



## **Trends in the Domestic Banking System: Addressing Fees**

Remarks by Governor John A Rolle

Delivered at the Bahamas Institute of Chartered Accountants, Accountants' Week  
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### **Introduction**

I want to begin by congratulating the Bahamas Institute of Chartered Accountants (BICA) on another successful Accountants' Week. The BICAs is a trusted and important institution, which plays a critical role in our country's financial services landscape, nurturing and overseeing the development of The Bahamas' professional accounting industry. Forums such as this, provide an avenue for the necessary exchange of knowledge to foster innovation and expansion within the sector.

Therefore, I am happy to be a part of the dialog.

There has been significant public discourse on the state of banking in The Bahamas, including very engaged discussion on fees and the quality of services. The Central Bank has signaled that it is doing important work in this area but mindful of the balanced approach, which ought to be taken, in an archipelago where efficiency and stability concerns intersect with dissatisfaction over the adequacy of the supply of services. Our initiatives do underscore the importance that digital innovation must play in the sector and, therefore, have some pointed relevance to this week's theme.

To lay the foundation, I will focus my presentation on trends within the domestic banking sector, their impact on consumers, and the policy implications. In particular, I will give a brief assessment of key balance sheet trends—including credit growth, deposits and liquidity—followed by an analysis of bank profitability. This will help frame the kinds of interventions, which we think are needed to alleviate structural constraints within the sector, support a return to more conventional patterns of earnings, strengthen the sector's viability, and enhance the consumer experience.

### **Headline Trends**

At a high level, the banking system remains very liquid and well capitalized. Inflows associated with investments, strong tourism activity, and receipts from the government's borrowing during the pandemic, have contributed to healthy levels of liquidity and their counterpart, the Central

Bank's foreign reserves. Indeed, it could be argued that the system has more liquidity than is necessary. This is as a result of private sector lending trends that have not fully recovered, since the Great Recession of 2008, even though some recent expansion has started. Another trend that became entrenched after the 2008 Global Financial Crisis, given the diminished importance of private sector credit, was a shift to more dependence on fee income. The incentive to lend diminished because of a persistent overhang of bad debt—which is now receding—and because the recovery after 2008 did not produce a desired resurgence of creditworthy borrowers in The Bahamas.

## Balance Sheet Trends

As can be seen in the series of charts on balance sheet trends (Charts 1a & 1b in the Appendix), along with an absolute falloff in the amount of outstanding credit to the private sector, the claims also contracted as a fraction of banks' domestic assets. While banks expanded the share of their exposures to the government (or public sector), they also accumulated a significantly greater share of assets as reserves or claims on the Central Bank. These reserves reach around 20 percent of domestic assets at present, as compared to slightly around 5 percent just ahead of the great recession.

These unremunerated assets feed into the definition of bank liquidity. In particular, there are regulated minimum amounts of liquidity that banks are required to hold in Central Bank reserves (their primary liquidity) and secondarily in liquid assets, which includes the first measure plus investments in government debt instruments. However, banks have accumulated significant excess holdings over the regulatory minimums (see Chart 2). The percentages scale on the right axis of Chart 2, shows the relative the magnitude of such surpluses.

Where did this liquidity originate? It largely reflects tourism and various inflows, including the reinsurance proceeds after Hurricane Dorian—which may not have been fully drawn-down—and which have not flowed into private credit.

Another noteworthy balance sheet trend was that while deposits continued to grow, the maturity shifted notably away from longer-term, fixed deposits to shorter-term demand balances (Charts 3a and 3b). This trend was likely due to a combination of factors, including the low interest rate earned on deposits.

## Trends in Profitability and Efficiency

Moving on to trends in commercial banks' profitability, there has been observable fluctuation in average net income, with sharp declines during periods of crisis or shocks to the economy or the sector. Further, while interest income relative to total income declined over time, there was an observable increased reliance on fees and noncredit-related income, compared to the total (Charts 4a and 4b).

Taking into account the entire period since the Great Recession, on average, recent profitability improvement has only restored the system to where it was just before the 2008 setback. Over the period, banks faced high bad debt expenses, with significant loss recognition occurring in 2014 and 2020.

