Financial Stability Report December, 2023

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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 businesses 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

The Central Bank maintained its risk-based approach to the supervision and monitoring of Supervised Financial Institutions (SFIs) during 2023, as risks within the financial sector remained well contained. Against this backdrop, the Bank strengthened its efforts surrounding international risk-based supervisory standards for financial institutions, and developing crisis management frameworks for Bahamian banks and credit unions, including the establishment of a Resolution and Crises Management Unit.

Over the year, the Bank relaxed some prudential controls on credit facilities, given the continued improvement in domestic economic activity. However, its overall surveillance remained focused on ensuring banks were deploying effective strategies to reduce the level of non-performing loans (NPLs).

As a result of commercial banks' robust capital buffers and provisioning levels, no new concerns arose regarding financial stability in the banking system. The consolidated stress tests—which included credit, liquidity and interest rate risks—revealed that Domestic Systemically Important Banks (DSIBs) maintained their ability to withstand sudden shocks, as banks' capital ratios continued to exceed the regulatory minimum of 17.0%. In particular, the banking sector's average capital to risk-weighted assets ratio varied between 29.1% and 32.8% in 2023. Further, the Bank Stability Index (BSI) showed that financial sector stability remained relatively unchanged in 2023, as compared to 2022. In addition, the Aggregate Financial Stability Index (AFSI) revealed that overall financial stability continued to normalize, against the backdrop of the ongoing improvements in the domestic economy.

In addition, the Bank performed a network analysis to assess the level of interconnectedness in the banking system and which relationships present the highest systemic risk. The results showed that there were direct interconnectedness between domestic banks. However, the high capital and liquidity ratios boasted by commercial banks lessened the systemic risk stemming from direct bilateral interlinkages in the system. Furthermore, contagion risks between banks were low, given the relatively small exposure to the capital ratio.

With regard to credit unions, the supervision of this sector continued to focus on risk-based outcomes around Anti-Money Laundering/"Know Your Customer" (AML/KYC), and corporate governance and credit risk management frameworks. Given the sector's narrow capital buffers, the Bank continued to monitor credit unions' management of delinquencies. During the year, credit unions' profitability indicators narrowed slightly, despite improvements in asset quality and liquidity levels. Nevertheless, capital adequacy levels continued to surpass international benchmarks.

In the insurance sector, performance indicators for both life and non-life portfolios, which are now being computed using the IFRS 17 accounting standards, remained robust and in line with international benchmarks. In particular, profitability for the sector strengthened relative to the prior year. Further, the insurance sector remained sound, as suggested by the adequacy of its financial stability ratios.

Aside from some background analysis in the appendix, the securities industry is not featured significantly in the financial stability assessment due to data availability constraints. However, while non-bank lenders, which are supervised by the Securities Commission of The Bahamas, are an increasing source of private credit, there is no evidence that this segment of the financial sector is significant enough to pose a material risk. This is further pronounced by the lack of sophisticated products and fairly narrow liquidity in the securities market.

The Central Bank, over the medium-term, will continue to employ effective strategies for the diligent surveillance of financial institutions, so as to ensure financial stability. Further, against the backdrop of the continued improvement in the domestic economy and improved labour market conditions, the Bank will pursue policies to promote effective liquidity management to safeguard external reserves against any potential increases in credit demand. The continued operations of the credit bureau are anticipated to augment these efforts, by providing information on borrowers' capacity.

STRUCTURE OF THE REPORT

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

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

The Bahamian economy's performance remained heavily influenced by global economic developments. In 2023, the International Monetary Fund (IMF) estimated that the global economy grew by 3.2%, marginally lower than the 3.4% growth in 2022, as economies continued to face headwinds, such as the ongoing geopolitical tensions in Eastern Europe and the Middle East. However, the global economy is projected to maintain its growth pace in 2024.

Regarding the major economies, their growth momentum was sustained in 2023. In the United States, the economy grew by an annualized 2.5%, higher than the 1.9% increase in 2022, attributed to a rise in consumer spending, non-residential fixed investment, state, local and federal government spending and exports (see Table 1). In the labour market, the unemployment rate remained unchanged at 3.6%, while the annual inflation rate narrowed to 4.1% from 8.0%. Against this backdrop, the Federal Reserve increased its target range for federal funds rate to 5.25%-5.50% in 2023, from 4.25%-4.50% in the previous year, in an attempt to reduce inflationary pressures and encourage further economic growth.

In other major economies, growth trends were mixed. In China, real output gains expanded to 5.2% from 3.0% in the preceding year. Further, in Japan, real GDP expansion increased to 1.9% vis-à-vis 1.0% in 2022, amid growth in public and private investment. In contrast, real economic growth in the euro area moderated to 0.4% from 3.4% in the prior year. Likewise, in the United Kingdom real output expansion slowed to 0.1% from 4.3% in the previous year, underpinned by declines in services, production and construction output.

1.2. Regional Environment

In 2023, most economies in the Caribbean region registered slowed growth, mainly as the COVID-19 rebound in output neared completion. Within these developments, unemployment rates fell and inflationary pressures softened, due to downward pressures on international oil and other commodity prices. Nonetheless, risks remained due to the exposure of tourism-based economies to changing conditions in key source markets, while commodity-based economies were affected by the volatility in international prices. Overall, average real GDP growth for the region moderated to 7.2% in 2023 from 14.6% in 2022 (see Table 2). Leading this outturn, real output in Guyana fell to 33.0% from 62.3% the year prior. All the other economies in the region recorded a slowdown, with the exception of Trinidad & Tobago, which registered a 60 basis point strengthening in economic growth to 2.1%, relative to the previous year.

TABLE 1

Selected Indicators for Developed Economies (%)

	2017	2018	2019	2020	2021	2022	2023
GDP Growth Rates							
United States	2.2	2.9	2.3	(2.8)	5.9	1.9	2.5
Euro Area	2.4	1.8	1.2	(6.6)	5.2	3.4	0.4
United Kingdom	2.4	1.7	1.6	(11.0)	7.6	4.3	0.1
China	6.9	6.8	6.0	2.2	8.4	3.0	5.2
Japan	1.7	0.6	(0.4)	(4.3)	1.5	1.0	1.9
Unemployment Rates							
United States	4.4	3.9	3.7	8.1	5.4	3.6	3.6
Euro Area	8.6	7.9	7.6	7.9	7.7	6.6	6.5
United Kingdom	4.4	4.1	3.8	4.5	4.5	3.7	4.0
China	3.9	4.0	3.6	3.8	3.8	5.5	5.2
Japan	2.8	2.4	2.4	2.8	2.6	2.4	2.6
Inflation Rates							
United States	2.1	2.4	1.8	1.2	4.7	8.0	4.1
Euro Area	1.5	1.8	1.2	0.3	2.6	8.4	5.4
United Kingdom	2.7	2.5	1.8	0.9	2.6	9.1	7.3
China	1.6	2.1	2.9	2.5	0.9	2.0	0.2
Japan	0.5	1.0	0.5	(0.0)	(0.2)	2.5	3.3

Sources: IMF, International Statistical Bureaus

TABLE 2

Selected Caribbean Countries' GDP Growth Rates (%)

	2017	2018	2019	2020	2021	2022	2023
Bahamas	2.5	2.9	(0.7)	(23.5)	17.0	14.4	4.3
Barbados	(0.2)	(0.5)	(0.1)	(17.6)	1.4	13.8	4.4
Belize	1.4	3.0	0.3	(14.1)	9.8	8.7	4.7
Eastern Caribbean	1.2	3.0	2.8	(14.0)	3.9	8.9	4.8
Guyana	2.1	3.4	4.7	43.4	19.9	62.3	33.0
Jamaica	0.7	1.4	1.0	(10.2)	4.4	5.2	2.2
Suriname	1.7	2.0	2.3	(13.5)	(3.5)	2.4	2.1
Trinidad & Tobago	(2.0)	0.3	0.0	(7.8)	(1.0)	1.5	2.1
Average	**0.6**	**1.8**	**1.3**	**(6.0)**	**6.3**	**14.6**	**7.2**

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

1.3. The Domestic Environment

The domestic economy's positive trajectory in 2023, supported further declines in non-performing loans (NPLs) and improvements in commercial banks' balance sheets. In 2023, real GDP grew by 2.6%, albeit a moderation from the 10.8% expansion in 2022, as economic indicators converged closer to their expected medium-term potential. Contributing, tourism remained buoyant, supported by robust growth in the high value-added air category and further expansion in the sea segment. Particularly, total visitor arrivals expanded to a record of 9.7 million in 2023 vis-à-vis the 7.0 million in the previous year, as air travel rose by

17.0% to 1.7 million passengers, extending the 1.5 million in the prior year, and sea passengers expanded by 43.5% to 7.9 million, surpassing the 5.5 million in 2023. In the vacation rental market, positive trends were noted, as total room nights sold increased by 23.8%, albeit a moderation from the 48.5% growth in the previous year.

Reflective of a decline in price pressures for imported fuel and other goods and services, domestic inflation moderated in the review year. Specifically, the increase in the Retail Price Index (RPI) slowed to 3.1% in 2023, from 5.6% in 2022, given average cost decreases for most of the index's components.

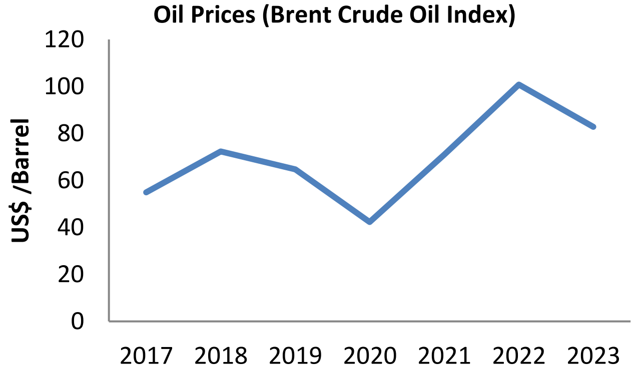
During the FY2022/2023, the fiscal deficit narrowed to $533.8 million, from $721.7 million in the preceding fiscal year. Total revenue grew by $249.7 million (9.6%) to $2,855.4 million, from the previous fiscal year. Similarly, total expenditure rose by $61.8 million, to $3,389.2 million. For the calendar year, the overall fiscal deficit slowed to $514.6 million in 2023, from $718.2 million in 2022. Contributing to this outturn, aggregate revenue increased by $168.9 million, to $2,899.3 million, combined with a $34.6 million reduction in aggregate expenditure to $3,413.9 million.

