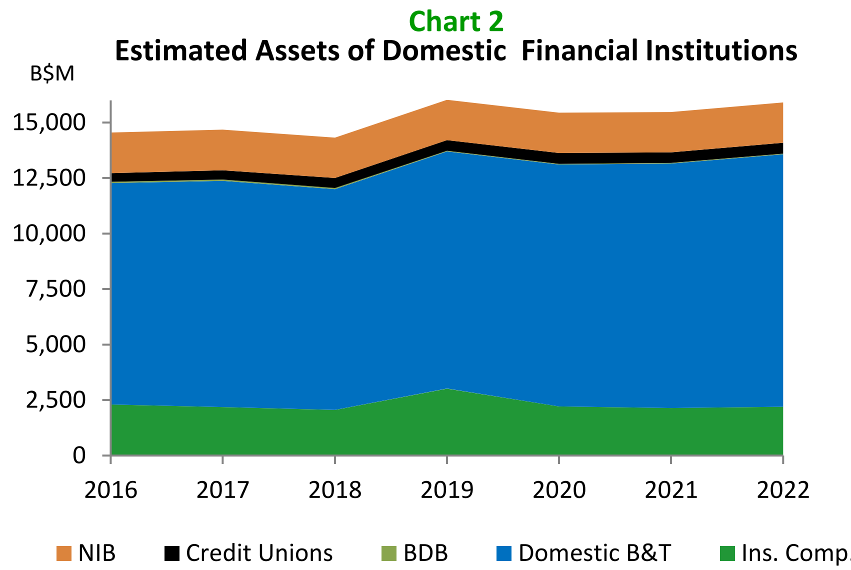
Source: Central Bank of The Bahamas

At end-2022, the banking sector's balance sheet was valued at $138.9 billion, of which international exposures dominated, accounting for $118.0 billion (85.0%) of the total. Domestic licensees (10 commercial banks and 10 mostly trust entities) held the remaining $20.9 billion (15.0%) of assets—which fell by 1.1% in 2022—divided between domestic ($11.4 billion) and foreign ($9.5 billion) assets. Deposits served as banks' most significant source of funds, while the majority share of domestic assets (49.2%) 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 17.1% and 2.0%. The majority of the sector's assets—in excess of two-thirds—were concentrated in the three (3) largest banks.

Fiduciary assets under the care of trust companies were estimated at $127.4 billion in 2022 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 considered systemically important for financial institutions' liquidity management practices. Meanwhile, neither BDB nor BMC attract deposit funding for their lending operations and they do not represent a systemically important source of credit expansion. BDB—which provides financing for small and medium-sized enterprises—reported a 7.5% decline in its assets base, to $32.7 million in 2022, as falloffs in deposit balances due from commercial banks and assets held with other local financial institutions, overshadowed the growth in outstanding loans. During the review year, at BMC, residential mortgages outstanding rose by 5.3%, to $197.2 million.



Credit Unions

Aside from commercial banks, credit unions are the only other deposit taking and loan granting institutions, with an asset base of $483.6 million in December, 2022. At end-2022, the total membership of these cooperatives increased by 5.3% to an estimated 49,658 individuals. In 2022, the number of active credit unions—inclusive of the Co-operative League—declined by 2 to 8. The market continued to be dominated by one institution, which represented approximately 44.8% of the sector's total assets, while smaller entities comprised more modest market shares, ranging from 0.2% to 14.8%.

Insurance Companies

The Insurance Commission of The Bahamas (ICB) reported that operators within the sector consisted of 12 life and health insurers, offering whole life, term life and universal life; and 19 non-life insurers, providing, *inter alia*, insurance for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—4 life insurers and 6 non-life insurers—which represent a combined market share of approximately 89.7% of total gross premiums written and the majority of insurance coverage as at December, 2022. The external insurance sector, which is registered under the External Insurance Act[8], mainly provides self-insurance coverage for non-resident entities in other countries. In 2022, it comprised 30 entities, of which 10 were external intermediaries, 13 were captive cells, with the remaining being non-captive insurers. The total asset base of the sector was relatively stable, remaining at $2.2 billion at the end of 2022.

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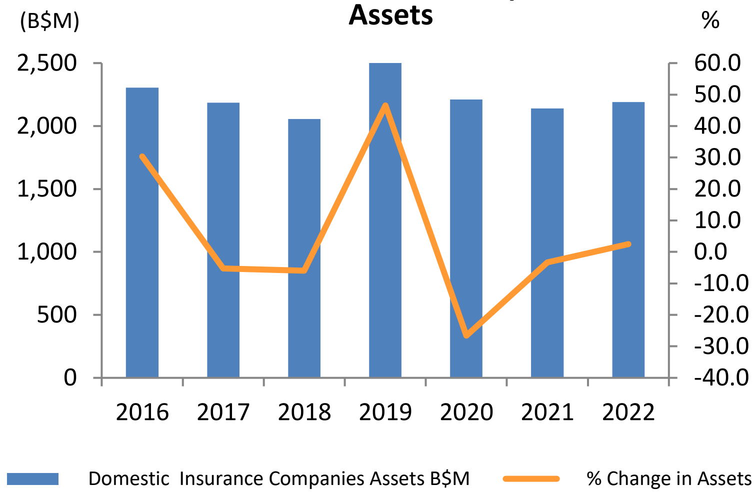
[8] See website: http://www.ibc.gov.bs/home

Chart 3
Domestic Insurance Companies' Assets



Source: Insurance Commision of The Bahamas

Capital Markets

The domestic capital market forms a small but, vital 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.