As shown on Chart 4b, net interest income, though, was more diminished in importance at the end of this rebound period, than at the midpoint of the last decade-and-a-half, and non-interest income, was more elevated. The net interest margin showed some initial rebound after 2008, only because of some compression in interest paid on deposits. However, this was not a lever that could be meaningfully used after 2014-2015.

Taking a closer look at expenses (Chart 5a), staff costs have occupied less of the total expense share but only due to the rising influence of other expenses—particularly bad debt costs (Chart 5b). However, the years 2022 and 2023 were outliers because, after banks wrote off significant debts in 2020 made outsized recoveries in the next two periods. Nevertheless, future costs are expected to have subsided on average, given that the average non-performing loans rate is now finally lower than it was at the start of the Great Recession.

Additionally, government fees have also contributed to higher costs, albeit to a lesser extent.

What are these trends pointing to or what are they symptomatic of?

They highlight structural shifts, more than a decade in the making, where the private sector lending activity was sluggish. It was not specific to The Bahamas but in fact was also being faced in other Caribbean markets. Amid the sluggish lending posture, and the quest for greater efficiency in operations, there have been escalated pressures for commercial banks to rationalize their presence in many markets.

### Policy Concerns and Caveats

However, there are some clear tensions between the adjustments that banks have sought and the needs and demands of consumers.

First, amid de-risking and cost rationalization, there has been a reduction in physical presence—especially in The Bahamas’ Family Islands—rising fees on deposit products and transactional services, as well as a decline in the standard of service. Customers though, rightly expect to see more emphasis placed on addressing these issues, which in itself can exert upward pressure on costs if not efficiently managed. Meanwhile, as a substitute for brick-and-mortar operations, banks have placed more emphasis on digital channels to deliver their services.

The task then is to craft prudent, balanced policy interventions. Such interventions must ease the tensions on both the demand and supply side of banking, promote greater efficiency in services delivery, and support a reduction in the reliance on fee income.

Safeguarding the stability of the sector, which recognises the important intermediation role of financial institutions is also critical. Banks must be maintained in a healthy capitalised state. This preserves public confidence; helps keep depositors settled safely, entrusting their funds to the system; and it upholds the central role that these entities play in payments, facilitating orderly commerce. This all feeds back into the priority assigned to promoting sound lending practices, as the fundamental support for healthy balance sheets.

## Identifying Central Bank Policy Initiatives

What does a balanced approach look like?

For the Central Bank, it means finding ways to stabilize and boost the supply of banking services, while consumer protection, financial inclusion, and other issues are tackled.

To stabilize and boost the supply, a digitally inclusive approach, with an educated customer base, equipped to function in this fashion, is the most effective path to take.

As to reducing dependence on fees, credit growth has to be elevated back to the forefront, making more productive use of liquidity, and relatedly, continuing to reduce the significance of non-performing loans. For credit to grow at a sustained faster rate, the quality pool of borrowers, in the employment space will also need enhancing. In particular, how job security tenure is defined helps to determine credit worthiness. As well, the growth potential of the economy has to be strengthened to further augment such pools of eligible borrowers.

To be clear though, drawing down liquidity also means tolerating some reduction in external reserves, because faster credit expansion will fuel more spending on imports. On average, banks also have more than adequate capital, for the time being. Hence more of these surpluses can be taken out at a faster rate through dividends, further easing the earnings burden off fees.

Moving beyond the balance sheet focus. The Central Bank also expects to strengthen its consumer financial protection efforts and provide input to the government on regulatory reforms to address service standards and supply.

Some of the more practical and low hanging fruits, so to speak, include requiring more transparency in the fee-setting practices of banks and promoting customer awareness of such charges across the industry. To this end, the Central Bank has published comparative fee data on its website, since 2022. Banks have always been required to provide notice of fee changes. Now, the Central Bank has outlined more clearly the expected timelines around this process.

But consumer protection and market conduct standards also have to place expanded emphasis on lending practices and credit products. The Central Bank intends to develop such proposals in the context of a more elaborated legal framework for the Office of the Financial Services Ombudsman, which is already housed at the Central Bank.