In 2023, monetary trends in the domestic environment were marked by a reduction in banking sector liquidity, as the growth in domestic credit outstripped the buildup in the deposit base. Likewise, external reserves contracted during the review period, amid a rise in public corporations' net foreign currency outflows, and a slowdown in net foreign currency inflows from the Government. Meanwhile, net inflows through the private sector were almost the same as the previous year. Further, commercial bank's credit quality indicators improved during the year, supported by the economy's uptrend and on-going loan write-offs. In addition, the weighted average interest rate spread narrowed, due to a rise in the weighted average deposit rate, while, the weighted average lending rate remained relatively unchanged.

At end-2023, external reserves stood at $2.5 billion, equivalent to an estimated 29.9 weeks of total merchandise imports, relative to 32.7 weeks in 2022. Usable reserves, or balances after statutory provisions for 50.0% of the Central Bank's demand liabilities, declined by $37.7 million to $1,136.5 million. In addition, the Central Bank's balance sheet experienced a slight decrease, as the end of year external reserves to demand liabilities ratio edged down from the 80.0% benchmark, to 79.1% in December, 2023.

Chart 1

Oil Prices (Brent Crude Oil Index)



Source: Bloomberg

The Bahamas: Macroeconomic Indicators									
	2015	2016	2017	2018	2019	2020	2021	2022	2023
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	6.4	0.6	4.2	3.1	3.2	(23.5)	14.2	15.5	9.2
Real GDP Growth Rate (%)	1.0	(1.0)	2.8	2.6	(1.4)	(21.4)	15.4	10.8	2.6
Inflation Rate (Average chg in RPI)	1.9	(0.3)	1.5	2.3	2.5	0.0	2.9	5.6	3.1
Unemployment Rate (May)*	12.0	12.7	9.9	10.0	9.5	26.2	17.6	10.8	8.8
Overall Fiscal Balance (B$M)	(252.0)	(467.1)	(622.5)	(337.4)	(251.7)	(1,365.9)	(881.8)	(718.2)	(514.6)
% of GDP	(2.2)	(4.0)	(5.1)	(2.7)	(1.9)	(13.7)	(7.8)	(5.5)	(3.6)
Private Sector Credit (B$000)	6,299.7	6,170.8	5,982.9	5,886.2	5,891.6	5,766.1	5,680.7	5,661.6	5,859.1
Weighted Average Lending Rate (%)	12.3	12.5	11.8	11.3	10.5	10.4	10.0	11.0	11.0
Weighted Average Deposit Rate (%)	1.4	1.2	1.0	0.8	0.6	0.5	0.5	0.5	0.5
Treasury Bill Rate (%)	0.9	2.0	1.9	1.7	1.8	1.9	2.9	2.9	2.9
Gross Int'l Reserves (B$M)	811.9	904.0	1,417.4	1,196.3	1,758.1	2,382.2	2,432.8	2,611.0	2,517.4
Import Cover Ratio (Tot. Merch. (CIF) in week	14.1	16.5	22.2	17.4	28.3	56.8	36.1	32.7	29.9
Current Balance (B$M)	(1,478.3)	(1,472.7)	(1,652.9)	(1,199.3)	(281.1)	(2,279.5)	(2,434.0)	(1,232.6)	(1,074.6)
as % of GDP	(12.7)	(12.5)	(13.5)	(9.5)	(2.2)	(22.9)	(21.4)	(9.4)	(7.5)
Total Public Sector Debt (B$M)	7,460.0	7,901.1	8,834.0	9,249.5	9,437.2	10,813.5	11,637.4	12,455.3	12,823.2
of which: External	2,175.8	2,373.0	3,233.9	3,171.8	3,123.1	4,478.0	4,760.8	5,225.0	5,372.7
Internal	5,284.2	5,528.1	5,600.1	6,077.7	6,314.1	6,335.4	6,876.7	7,230.3	7,450.4
Total Arrivals ('000s)	6,112.1	6,265.0	6,135.8	6,622.0	7,249.5	1,794.5	2,100.6	7,000.7	9,654.1
Tourist Expenditure (B$M)	2,537.5	2,725.9	2,930.2	3,727.6	4,125.5	967.3	2,321.7	4,221.8	N/A
Construction Number of Permits Issued	1,312.0	1,109.0	1,355.0	1,504.0	1,553.0	1,278.0	1,578.0	1,584.0	1,519.0
Value of Starts (B$M)	119.8	96.2	136.6	118.2	102.9	154.6	313.7	340.2	N/A
Value of Completions (B$M)	229.8	202.2	1,493.6	333.8	213.0	200.0	307.3	435.5	N/A
Average Oil Prices (Brent Crude Oil Index)	52.6	45.8	55.0	72.4	64.7	42.3	71.0	100.8	82.8

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

*2020, 2021 & 2022 rates represent WEO estimates

N/A - Not Available

CHAPTER 2: BANKING SECTOR

Due to The Bahamas' exchange control restrictions, banks are precluded from undertaking domestic business activities, other than through assets funded with domestic liabilities. Consequently, this inhibits direct connection or balance sheet flows between international to domestic banking operations. As a result, the focus of this chapter is on the stability of the domestic banking sector.

2.1 Asset Trends

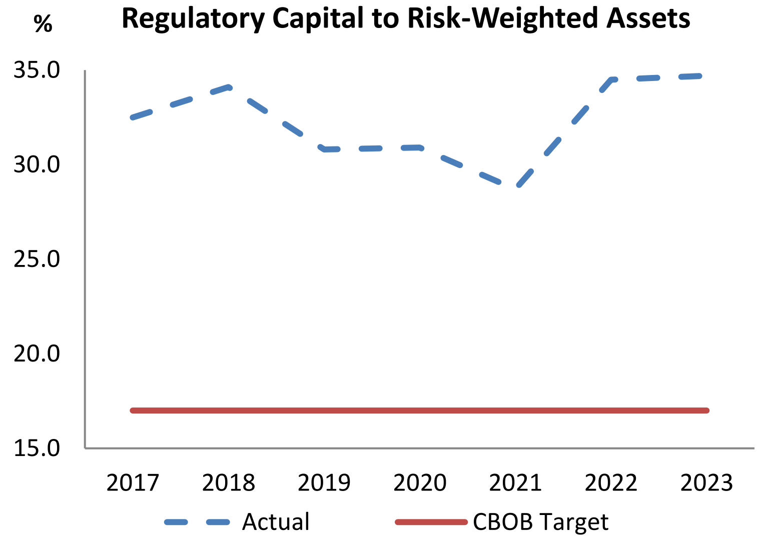
Total domestic assets of the banking system rose by 2.2% to $11.7 billion in 2023, a moderation from the 4.2% buildup a year earlier. This included a 0.7% decrease in banks' claims on the Central Bank, a switch from the 24.7% accumulation in 2022. Providing some offset, loans and advances grew by 0.4%, a reversal from the 0.1% falloff in the previous year. In addition, the expansion in banks' holdings of securities increased to 7.6%, from 3.7% in 2022. As a share of the total asset portfolio, loans and advances comprised the largest segment at 55.8%, followed by securities (20.5%), and claims on the Central Bank, that is cash and balances (19.2%).

2.2 Capital Adequacy

Domestic banks remained well capitalised during the year, although the ratio of average capital to risk weighted assets narrowed by 20 basis points to 34.7%, at end-December 2023. Overall, the system's capital adequacy ratio remained well above the Central Bank's target ratio of 17.0% of risk-weighted assets and the international benchmark of 8.0%[1].

Chart 2

Regulatory Capital to Risk-Weighted Assets



Source: Central Bank of The Bahamas

2.3 Asset Quality

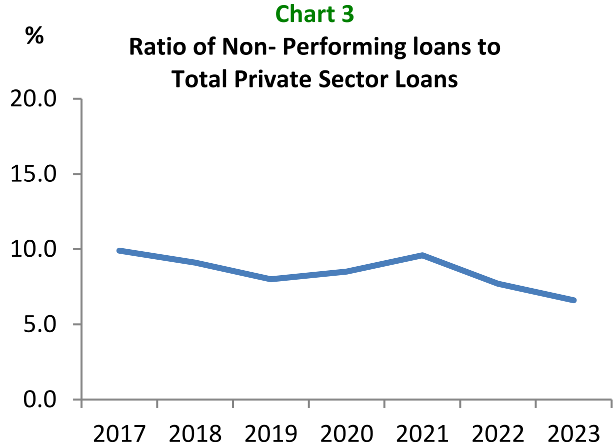
Domestic banks' credit quality indicators improved during the year, owing to the sustained strengthening in the domestic economy, combined with ongoing loan write-offs. In particular, total private sector loan arrears reduced by $48.5 million (7.9%) to $561.7 million, following a $169.6 million (21.8%) contraction in the preceding year. This outcome reflected declines in mortgage and consumer arrears, which overshadowed the rise in commercial delinquencies. As a result, the ratio of arrears to total private sector loans tapered by 1.0 percentage point to 10.3%, from a 2.9 percentage point decrease a year earlier.

An analysis of delinquencies by average age indicated that the non-performing loan (NPL) segment reduced by $53.5 million (12.9%) to $361.5 million, following the prior year's $113.0 million (21.4%) retrenchment. Contributing to this outturn, NPLs for mortgages decreased by $36.1 million (14.1%), while NPLs for

[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.

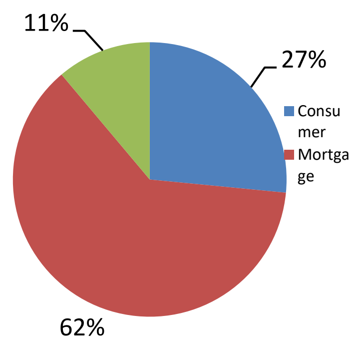
consumer arrears were lower by $17.8 million (15.6%). In contrast, commercial delinquencies edged up by $0.4 million (0.9%). However, short-term arrears grew by $5.0 million (2.6%) to $200.2 million, a reversal from the $56.6 million (22.5%) decline in the previous year. Underlying this outcome, commercial and mortgage delinquencies increased by $7.1 million (72.5%) and $4.6 million (3.7%), respectively. Conversely, consumer delinquencies fell by $6.7 million (11.2%). Consequently, the NPL ratio against total private sector loans fell by 1.1 percentage points to 6.6%; while the ratio of past due loans to total private sector loans edged up by 0.1 percentage points to 3.7%.

