**THE FINANCIAL SECTOR OF THE BAHAMAS**

The financial services sector, is estimated between 10 to 15 percent of GDP, including both domestic and international operations; with the use of exchange control regulations there is a distinct segregation of domestic and foreign currency operations. As at December 2017, the sector had 242 banks and trust companies; 19 of which operated either fully or partially within the domestic space with over 4,000 individuals employed, and approximately 75 percent working within local domestic banks. There are five money transmission service providers; ten local credit unions (CUs), 50 insurance companies—with roughly 30 operating within the domestic space—as well as several financial & corporate service providers and investment fund administrators. The largest public sector banking entities include: the Bahamas Development Bank (BDB), the National Insurance Board (NIB) and the Bahamas Mortgage Corporation (BMC). Most recently, a few SPVs have been established with the acquisition of a variety of financial assets.

The balance sheet of the banking sector showed total assets of US$189.8 billion at end-2017. International banks accounted for at least 90 percent ($171.1 billion) of the total, specializing in private banking, wealth management, lending and trading. The remaining $18.7 billion is represented on the books of domestic banks. Domestic and foreign assets amounted to $10.2 billion and $8.5 billion respectively (see Figure 1). Insurance companies and credit unions, with assets of $1.9 billion and $420.3 million at the end of 2017, compared to $2.3 billion and $395.5 million, in 2016. The Bahamas Development Bank (BDB), a Government-owned financial institution, which provides financing to small and medium-sized enterprises, asset base contracted by 6.6 percent to $53.5 million, as reductions in demand deposits, “other” miscellaneous assets and outstanding credit were primary drivers**.** (Figure 1).

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| **Figure 1: Share of Domestic Assets by Financial Institutions** |   |
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*Source*: Central Bank of the Bahamas

A banking stability index (BSI) was developed in 2017 andaims toexamine the stability of Deposit Taking Institutions (DTIs) within the archipelago. Using a weighted average of performance indicators: capital adequacy, asset quality, profitability, and liquidity, movements in the index showed a changing of banking sector stability. The analysis showed for the past eight years mostly all of subcomponents reflected gains and the banking sector remained sound. Asset quality improved to 0.46 from 0.33 in 2016, a significant turnaround from a decrease of 0.56 in 2010, which demonstrated the continuous improvements in credit quality over the past few years. Capital adequacy indicator declined by 0.08 to 0.24 from the previous year value of 0.32 and still below 0.28 recorded for 2010. Nonetheless with a value closer to 1, the normalized average indicates there is no heightened risk to stability. The liquidity indicator declined by 0.06 in 2017 compared to 0.59 in the prior year, still more than twice the value at the end of 2010 (0.25). Liquidity indicator showed the elevated levels of liquidity in the sector. Offsetting is the profitability indicator which fell to 0.10 from 0.31 in 2016, and almost the same level as 2010 (o.11).  Rising operational costs, interest income contributed to the deterioration in profitability. The overall BSI declined to 1.33 in 2017 from 1.55 in 2016.

The commercial banking sector remains well capitalized, liquid and profitable. The capital adequacy ratio (CAR) of the commercial banks increased to 32.5 percent at the end of December 2017 and well above the average capital adequacy ratio 28.6 percent as at December 2016. This however remains above the international benchmark of 8 percent and the Central Bank’s rate of 17 percent, which was instituted in 2009 to mitigate the systemic risk associated with the significant credit concentrations in the financial system. Profitability levels with the return-on-assets ratio from 2.0 percent 2016 and is estimated to decline slightly to 1.80 by December 2017. The return-on-equity ratio decline to 6.8 percent in 2017 from 7.9 percent at the end of 2016. Contributing to these developments, other “miscellaneous” operating costs increased, while, the effective interest rate spread narrowed. Liquidity also improved with the liquid-assets-to-total-assets ratio improved from 25.9 percent for 2016, to 29 percent as at December 2017, more than double the required level.

Domestic credit (see Figure 2). The increased usage of external debt proceeds coupled with a reduction in private sector credit impacted domestic credit which contracted by roughly 4 percent while private sector credit fell by 0.7 percent as at the end of 2017. For the first six months of 2018, domestic credit marginally improved to 0.9 percent, as private sector credit declined. Although there is liquidity, lending has been risk-averse because of high non-performing loans (NPLs), which remains high (now down to 8.9 percent as of June 2018). Restructuring credit measure and loan write-offs, helped improved indicators for the banks’ credit quality. However, NPL level remains a concern, as it more than two times the level of NPL in Trinidad and Tobago (4.1 percent). Total provisions to non-performing loans increased to 77.6 percent in June 2018 from 74.6 in 2017, a rate above the USA (57.7 percent, FRED database)[[1]](#footnote-1)[1].