Our added financial inclusion emphasis includes plans to introduce a “basic banking account”, with limitations of fees that would be permitted on the facility. We also expect to develop standards to improve access to cash and digital money, with considerable thought to achieving better outcomes for the Family Islands.

In support of a more immersive push for efficient digital services, the Central Bank is working to develop and deploy a Fast Payment System. While the Central Bank expects to own the infrastructure to better manage costs, banks, credit unions, and payments services providers have already been invited to the table to begin industry-level discussions on this venture.

We are also, supportive of agency banking—wherein an agent or authorized entity would act as an intermediary between customers and a licensed financial institution, to improve the access to

persons in remote areas. On an interim basis, agency proposals are being encouraged under the money transmission framework.

The timeline for selected initiatives by the Central Bank are concentrated over 2024 and 2025 (Chart 6). Public consultation will feature very importantly throughout this process. It will be an important opportunity to understand how existing practices inside The Bahamas benchmark against the approaches already taken in other countries.

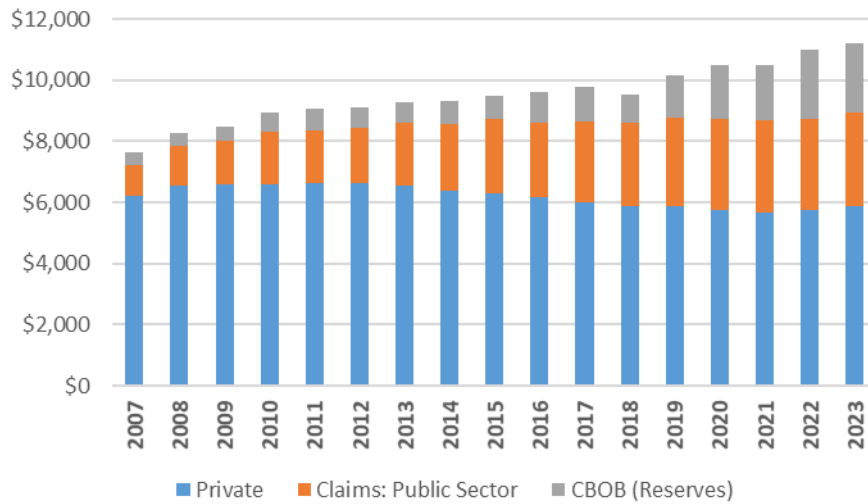
## Conclusions

As I conclude, I want to reiterate a few key takeaways. First, it is important that regulations are balanced with sustained interventions to improve the operating environment for banks. Second, it is critical that policy makers and stakeholders remain mindful of the financial stability implications of medium-term interventions in the sector. Third, and importantly, stronger emphasis must be placed on enabling private sector credit growth. Finally, policy measures must incentivize increased financial services supply in underserved Family Island communities.

## Appendix of Figures and Charts

### Chart 1a

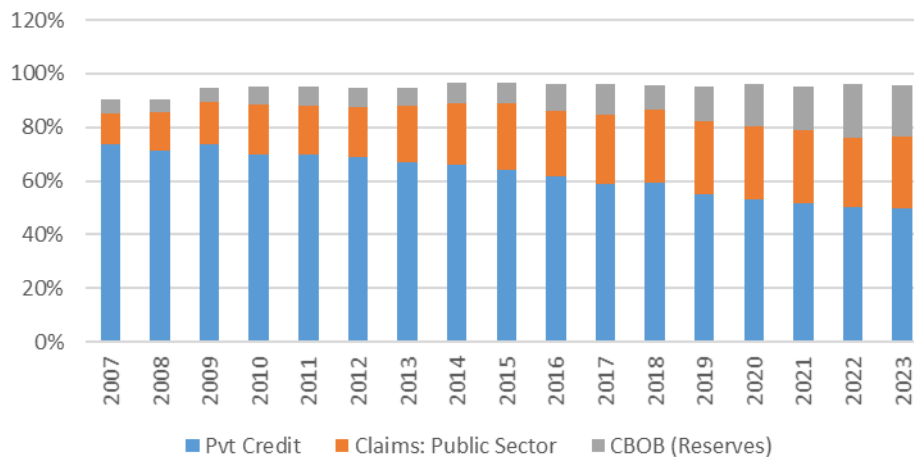
#### Bank Credit and Un-Remunerated Reserves (B\$M)