Chart 3
Ratio of Non- Performing loans to Total Private Sector Loans



Source: Central Bank of The Bahamas

Chart 4
Composition of Private Loan Arrears (2023)



Source: Central Bank of The Bahamas

2.4 Profitability

Domestic banks' profitability growth moderated in 2023, as net interest income gains were almost offset by higher operational costs. In particular, net profits grew by $5.4 million (1.4%) to $402.4 million, in comparison to the year earlier $142.3 million (55.8%) expansion. As a result, the ratio of net income to equity (ROE) edged up to 18.0% from 17.9% in 2022. However, the ratio of net income to average monthly assets (ROA) fell slightly to 3.4% from 3.5% in the prior year.

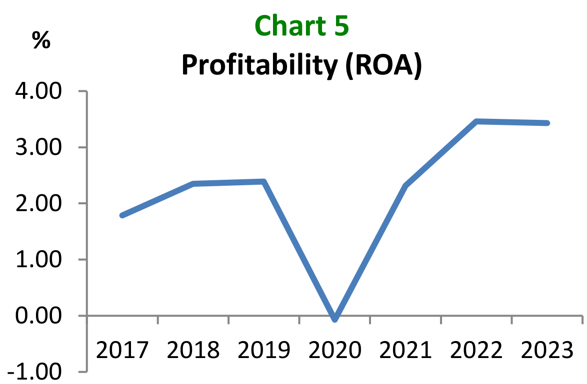
Given declining credit delinquency rates, total provisions for bad debts decreased further by $41.8 million (11.2%) to $330.0 million, following the previous year's $140.8 million (27.5%) reduction. Consequently, the associated ratio to average assets narrowed by 41 basis points to 2.8%. Conversely, total depreciation costs firmed by 16.2%, a turnaround from a 4.6% decrease last year, with the corresponding ratio higher by 3 basis points at 0.2%. Further, total operating costs increased by 12.4%, exceeding the 2.3% growth in the preceding year, which led to a 38 basis point rise in the attendant ratio to 4.0%. Meanwhile, the ratio of net interest income to average assets firmed by 42 basis points to 5.1%, while the ratio of commission and foreign exchange income to average assets rose by 6 basis points to 0.56%.

2.5 Liquidity

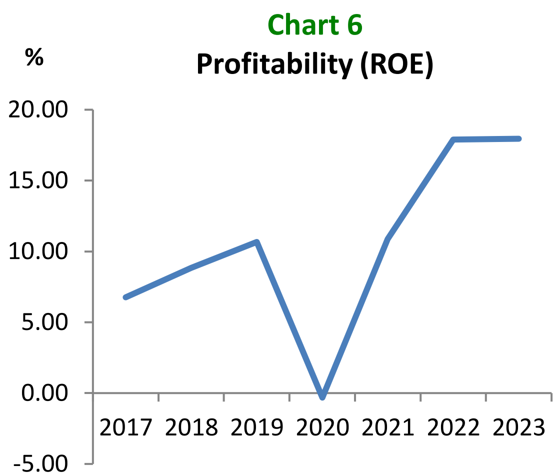
Banking sector liquidity trended upward in 2023, though at a moderated pace. As a proportion of total assets, banks' holdings of liquid assets firmed further by 0.4 percentage points to 37.4%, relative to the 3.2

percentage point gain in 2022. Further, the ratio of liquid assets to short-term liabilities moved higher by 0.6 percentage points to 49.4%, extending the prior year's 2.1 percentage points uptick.

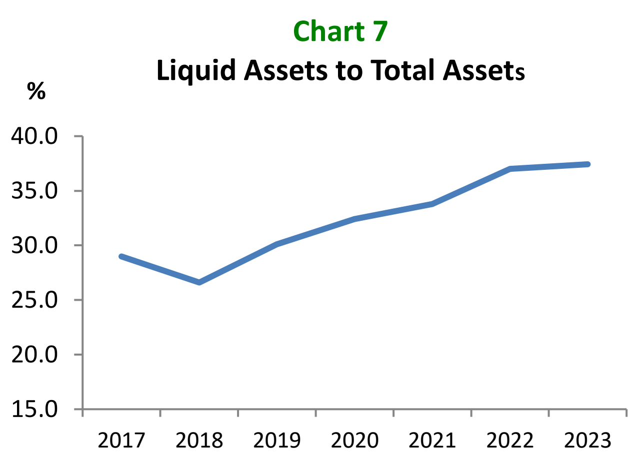
Correlated with liquidity trends, the ratio of deposits to total loans also rose by 2.2 percentage points to 135.7%, following the 11.2 percentage point rise in 2022. Meanwhile, the share of demand balances in total deposits fell by 0.6 percentage points to 50.0%, partly reversing the 3.0 percentage point increase in the year prior (see Table 4).



Source: Central Bank of The Bahamas



Source: Central Bank of The Bahamas



Source: Central Bank of The Bahamas

TABLE 4

Key Domestic Banks Financial Stability Indicators (%)	2018	2019	2020	2021	2022	2023
Liquidity Indicators						
Loan to Deposit Ratio	96.4	87.5	87.2	81.8	74.9	73.7
Deposits to Loan Ratio	103.7	114.3	114.7	122.2	133.5	135.7
Demand Deposits to Total deposits	40.7	45.2	45.1	47.6	50.6	50.0
Liquid Assets to Total Assets	26.6	30.1	32.4	33.8	37.0	37.4
Liquid Assets to Short-Term Liabilities	38.3	41.6	45.7	46.7	48.8	49.4
Credit Risk Indicators						
NPL to Total Private Sector Loans	9.1	8.0	8.5	9.6	7.7	6.6
Total Assets Growth rate	(2.4)	7.4	2.0	1.1	4.2	2.2
Loans & Advances Growth rate	0.9	1.4	(0.3)	(3.2)	(0.1)	0.4
Capital Adequacy						
Regulatory capital to risk-weighted assets (avg)	34.1	30.8	30.9	28.7	34.5	34.7
Trigger Ratio	14.0	14.0	14.0	14.0	17.0	17.0
Target Ratio	17.0	17.0	17.0	17.0	17.0	17.0
Profitability Indicators						
ROAA (annualized)	2.3	2.4	(0.1)	2.3	3.5	3.4
ROAE (annualized)	8.8	10.7	(0.3)	10.9	17.9	18.0
Net interest income to average earning assets (annualized)	5.1	5.0	4.8	4.6	4.7	5.1
Net interest income to gross income	68.5	67.4	70.1	65.0	63.4	62.9
Non interest expenses to gross income	49.7	50.5	62.9	52.7	51.5	51.9
Personnel expenses to non interest expenses	41.2	39.0	32.7	38.1	36.0	32.5
Trading and fee income to total income	3.8	4.7	5.4	6.2	6.8	6.8
Effective Interest Rate Spread	7.1	6.8	7.0	6.9	6.9	7.4

Source: Central Bank of The Bahamas

2.6 Interlinkages in the Financial System – Commercial Banks

A network analysis for commercial banks in The Bahamas was conducted using inter-financial data for December 2023 (See Figure 1). Network analysis allows for an examination of the inter-connectedness of relationships within the financial system, whether banks, credit unions, or other intermediaries. The relationships are typically represented as a network, with nodes representing entities or sectors, directional lines representing the connections or relationships between them, and the thickness of the lines denoting the relative magnitude of the exposures. These connections can take various forms, such as interbank funding, capital, exposure to common assets, or other financial relationships. Such analysis supports systemic risk assessment, particularly where liquidity difficulties or losses in one sector or entity can spread to others, or trigger a cascading impact across the entire financial system.

As depicted in Figure 1, the inter-bank funding network displayed notable direct interconnectedness between domestic licensees, which comprised of eight commercial banks. For confidentiality reasons, all institutions were assigned names, Bank A to Bank H.

Figure 1.1 Network of Gross Credit Exposures within Commercial Banks at end-December, 2023

Contagion risks between banks appear to be low, given the relatively small exposures compared to capital levels. Moreover, high capital and liquidity ratios lessen the systemic risks stemming from the identified direct bilateral linkages. In particular, credit exposures mainly comprised of demand/call, fixed and borrowings/loans, including Bahamian dollars and foreign currency transactions. Bank A and Bank B were both important creditors, with lender-based roles stemming across multiple institutions. Amidst this, a reciprocal lending relationship existed between Bank D and Bank F, with the largest credit flow of $168.0 million. The smallest credit flow, between Bank A and Bank E, was less than $1.0 million. Bank H was isolated in the network, having no inter-bank exposures with others in the network. Otherwise, four of the commercial banks were the most central entities in the funding network, with Bank A exposed to the most banks, while Bank F has the highest credit exposure to one institution.

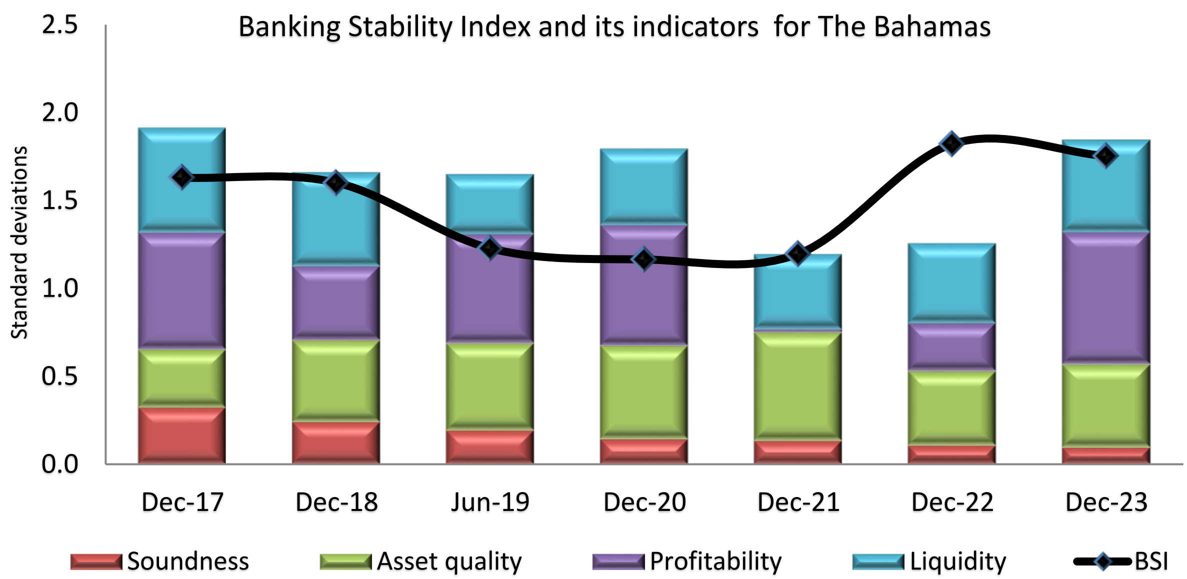
2.7 An Assessment of the Stability of the Banking Sector

2.7.1 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. For 2023, the BSI—which measures the soundness of DTIs in The Bahamas—was relatively stable vis-à-vis the previous year, reflective of the sustained, healthy economic environment. The index stood at 1.75 compared to 1.82 in 2022, signaling that risk to the sector remained low. In particular, the normalized asset quality indicator moved higher to 0.52 from 0.47 in the preceding year. Further, the capital adequacy indicator rose to 0.11 from 0.10 in the year prior, while the liquidity and interest rate indicators stabilized at 0.53 and 0.04, respectively, as banking sector liquidity maintained robust levels and risk remained low. Only the normalized profitability indicator eased, to 0.06, from 0.75 in the previous year, as the average return on equity and assets ratios decreased slightly. Overall, the BSI increased on a standard deviation of 1.1 in December 2023, from 0.9 in 2022, suggesting that liquidity levels within the sector stayed at elevated levels, as the share of liquid assets to total assets grew.