**Figure 2: Credit Growth – Percent Change**



*Source*: Central Bank of the Bahamas

**Credit unions maintaining a strong presence in the archipelago**. The ratio of impaired loans to assets (asset quality), was measured at 12.6 percent at the end of 2017, when compared to 11.8 in 2016. The major components included, 90 days and under segment which included 10.8 percent of the total rose by 61.6 percent to $3.1 million, following a 29.0 percent decline in 2016. Offsetting were the arrears more than 90 days, which fell by 5.9 percent to $20.8 million, still lower than 8.1 percent reduction in the prior period. The current ratio remains roughly 2.6 points above the international benchmark[[2]](#footnote-2)[2]. Profitability indicators show stability as both interest and non-interest income maintain previous levels. The return-on-assets (ROA) ratio moved to 0.04 percent as at the end of 2017, almost ten basis points above 2016. The return-on-equity (ROE) ratio strengthen to 3.6 percent from 3 percent in the prior year.  Liquidity levels also improved as cash balances increased, to 40.8 percent in 2017 from 39.5 percent at the end of 2016.

**The insurance sector[[3]](#footnote-3)[3], increased the number of operating firms to 30 at end-2017**. Including 11 life and health insurers, offering services for whole life, term life and universal life, and 19 non-life insurers, providing, coverage for automobiles, fire, liability and property. A few large firms approximately 4 life insurers and 6 non-life insurers combine to hold market share of roughly 80 percent of total gross premiums written. The local insurance sector maintained its significant size at approximately 5.6 percent of GDP (measured by total gross premiums to GDP), at the end of December 2017, slightly lower than the 6.4 percent recorded in the prior period.  After losses in 2016, related to the passage of Hurricane Matthew, the non-life insurance sector returns to record a profit. Profits from the dominant life insurance segment[[4]](#footnote-4)[4] however declined, due to rising operational expenses. Capital adequacy indicator in the life insurance sub-sector moved slightly from 29.3 percent at end-2016 to 29.5 percent at end December 2017, at least 3 times the international benchmark level of 8 percent. Profit levels decline as the return-on-equity (ROE) 9.2 percent at end 2017 from 10.8 percent in the prior period. While, profitability in the non-life insurance sub-sector showed, both the ROA and the ROE ratios recorded positive values, of 1.9 percent and 5.6 percent, moving substantially from a negative 0.8 percent and 3.8 percent, respectively, in 2016. Net claims paid-out exceed net premiums collected moved to 28.9 percent from 55.7 percent in the prior period.[[5]](#footnote-5)[5] (Financial Stability Report 2017).

**The financial commitments made to CLICO policyholders,** the administration has budgeted $12.4 million for distressed policyholders in the upcoming fiscal year (FY2018/19).In 2017/2018, the government allocated $10 million for CLICO payouts, with a further commitment of $10 million in 2018/2019 and 2019/2020. However, the allocations have increased by $2.4 million for both fiscal periods. In the recent budget, the government committed another $12.4 million for CLICO payouts in 2020/2021 as well. Potential contingent liabilities, according to the IMF, are currently capped at less than 0.4 percent of GDP, thereby not posing significant pressures on spending. A special purpose vehicle may be created to address the obligations to the policyholders. Additional strain may arise from claims on the national insurance program and increased pressure on the public healthcare system.

**Strong compliance with AML/CFT and tax transparency standards should help mitigate the withdrawal of CBR and safeguard the integrity of the financial sector.** The recent IMF Article IV 2018 report noted that the authorities are taking steps to strengthen their AML/CFT framework for domestic and offshore institutions. They have amended legislation to subject general insurance companies to some of the AML/CFT requirements and have created a separate Analytics Unit at the central bank to perform risk-focused assessments, request annual reporting, and support more targeted examinations. The IMF Staff noted that it is critical to work closely with the Caribbean FATF (CFATF) and the FATF to promptly address the strategic deficiencies in the AML/CFT regime identified in the 2017 Mutual Evaluation Report (MER). The authorities have also committed to implement the OECD's international standards on tax transparency for the automatic exchange of financial account information. The authorities have also committed to implement the Base Erosion and Profit Shifting (BEPS) minimum standards to tackle BEPS[[6]](#footnote-6)[6]. The MER documented that there appears to be some reasonable understanding of ML/TF risks within the archipelago and through a well-functioning system for international co-operation, the current mutual legal assistance (MLA) and extradition process is well supported.  Strong customer due diligence (CDD) and other measures are applied in a rule-based manner by Financial institutions (FIs) and designated non-financial businesses and professions (DNFBPs), who are noted to be aware of their regulatory AML/CFT obligations. The IMF Article IV 2017 report suggest that the Bahamas has suffered no significant disruptions in the loss of correspondent banking relationships (CBR). Using information from the central bank survey of CBR users, The IMF report shows that almost 26 percent of respondents, mostly concentrated in the offshore sector, have faced some restrictions or termination of CBR relations but have been able to continue activities through other existing relationships or their parent company (IMF Article IV Reports).