While there are currently no financial stability concerns associated with the domestic capital market, performance indicators for the local equity market were mixed during the year. The BISX All-Share Price Index increased by 18.7% to 2,645 points, extending last year's 6.5% uptick (see Chart 4). However, the volume of shares traded on BISX fell by 26.4% to 8.9 million, a reversal from a two-fold growth in 2021. As a result, the total value of shares traded contracted to $65.3 million, a turnaround from an expansion a year earlier.

During the review year, the index's market capitalization rose by 8.4% to $10.1 billion, expanding the 5.9% gain in the preceding year. In addition, the number of companies listed remained unchanged at 47 (see Chart 5). The number of securities listed on the Exchange, excluding public debt instruments stabilized at 37, comprising of 20 common shares, 8 preference shares and 9 bonds. However, the number of BRS and debt tranches held steady at 231 and 240, respectively, as the number of publicly traded securities on the exchange totalled 268.

Chart 4
BISX All Share Index

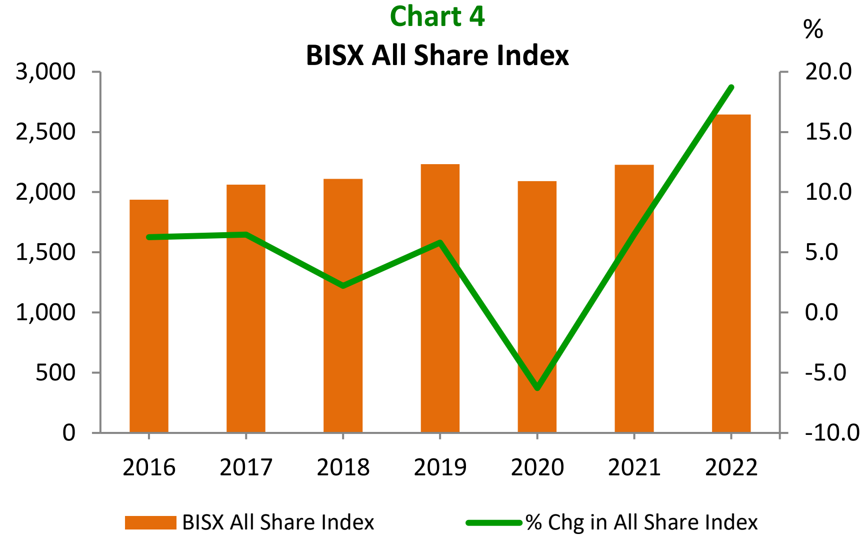
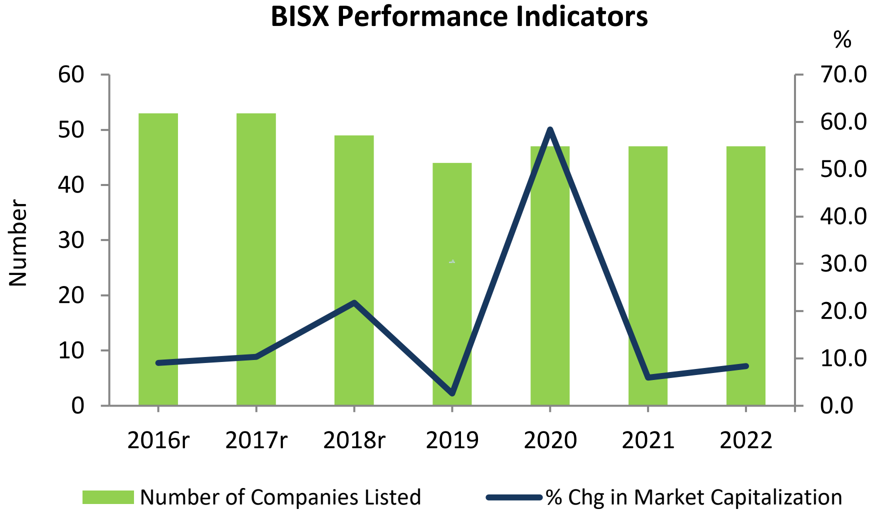


Chart 5
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Payments System

With regard to the domestic payment settlements infrastructure, the Real Time Gross Settlement System (RTGS) is owned and operated by the Central Bank and settles large value transactions (in excess of $150,000). Additionally, the Bahamas Automated Clearing House Association (BACH) processes lower value transactions and is owned by the clearing banks. In 2022, the total value of transactions processed within the RTGS system firmed to $43.1 billion, from $36.0 billion a year-earlier. Further, the value of retail payments processed through the BACH increased modestly, by 1.1% to $4.3 billion.

In terms of other electronic-based payment instruments, the value of debit card transactions grew by 16.6% to $2.3 billion. Similarly, during the review year, credit card usage rose by 2.0% to $221.2 million. As it relates to ATM transactions, the number was higher, by 9.6% at 8.9 million and the attendant value firmed by 11.9% to $2.1 billion. The improvements registered in electronic payments usage during the review year are reflective of banks' ongoing efforts to encourage customers to utilize more digital payment options, as well as many individuals' acceptance of digital and contactless payments brought on by the pandemic.

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 normalised 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 normalised 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 4-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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