Chart 8

Banking Stability Index and its indicators for The Bahamas

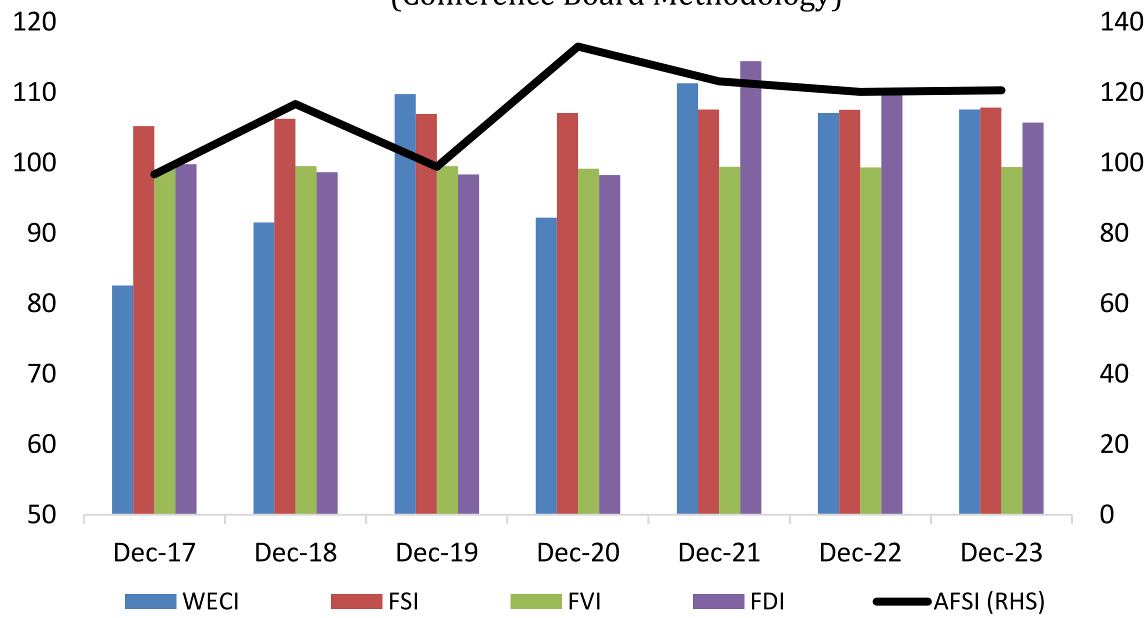


2.7.2. Aggregate Financial Stability Index

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.

An analysis of the AFSI revealed that the overall index normalised, at a fairly stable 110.3 in 2023, vis-à-vis 110.1 in 2022. A breakdown by the components revealed that the world economic climate sub-index grew to 119.5 from 115.1 in the previous year, as growth in the global economy was maintianed, albeit at a slower pace. Conversely, the financial development index narrowed to 107.3 in 2023 from 110.7 in 2022, as both the stock of market capitalization and total credit to GDP declined in the review year. Further, the financial soundness index edged down to 115.6 from 115.7 in the year prior, reflectivie of a narrowing in the liquid assets to total assets and capital to total assets ratios, along with a decrease in the non-performing loans ratio. Meanwhile, the financial vulnerability sub-index was relatively unchanged at 98.7 in 2023 relative to 2022, attributed to an improvement in the total fiscal balance to GDP ratio and moderation in inflation.

Chart 9
Aggregate Financial Stability Index for The Bahamas
(Conference Board Methodology)



2.7.3. Stress Testing

The primary tool used to assess the resilience of the banking system is stress testing, including capital adequacy or credit loss absorbing capacity. Credit risk assessments consider varying levels of non-performing loans (NPLs), which could be triggered by economic or financial shocks. In addition, interest rate shocks consider loss absorbing capacity from market rate shifts, while liquidity shocks examine failure risks from potential surges in deposit withdrawals.

Given the high capital and liquidity positions of banks, stress test results also continue to reflect a resilient system. There are no immediate financial stability concerns, given the commercial banks' high capital buffers and satisfactory provisioning levels.

Credit Risk Stress Tests

The credit risk stress test uses extreme, but plausible, stress scenarios to assess whether the domestic systemically important banks (DSIBs) have adequate capital or total loss-absorbing capacity to withstand various levels of shocks to NPLs, which may be precipitated by a probable economic or financial crisis. The credit stress scenarios examined shocks to NPLs of 100%, 150% and 200% and the consequent impact of these on DSIBs' statements of income and ultimately capital. The consolidated results, which produced simulated declines in banks' capital levels of up to 7.9%, consistently yielded no capital injection requirement. At all levels of shocks, capital remained well above the established regulartory target ratio of 17.0%. In particular, the banking sector's average capital-to-risk-weighted assets ratio fluctuated between 29.4% and 38.5% (see Chart 10).

Chart 10

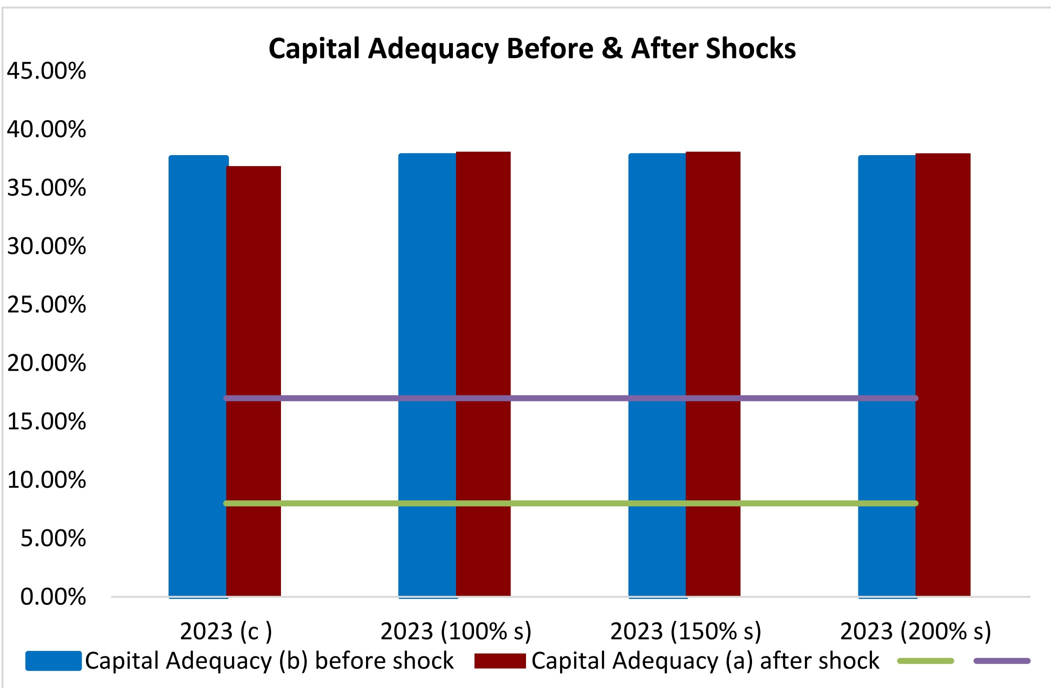
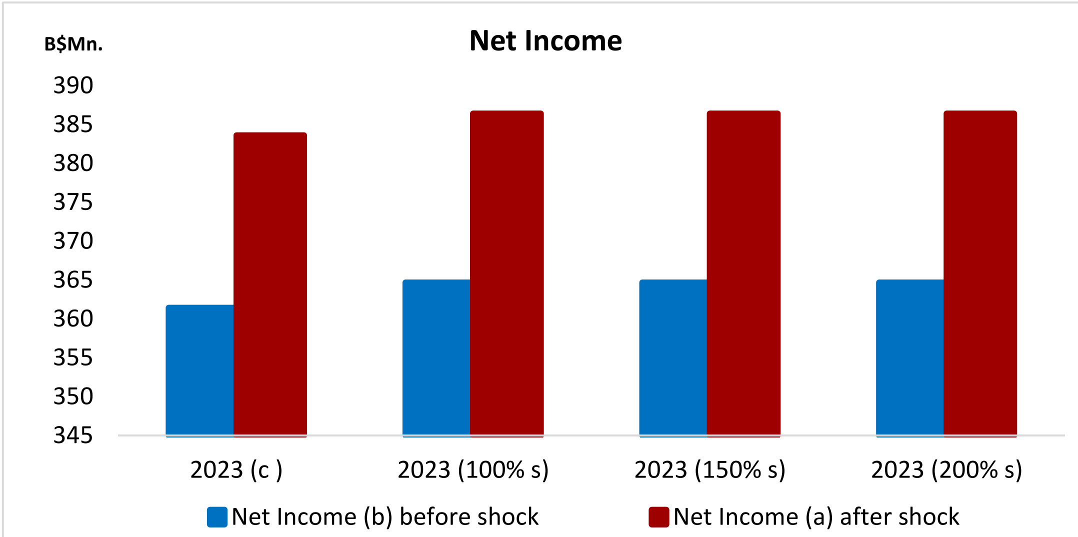


Chart 11



Source: Central Bank of The Bahamas

Interest and Liquidity Shocks

Stress test results continued to show that commercial banks are less vulnerable to interest rate risks, as exposure to assets with price sensitivity to interest changes is low. Moreover, banks' most significant longer-term credit product, mortages, feature periodic interest rate adjustments, according to changes in base rates. Robust levels of eligible capital provide further buffers. Simulations further indicate that the risk of near-term depletion of liquidity was negligible, attributed to the high level of liquidity across the banking system, supported by banks' continued conservative posture to lending.