**The recent IMF Article IV report noted improvements to risk-based supervisory framework. The Central Bank of The Bahamas (CBoB) has continued to improve its risk-based supervisory framework.** Introducing the concept of “evergreening” to enhance the risk assessment process, intended to map the risk outlook of financial institutions and establish triggers for supervisory action, while draft amendments have been made to various laws aligning the regulatory framework to international standards.  Recently completed stress tests, show that capital adequacy levels remain above the minimum requirement levels of 17 percent, while liquidity stress tests have no material impact banks’ balance sheets.  Regarding Basel II/III standards. All components of Basel II have been completed along with the capital component of Basel III. Local commercial banks have been reporting on Basel II capital component since 2013. Focus will move now to completing the remaining elements of Basel III, the countercyclical capital buffer, and liquidity coverage ratios. CBoB is also simplifying its Basel II (Minimum Disclosure requirements) and Basel III regulatory framework, consistent with the proportionality principle set out by the Basel Committee. For the insurance sector risk-based capital regime. The Insurance Commission (IC) has strengthened onsite inspections and introduced a risk-based capital regime for long-term insurance companies. The IC plans to conduct a 3-year pilot program to also include general insurance companies in their risk-based capital regime.

**Table: The Bahamas Credit Composition (in percent of B$), 2010-2018**



*Source:* The Central Bank of The Bahamas
Notes: The separation of Commercial and Other Loans into its own category began in 2010/11.

**Deposit insurance has been in place since 1999**. According to the Deposit Insurance Corporation (DIC) of The Bahamas, the basic DIC insurance amount is B$50,000 per depositor, per bank, per ownership category. All deposits, namely single, joint, and trust, are insured separately from an accumulated pool of DIC member institutions aimed at covering potential claims, if a member fails. Outside this resource, there is provision in the Act for the Minister of Finance (the Minister) to levy special contributions on members, should funding requirements exceed these amounts. Usually the accumulated pool or fund is placed in Government of The Bahamas securities, however the most recent The IMF Article IV report has since suggested that a target ratio be developed for Deposit Insurance Corporation (DIC) equity capital and determine primary and secondary borrowing sources.

Access to Credit: Despite ample balance sheet space, banks are cautious in making new loans. Persistent weakness (since the global financial crisis) in economic activity coupled with a debt overhang problem has strained households’ debt-servicing capacity, constraining their access to credit. A central bank survey of bank lending conditions consistently shows an excessively high debt-service-to-income ratio as the most common reason for rejecting loan applications. At the same time, weak economic activity has also affected businesses’ profitability. Therefore, banks have been reluctant to lend in an environment where the only recent development of a credit bureau and the absence of book-keeping tradition, combined with a prolonged recession, make it more challenging to screen borrowers. Large intermediation spreads—which in addition to limited competition also reflect a risk premium on lending—have widened significantly since the global financial crisis. These factors have kept credit to the private sector, excluding NPLs, broadly flat.

1. [1] Bank of The Bahamas (BOB) and other state-owned enterprises (SOEs) continue to be a cause of concern for credit rating agencies, Moody’s released its latest credit opinion on The Bahamas, citing BOB and SOEs as entities with contingent liabilities that could lead to the worsening of the government’s debt metrics. While Moody’s did not move The Bahamas’ Baa3 rating with a negative outlook in any direction, it did warn that BOB and SOEs could, among other metrics, lead The Bahamas to another downgrade. Moody’s said the decision to move the country’s rating up or down could come in the next year to year-and-a-half, with possibly only the negative outlook changing to stable. Moody’s added that the government’s payment of $80 million as capital expenditure related to the special purpose vehicle for toxic loans on BOB’s books, Resolve, undercut government’s savings plan. [↑](#footnote-ref-1)
2. [2] Set by the World Council of Credit Unions at 10 percent. [↑](#footnote-ref-2)
3. [3]Data from the Insurance Commission of The Bahamas (ICB) [↑](#footnote-ref-3)
4. [4] 72.1 percent of total assets and 66.1 percent of gross premiums [↑](#footnote-ref-4)
5. [5] Non-life insurers’ assets reverted back to trend in 2017, contracting by 43.6% ($409.6 million) to $530.4 million, as re-insurance recoveries decreased markedly, by 44.1% to $245.5 million, following a significant temporary increase in 2016, when outstanding claims were paid to policy holders who were affected by Hurricane Matthew. [↑](#footnote-ref-5)
6. [6] The Proceeds of Crime Bill and Financial Transaction Reporting Bill was passed in parliament March 2018, which will strengthen the country’s AML/CFT regime. [↑](#footnote-ref-6)