CHAPTER 3: CREDIT UNIONS

Credit unions remained the second largest group of deposit taking and loan granting institutions, following commercial banks. The Central Bank adopts a risk-based approach to the regulation of these entities. During the year, the sector operated with capital buffers below that of banks, with exposures mainly concentrated in the tourism industry. Nevertheless, the average liquidity ratio remained well above the minimum statutory thresholds. The sector continued to receive heightened protection from enrolment in the Deposit Insurance Scheme, and remained under improved prudential oversight. In 2023, the total number of credit unions held steady at 8.

3.1. Assets and Liabilities

Total assets within credit unions extended by 2.3% ($11.3 million) to $495.0 million in 2023, extending the 1.9% growth in 2022. In the underlying developments, deposits held with the league grew by 3.4% ($3.5 million) to $106.5 million, although lower than the 7.2% gain in the previous year. Similarly, loans to members, which represented a dominant 49.7% of total assets, rose by 2.0% ($4.8 million) to $246.2 million, albeit lower than the 2.3% increase in the prior year. A disaggregation by loan portfolio revealed that consumer credit remained the main form of credit, at 56.2% of total loans, followed by mortgages, at 43.2%, and revolving lines of credit (0.2%).

Total deposits within credit unions rose by 1.3% ($5.5 million) to $420.0 million, in line with growth of the same magnitude in the previous year. Specifically, savings deposits—which accounted for 64.6% of the total—grew by 4.7% ($12.2 million) to $271.2 million, augmenting the 3.4% buildup a year earlier. Conversely, term deposits—at 26.8% of the total—declined by 6.0% ($7.1 million) to $112.7 million, exceeding the 4.7% falloff in the preceding year.

Chart 12

Credit Unions Growth in Assets and Loans

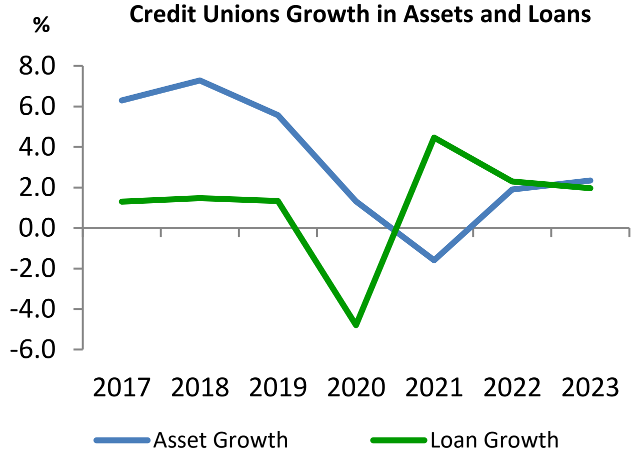
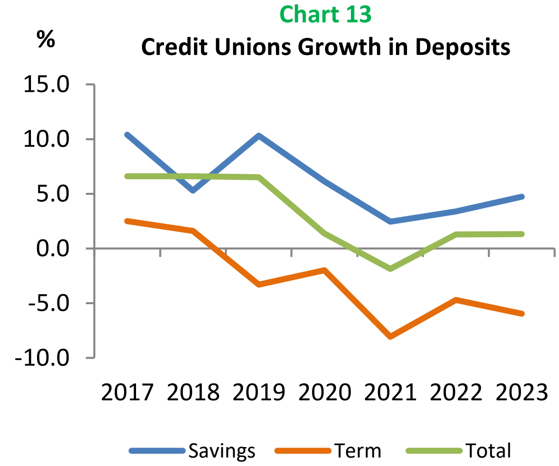


Chart 13

Credit Unions Growth in Deposits

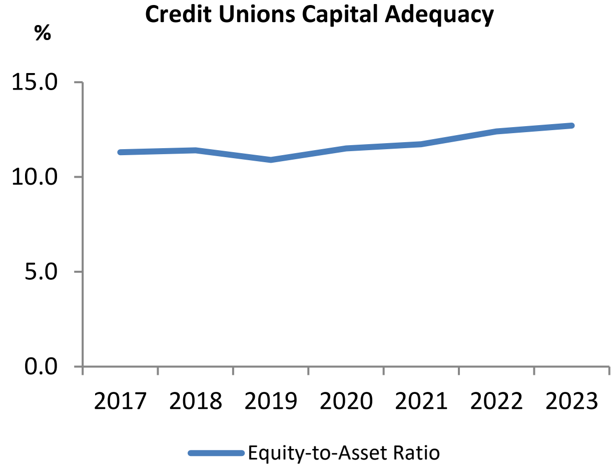


Source: Central Bank of The Bahamas

3.2. Capital Adequacy

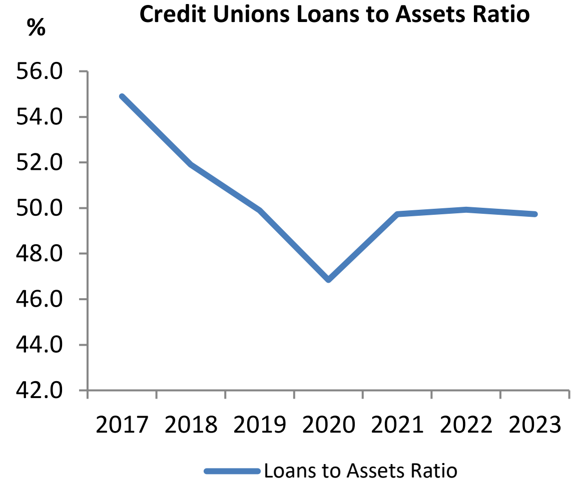
In 2023, credit unions' capital ratio remained above the 10.0% international PEARLS benchmark, at 12.7%. However, the aggregate capital & surplus resources—held to cover unexpected losses—decreased by 2.8% ($0.5 million) to $19.0 million, following a 36.2% expansion a year earlier. Nonetheless, the relevant ratio of total equity to total assets (the gearing ratio) firmed to 12.7% from 12.4% in 2022.

Chart 14
Credit Unions Capital Adequacy



Source: Central Bank of The Bahamas

Chart 15
Credit Unions Loans to Assets Ratio



Source: Central Bank of The Bahamas

3.3. Asset Quality

Credit unions' total impaired loans decreased by 10.3% ($3.5 million) to approximately $30.0 million in 2023, following a 14.8% decline in the preceding year. Correspondingly, the ratio of delinquencies to total loans narrowed to 12.2% from 13.9% in the prior year. An analysis by the average age of delinquency showed that non-performing loans (NPLs)—which accounted for 76.0% of total delinquencies—declined by 18.6% ($5.2 million) to $22.8 million during the review period. In contrast, short-term delinquencies (31-90 days) rose by 32.5% ($1.8 million) to $7.2 million, a turnaround from a 44.7% reduction a year earlier.

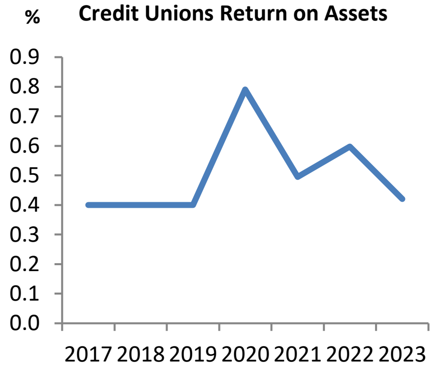
Given the reduction in NPLs, the collateral value of impaired facilities decreased by 9.9% ($1.8 million) to $16.1 million in 2023. Further, the value of uncollateralized exposures fell by $1.7 million (10.9%) to $13.9 million. Similarly, credit unions' total provisions for loan losses fell by $0.3 million (0.03%) to $8.7 million, a reversal from the 9.7% increase in the previous year. Consequently, the ratio of provisions to total gross loans narrowed to 3.5% from 3.7% in 2022, while the coverage ratio for short-term arrears was unchanged at 35.0% and for NPLs, at 100%.

The value of non-earning assets—inclusive of land, buildings, vehicles, furniture and cash—decreased by 7.6% ($3.3 million) to $39.7 million, a switch from a 16.8% increase in 2022. As a result, the relevant ratio of non-earning assets to total assets fell by 90 basis points to 8.0%, a reversal from the 1.1 percentage point growth in the prior year.

3.4. Profitability

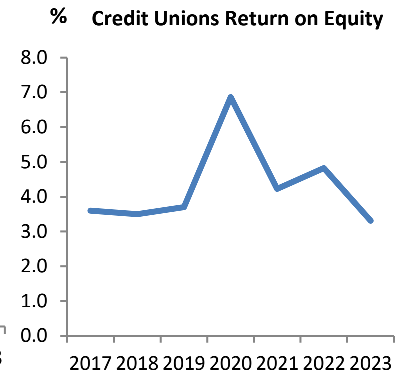
During the review period, credit unions' overall profits declined by $0.8 million (28.0%) to $2.1 million, relative to the previous year. As a result, the ROA moved lower by 20 basis points to 0.4%, while the ROE decreased by 1.5 percentage points to 3.3%.

Chart 16
Credit Unions Return on Assets



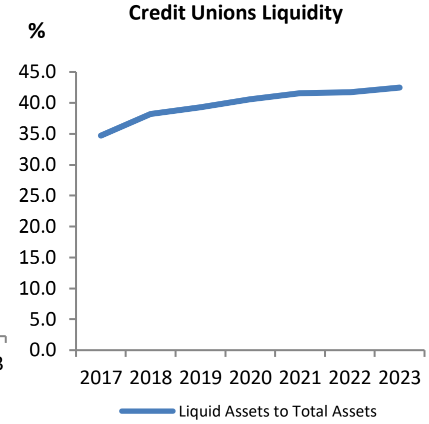
Source: Central Bank of The Bahamas

Chart 17
Credit Unions Return on Equity



Source: Central Bank of The Bahamas

Chart 18
Credit Unions Liquidity



Source: Central Bank of The Bahamas

3.5. Liquidity

Credit unions' liquidity strengthened over the year, reflective of a rise in liquid investments (28.9%), which offset the falloff in financial investments (2.6%) and cash balances (6.8%). Underlying this development, the ratio of liquid assets to total assets moved higher by 70 basis points to 42.5%, relative to the preceding year. Similarly, the alternative indicator—the ratio of liquid assets net of short-term payables to total deposits—rose by 1.3 percentage points to 49.8% at end-2023. Both ratios significantly exceeded the minimum prudential standard of 15.0%.

TABLE 5

Selected Financials for Credit Unions (B$M)	2017	2018	2019	2020	2021	2022	2023
Total Assets	420.3	450.9	476.0	482.3	474.6	483.6	495.0
Total Gross Loans	230.8	234.2	237.3	225.9	236.0	241.4	246.2
Total Deposits	362.2	386.2	411.3	416.9	409.1	414.4	419.9
Liquid Assets	146.0	172.3	195.9	209.5	197.1	201.8	210.2
Savings	198.4	208.9	230.4	244.5	250.5	259.0	271.2
Term Deposits	142.0	144.3	139.6	136.8	125.8	119.9	112.7
Total Members' Equity	47.4	51.3	52.1	55.6	55.6	60.0	62.9
Non-Earning Assets	33.4	37.1	50.2	39.9	36.8	43.0	39.7
Allowance	7.4	7.5	8.0	7.2	8.2	9.0	8.7
Short-Term (ST) Payables	0.5	0.7	1.0	1.1	1.2	0.9	1.1
Capital & Surplus	17.5	19.7	16.4	16.0	14.3	19.5	19.0
Provisions	3.9	3.5	3.4	3.7	2.6	1.5	1.5
Net Income	1.7	1.8	1.9	3.8	2.3	2.9	2.1
Institutional Capital	9.4	9.4	7.8	7.2	5.2	9.9	8.3
# of Credit Unions	10	10	10	10	10	8	8
Financial Ratios (%)							
Equity-to-Asset Ratio	11.3	11.4	10.9	11.5	11.7	12.4	12.7
Return on Assets	0.4	0.4	0.4	0.8	0.5	0.6	0.4
Return on Equity	3.6	3.5	3.7	6.9	4.2	4.8	3.3
Provisions to Loans	1.7	1.5	1.4	1.6	1.1	0.6	0.6
Total Gross Loans to Total Assets	54.9	51.9	49.9	46.8	49.7	49.9	49.7
Liquid Assets to Total Assets	34.7	38.2	41.2	43.4	41.5	41.7	42.5
Non-Earning Assets/Total Assets	8.0	8.2	10.5	8.3	7.8	8.9	8.0
(Liquid Assets-ST Payables)/Total Deposit	40.2	44.4	47.4	50.0	47.9	48.5	49.8

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

CHAPTER 4: THE INSURANCE SECTOR

The insurance industry remains vital in securing a vibrant and sound financial services sector. As the country remains exposed to climate change risks, the industry supports efforts to secure and hedge against losses caused by natural disasters. During 2023, the domestic insurance sector maintained its conservative stance, with its preference to long-term stable investments, such as Government bonds. Against this backdrop, minimal concerns arose regarding the sector's stability.

Information from the Insurance Commission of The Bahamas (ICB) showed that in 2023, the number of domestic insurers decreased to 29 from 30 in 2022. These consisted of 11 life and health insurers, offering whole life, term life, as well as universal life, and 18 non-life insurers, providing, *inter alia*, coverage for automobiles, fire, liability and property. In addition, there is one association of underwriters. The sector continued to be dominated by a few large firms—five life insurers and six non-life insurers—which represented a combined market share of approximately 89.8% of total gross premiums written, and the majority of insurance coverage, as at end-December 2023.

The external insurance sector, which is registered under the External Insurance Act,[2] mainly provides self-insurance coverage for non-resident entities. In 2023, the sector consisted of 63 entities, 20 of which were insurance companies and 11 were captive cells. These insurers' main impact on the domestic economy continued to be through employment and the fees charged by local service providers. As external operations do not impact the local financial sector, the financial stability analysis focuses only on the domestic operations.

According to key indicators, which are now being computed using the IFRS 17 accounting standards, in 2023, the domestic insurance sector continued its moderate growth trajectory. In particular, the life insurance component—the dominant segment—registered a profit of $46.4 million, exceeding the $26.1 million posted last year. Meanwhile, the non-life sector recorded a slowdown in operating profit, moving to $11.8 million from $16.4 million a year earlier. However, the penetration ratio (revenue from contracts to GDP)[3] stabilized at 2.9% in 2023, vis-à-vis the previous year. Overall, the sector remained financially sound, as revealed by the adequacy of its financial stability ratios.

4.1 Life Insurance

The life insurers held 71.7% of aggregate assets, representing the dominant segment of the market. Based on preliminary data, life insurers' total assets rose by 2.7% ($34.9 million) to $1.3 billion in 2023, owing largely to a 33.2% ($46.2 million) rise in other assets to $185.4 million. In addition, receivables grew by 9.1% ($1.3 million) to $15.3 million, while a muted gain of 1.0% ($0.1 million) to $13.3 million was recorded for intangibles. In contrast, during 2023, the dominant investments category—at 68.0% of total assets—reduced by $2.9 million (0.3%) to $910.6 million, with revaluations impacting securities, mortgages and other "miscellaneous"

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

investments. Further, cash & deposits segment—the most liquid asset category—registered an $8.3 million (9.4%) reduction to $80.9 million. Re-insurance recoveries and fixed assets were also lower by 10.0% and by 3.2%, respectively.

Table 6

Life Insurance: Financial Soundness Indicators (%)

	2022	2023
Capital Adequacy		
Capital/Total Assets	30.9%	29.7%
Capital/Contractual Service Margin (CSM)	54.3%	51.1%
Insurance Service Result/Capital	6.9%	7.5%
Asset Quality		
(Real Estate + unquoted equities + receivables)/Total Assets	11.2%	9.3%
Equities/Total Assets	3.7%	3.8%
Real Estates/Total Assets	4.9%	5.0%
Earnings & Profitability		
Expense Ratio (expense/insurance service results	8.4%	8.5%
Investment Yield (investment income/investment assets)	4.1%	9.2%
Return on Equity (ROE)	6.5%	11.6%
Return on Assets (ROA)	2.0%	3.5%

** Compiled using the IFRS 17 standards*

In terms of funding, life insurers' total liabilities grew by 5.8% ($51.9 million) to $941.2 million, underpinned by a $36.3 million (4.9%) expansion in insurance contract liabilities—which finances policyholders' claims and future benefits. In addition, "other liabilities" rose by $22.3 million (16.3%) to $159.3 million. Meanwhile, aggregate equity levels decreased by $5.4 million (1.3%) to $398.4 million, explained by a reduction in retained earnings (4.9%), which overshadowed the growth in other 'miscellaneous' reserves (13.1%). Further, share capital stabilized at $15.8 million.

With regard to earnings, the net income of domestic insurers increased by $20.3 million (77.5%) to $46.4 million, vis-à-vis the previous year. Contributing to this outturn, revenue from contracts expanded by $37.1 million (9.9%) to $412.3 million, while net investment income posted a more than two-fold gain to $83.4 million from $37.2 million in 2022. Providing some offset, total expenses moved higher by $20.8 million (6.2%) to $354.7 million. As a result, the return on equity (ROE) firmed to 11.6% from 6.5%, and the return on assets (ROA) ratios to 3.5% from 2.0% in 2022. In addition, the investment yield ratio rose to 9.2% from 4.1% in the preceding year, reflective of the growth in investment income. Further, the expense ratio edged up to 8.5% from 8.4% in the preceding year.

During 2023, financial soundness indicators for the life insurance industry registered improvement on balance, remaining above international benchmarks. Specifically, the value of equities as a proportion of total assets—which are considered relatively higher risk—increased slightly to 3.8% from 3.7% in 2022. Likewise, the real estate-to-total assets ratio edged up to 5.0% from 4.9% in the prior year. Meanwhile, as a measure of the liquidity of insurance companies, the real estate plus unquoted equities and receivables to total assets ratio moderated to 9.3% from 11.2% in the previous year.

In terms of capital ratios, the insurance service results-to-capital ratio increased to 7.5% from 6.9% in 2022, while the capital to total assets ratio narrowed to 29.7% from 30.9%. Further, the capital-to-contractual service margin ratio declined to 51.1% from 54.3% in the preceding year (see Table 6).

4.2. Non-Life Insurance

Non-life insurance assets also grew by 4.6% ($23.3 million) to $528.9 million in 2023, as cash and deposits—which represented 29.2% of the total—rose by $18.3 million (13.4%) to $154.6 million. In addition, re-insurance recoveries—which includes hurricane claims settlements—increased by $2.1 million (1.5%) to $138.8 million compared to the year prior. Further, other miscellaneous assets and intangibles advanced by $3.8 million (14.6%) to $30.0 million and to $0.9 million (37.4%) to $3.4 million, respectively. In an offset, investments reduced by $1.8 million (1.6%) to $116.9 million. In addition, receivables decreased by $5.2 million (9.7%) to $48.3 million and fixed assets by $0.6 million (3.7%) to $15.9 million.

The sector's total liabilities expanded by $18.6 million (7.1%) to $278.3 million in 2023, underpinned by a rise in insurance contract liabilities, by $19.3 million (8.7%) to $242.1 million, and "other" liabilities, by $1.4 million (6.2%) to $23.6 million, overshadowing the $2.1 million (14.4%) decline in reinsurance contract liabilities.

In this environment, balance sheet equity rose by $4.8 million (1.9%) to $250.7 million, on account of an increase in retained earnings, by $13.7 million (12.5%) and shared capital, by $2.4 million (3.9%), which outstripped the reduction in other "miscellaneous" reserves by $11.4 million (14.9%).

In terms of earnings, non-life insurance companies posted an estimated net gain of $11.8 million in 2023, lower than the prior year's $16.4 million. Contributing to this outturn, total insurance service expenses advanced by $49.1 million (32.8%) to $198.6 million, relative to last year. In an offset, income from contracts advanced to $505.5 million from $459.8 million in 2022.

Financial soundness indicators appeared improved for the non-life insurance sector in 2023. A disaggregation by asset composition revealed that the investment yield ratio moved higher to 9.7% from 7.9% in the previous year. In addition, the expense ratio decreased to 10.9% from 15.5% in the prior year and the risk retention ratio[4] to 4.3% from 5.1% in 2022. Further, the loss ratio—which measures whether net claims paid-out exceeded insurance services—fell to 23.6% from 46.9% in the preceding year (see Table 7). Meanwhile, the equity to total assets narrowed to 47.4% from 48.6%. In this environment, the ROE ratio fell to 4.7% in 2023, from 6.7% in 2022, while the ROA ratio reduced to 2.2% from 3.3% in the year prior.

[4] This ratio examines the relationship between insurance service results and revenue from contracts written.

Table 7
Non-Life Insurance: Financial Soundness Indicators (%)

	2022	2023
Asset Quality		
(Real Estate + unquoted equities + receivables)/Total Assets	53.6%	38.6%
Reinsurance and Technical Reserves		
Risk Retention Ratio (insurance service results /revenue from	5.1%	4.3%
Contract Service Margin (CSM)/Net Claims	52.7%	44.1%
Contract Service Margin (CSM)/Insurance Service Results	9.6%	9.8%
Earnings & Profitability		
Expense Ratio (expense/insurance service results	15.5%	10.9%
Loss Ratio (net claims/insurance service results)	46.8%	23.6%
Investment Yield (investment income/investment assets)	7.9%	9.7%
Investment income/insurance service results	40.1%	52.0%
Return on Equity (ROE)	6.7%	4.7%
Return on Assets (ROA)	3.3%	2.2%

** Compiled using the IFRS 17 standards*

CHAPTER 5: SECURTIES AND NON-BANK MONEY LENDERS

The Central Bank's efforts to improve the data coverage of the securities industry and non-bank money lenders are ongoing. Nevertheless, activities in these sectors are not expected to pose any material risk to financial stability. Further, in the domestic securities markets, while market capitalisation vis-à-vis GDP is 75.0%, only debt and equity instruments are traded in a very illiquid or low-turnover environment. Derivative assets are not yet employed on any of the trading platforms. From a contagion point of view, the markets also have limited connectivity to the banking sector, beyond low-volume shifts in liquidity during episodes of initial public offerings of securities. With regard to the non-bank moneylenders, they 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 relative to 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

Financial risks remained well contained for The Bahamas in 2023, with no immediate threat to the stability of the system and with no heightened medium-term concerns. In particular, the Central Bank's stress testing results, which emphasize the core significance of the commercial banks, revealed that the financial sector remained resilient to detrimental macro-financial shocks, specifically related to credit and liquidity risks. The credit risk stress test used extreme, but plausible, scenarios to assess whether the domestic systemically important banks (DSIBs) had adequate capital or total loss-absorbing capacity to withstand various levels of shocks to NPLs, which may be triggered by a probable economic or financial crisis. The consolidated results, produced simulated declines in capital levels but consistently yielded no capital injection requirement. At all levels of shocks, capital remained well above the established regulatory target. Further, domestic banks are less vulnerable to interest rate risks, due to the infrequent movement in the Bahamian dollar Prime lending, relatively low asset valuation exposure to interest rate changes, and mortgage portfolio, which exhibit medium-term interest rate flexibility. Stress test simulations indicated that the risk of near-term depletion of liquidity was negligible, attributed to the existing high levels of balances across the system, and banks' continued conservative posture to lending.

The surveillance of credit risk management and trends remained focused on ensuring that domestic banks were deploying effective strategies to reduce non-performing loans (NPLs). As a result of industry efforts, the NPL rate declined to 6.6% at end-December 2023, from 7.7% in 2022. Moreover, at the close of 2023, the facilities accommodated COVID-19 payment deferral programme had diminished to just 0.3% of the loan portfolio.

Given subdued private sector lending trends, the Central Bank relaxed lending standards in 2023, giving banks and credit unions more flexibility to provide mortgages, within broadly prudent guidelines. The Bank eliminated the requirement for borrowers to obtain mortgage indemnity insurance to qualify for a reduced equity or down payment amount on residential mortgages. In the absence of the insurance, the minimum down payment for these mortgages was 15.0%. Corresponding with the Bank's relaxed rules for other personal lending, issued in August 2022, financial institutions were guided to vary down payment requirements for residential mortgages, in keeping with their internal frameworks for evaluating and managing individual borrower risks; while still limiting average borrower exposures to within a debt service ratio of 50.0%. Given these measures, the Central Bank does not expect a significant impact on personal lending, but the cost burden to borrowers will lessen to allow more individuals to qualify for credit.

Meanwhile, the Central Bank continued to issue new and revised guidance to clarify or inform other regulatory expectations around supervised financial institution's (SFI) operations, in line with the tailored adoption of international standards and the effective implementation of Bahamian statutes and regulations. In June 2023, the Bank released guidance notes on Enterprise Risk Management (ERM). These lay out the Bank's minimum expectations of how SFIs should develop, implement and maintain their ERM frameworks. Further, SFIs were encouraged to tailor their frameworks to align with the nature, size and complexity of their businesses and risk appetites. In addition, SFIs were informed that the Central Bank expected to be notified of any changes or deviations from their Board approved risk management frameworks. With the release of the guidance, SFIs are now required to ensure that their enterprise-wide risk management assessments submitted to the Bank align with the guidance notes.

The non-bank financial institutions, including entities supervised by the Insurance Commission and the Securities Commission, collectively pose no system risks to domestic financial stability. However, emphasis remains on strengthening the balance sheet of credit unions, and extending macro-prudential surveillance to the remaining sub-sectors. Among recent efforts, the Bank initiated consultation to establish the Bahamas Financial Stability Council (BFSC) with key stakeholders comprising the Ministry of Finance, the Central Bank, the Securities Commission, the Insurance Commission and the Deposit Insurance Corporation. Governed by a memorandum of understanding (MOU), the BFSC would improve interagency coordination and information exchange on financial stability indicators, as well as provide for strategic coordination in instances where a required crisis management response was triggered. The MOU is expected to be concluded and brought into effect in 2024.

Some other noteworthy initiatives are concentrated within the Central Bank's own supervisory regime. These included continued work to develop a legal framework, infrastructure and key tools for an effective recovery and resolution regime. This has significance for how any potential crisis would be managed or resolved. Additionally, the new Digital Assets Guidelines were finalized and released in December 2023. The Guidelines provide an overview of the Bank's expectations of SFIs that are exposed to digital asset activities. The Bank subscribed to the philosophy of "same risk, same activity, and same treatment" adopted from the Basel Committee on Banking Supervision's Crypto Asset Exposures Framework. Therefore, the prudential treatment of digital assets is based on the risks that are associated with the underlying characteristics of these assets. In their corporate governance and risk management frameworks, SFIs are expected to demonstrate understanding and acceptance of the risks to which they are exposed, to manage such exposures and to maintain capital adequacy against the risk weights assigned to digital assets, in line with the evolving Basel framework. While a limited number of SFIs engaged in international operations are expected to offer some off balance sheet exposures around client services in digital assets, direct exposures to the instruments are expected to remain negligible to nil. In the domestic sector, even ancillary services remain at unremarkable levels.

Central Bank's core initiatives, along with collaboration and the oversight across domestic financial sector regulators are expected to continue to strengthen the micro and macro-prudential framework for financial stability in The Bahamas, maintain stability and robustness of the sector.

CHAPTER 7: CONCLUSION

The Bahamas' domestic financial system sustained its soundness and stability in 2023. Indications for the outlook suggest that the financial system will remain stable, as efforts continue to concentrate on improving the quality of surveillance, and to strengthen coordination across key regulators in the sector. In this environment, strong emphasis also remains on pursuing policies that will help to mitigate risks to Central Bank supervised financial institutions (SFIs), including operationalizing the Basel capital rules, and strengthening the Bank's policy stance and associated guidelines for digital assets. The Bank also continues to monitor domestic SFIs to ensure they are maintaining prudent and sound internal risk management policies and ensuring internationally compliant systems within supervised financial institutions.

APPENDICES

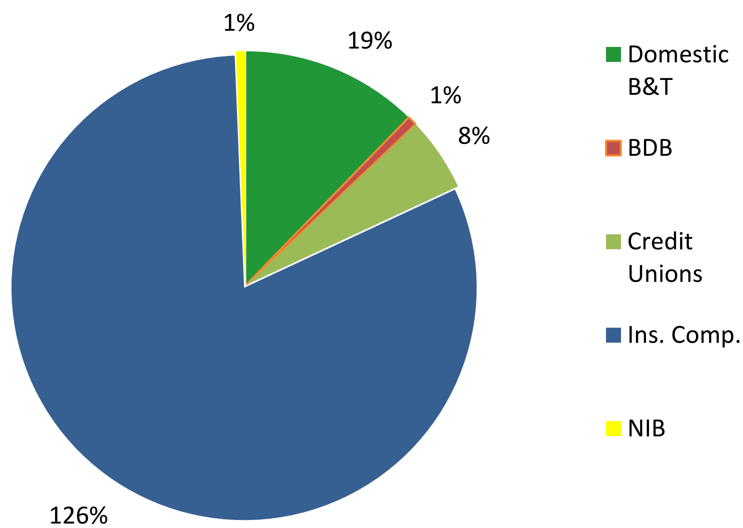
Appendix 1

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-23)



At end-2023, there were 197 banks and trust companies (see Table 1, Appendix), which employed approximately 3,681 persons, with the largest single concentration in the 20 local domestic banks and trust companies[5] (3,021 persons). Other entities within the sector included 5 money transmission businesses (MTBs), 3 payment service providers, 8 local credit unions, 155 insurance companies, 292 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 29 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

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

(BMC)[6]. The Bahamas International Securities Exchange (BISX) is also an important component of the domestic financial sector; but with relatively small trading volumes and the absence of complex derivatives or other sophisticated instruments.

TABLE 1

Structure of the Financial System

	2017	2018	2019	2020	2021	2022	2023
Banks &Trusts							
International	225	211	199	195	193	182	177
Domestic	17	20	22	22	21	20	20
Total	**242**	**231**	**221**	**217**	**214**	**202**	**197**
Non-Bank Financial Institutions							
Investment Funds	783	748	742	712	677	682	659
Credit Unions	10	10	10	10	10	8	8
Insurance companies	144	151	160	159	152	158	155
Domestic Companies & Agents	115	118	127	127	122	128	126
External Insurers	29	33	33	32	30	30	29

r - revised

Source: Central Bank of The Bahamas

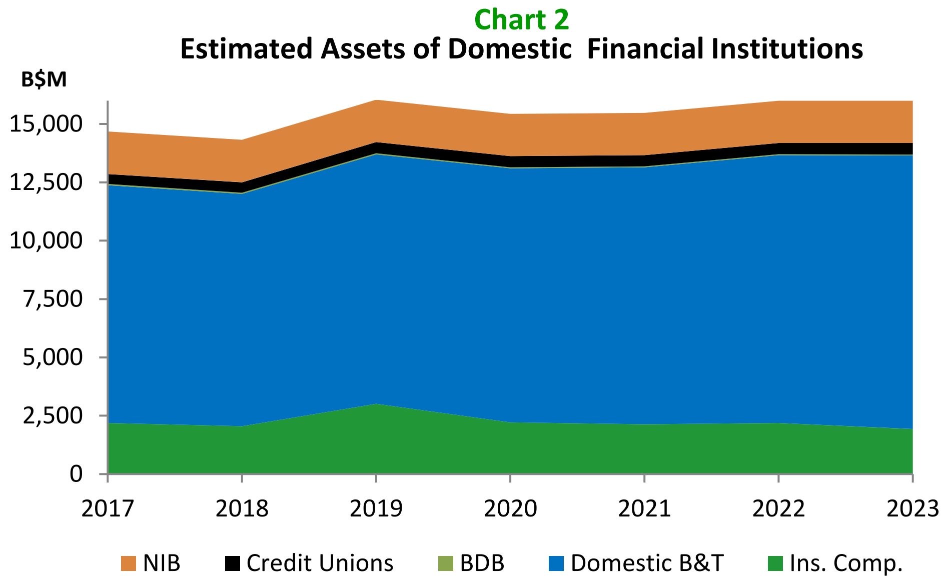
Banking Sector

At end-2023, the banking sector's balance sheet was valued at $126.9 billion, of which international exposures dominated, accounting for $107.8 billion (84.9%) of the total. Domestic licensees (10 commercial banks and 10 mostly trust entities) held the remaining $19.1 billion (15.1%) of assets—which fell by 7.1% in 2023—divided between domestic ($11.7 billion) and foreign ($7.4 billion) assets. Deposits served as banks' most significant source of funds, while the majority share of domestic assets (49.4%) comprised 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 18.0% and 1.8%. 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 rose by 6.5% to an estimated $295.3 billion in 2023 and were almost exclusively held by international financial firms.

State Owned Enterprises

Key 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—posted a 1.4% decrease in its assets base, to $32.2 million in 2023.



Credit Unions

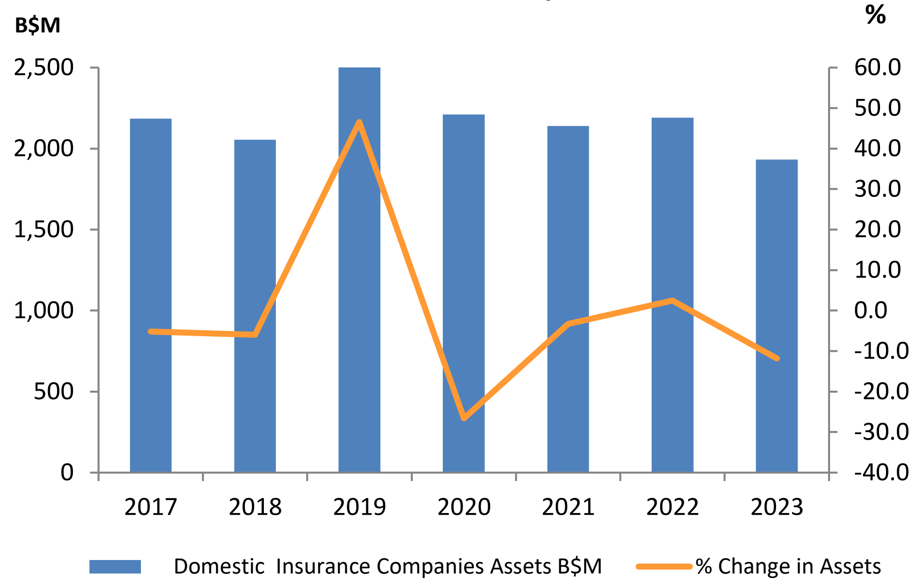
Apart from commercial banks, credit unions are the only other deposit taking and loan granting institutions, with an asset base of $495.0 million as at December, 2023. At end-2023, the total membership of these cooperatives increased by 5.4% to an estimated 51,496 individuals. In 2023, the number of active credit unions—inclusive of the Co-operative League—held steady at 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 89.8% of total gross premiums written and the majority of insurance coverage as at December, 2023. The external insurance sector, which is registered under the External Insurance Act[7], mainly provides self-insurance coverage for non-resident entities in other countries. In 2023, it comprised 29 entities, of which 9 were external intermediaries, 16 were captive cells, with the remaining being non-captive insurers. The total asset base of the sector declined by $258.9 million (11.8%) to $1.9 billion at the end of 2023.

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

Chart 3
Domestic Insurance Companies' Assets



Source: Insurance Commision of The Bahamas

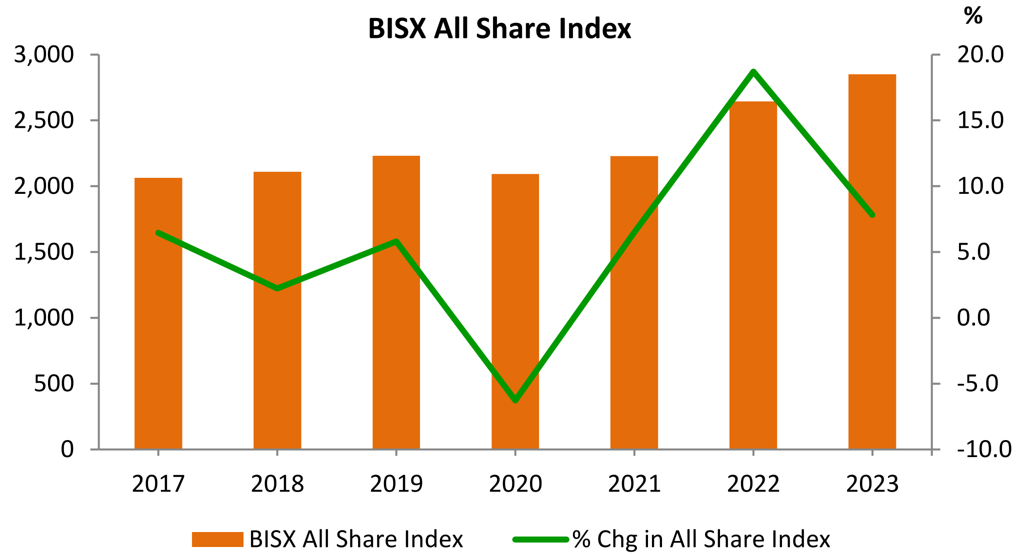
Capital Markets

The domestic capital market forms a small, but vital, part of the financial landscape of the country, primarily representing local public companies, with Governments domestic bonds, on The Bahamas International Securities Exchange (BISX). Currently, there are no financial stability concerns associated with the domestic capital market.

During the review year, performance indicators for the local equity market maintained its upward momentum, reflecting improved economic conditions. The BISX All-Share Price Index grew by 7.8% to 2851.64 points, following last year's 18.7% increase (see Chart 4). However, the volume of shares traded on BISX contracted by 45.0% to 4.9 million, from 8.9 million in 2022. Conversely, the total value of shares traded accelerated to $77.9 million, extending gains of $65.3 million from the previous year.

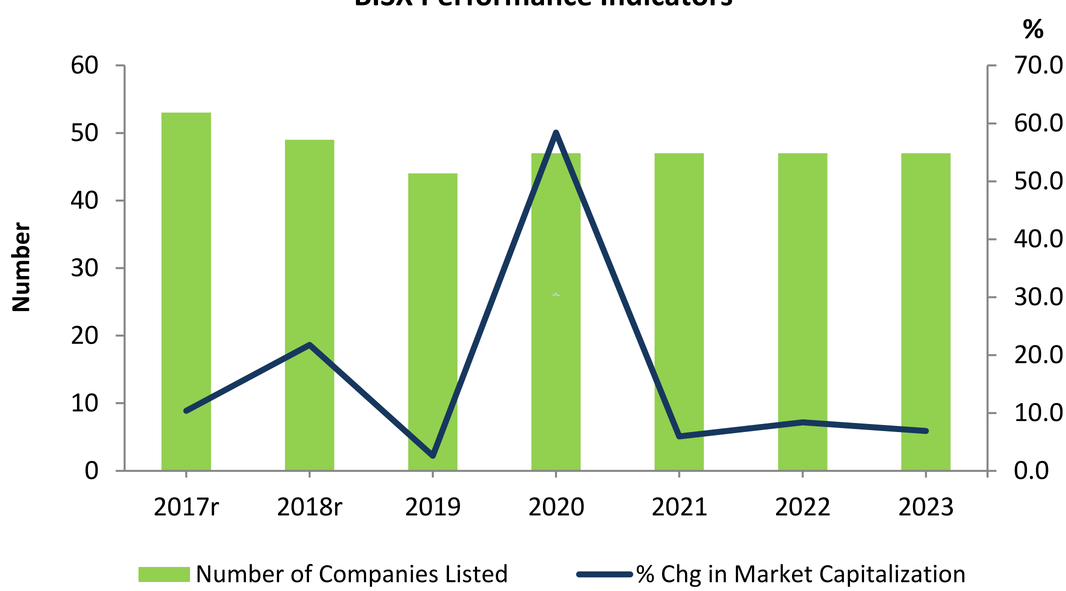
The index's market capitalization rose by 6.9% to $10.8 billion, following an 8.4% expansion in the prior year, while the number of companies listed remained unchanged at 47 (see Chart 5). The number of securities listed on the Exchange, excluding public debt instruments fell to 29, comprising of 20 ordinary shares, 4 preference shares and 5 debt tranches. The sum of debt tranches decreased to 236, inclusive of 231 BRS, resulting in the number of publicly traded securities on the exchange totalling 260. The five largest companies listed on the Exchange accounted for a dominant 76.8% of total market capitalization, declining by 7.7 percentage points from 84.5% the previous year.

Chart 4
BISX All Share Index



Source: Central Bank of The Bahamas & BISX

Chart 5
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Payments System

In terms of 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). In addition, the Bahamas Automated Clearing House Association (BACH), processes lower-value transactions and is owned by the clearing banks. In 2023, a downward movement in domestic electronic payment transactions was observed, notwithstanding the ongoing improvement in the ACH and RTGS systems, and banks' continued encouragement for clients to utilize digital payment services. The total value of transactions processed within the RTGS system decreased by 8.1% to $39.6 billion, from the year prior. Conversely, the value of retail payments processed through the BACH grew by 22.9% to $9.1 billion.

While cash usage remains, the shift to more digital forms of payments persisted throughout the year, resulting in a broadening in the use of debit cards and automated banking services. As it pertains to other electronic-based payment instruments, the value of debit card transactions increased by 18.9% to $2.8 billion in 2023. Similarly, during the review year banks reported a 16.7% expansion in credit card usage to $1.4 billion. With regard to ATM transactions, the volume grew by 13.0% to 10.0 million, and the corresponding value expanded by 26.2% to $2.7 billion in the review year. Technology continues to drive much of the activity within the domestic payments landscape of The Bahamas. The improvements registered in electronic payments usage during the review period are reflective of commercial banks, payment service providers, and the SandDollar Adoption Unit's, 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 normalized weighted average of key performance indicators, namely capital adequacy, asset quality, profitability and liquidity. Each variable was normalized using statistical standardization, which allows for the different variables to be on the same scale. The normalized range of values are from 0.0 to 1.0. An increase in the index value shows greater stability. The BSI is measured in standard deviations from the 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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