Note: "Private" = Private Credit or Pvt. Credit

### Chart 1b

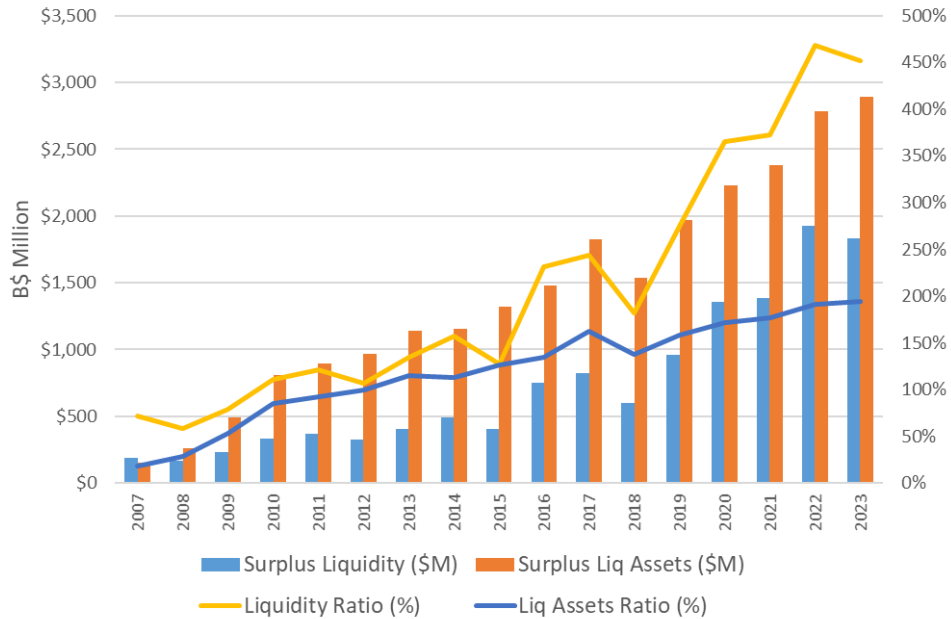
#### Bank Credit and Un-Remunerated Reserves (% of Domestic Assets)



Note: "Private" denotes private sector credit (Pvt. Credit)

Source: Central Bank of The Bahamas

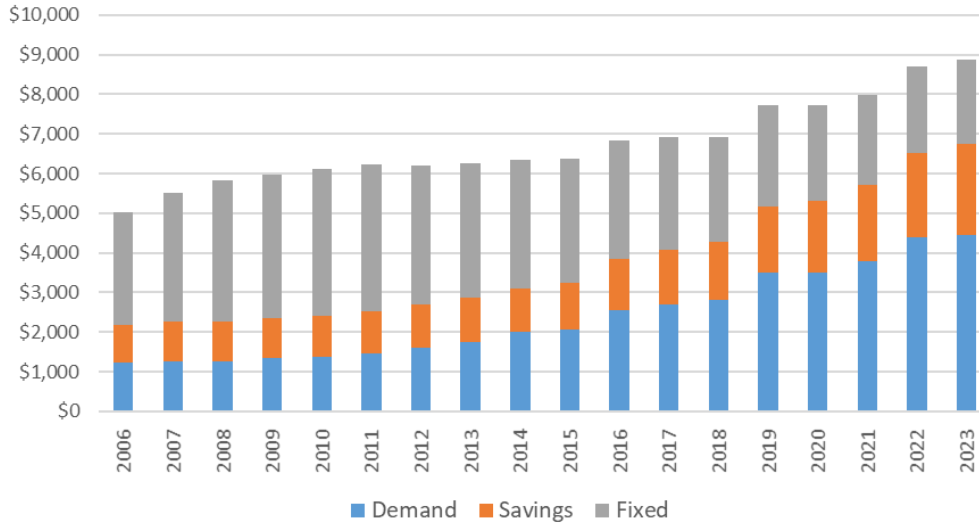
**Chart 2**  
**Liquidity Trends**



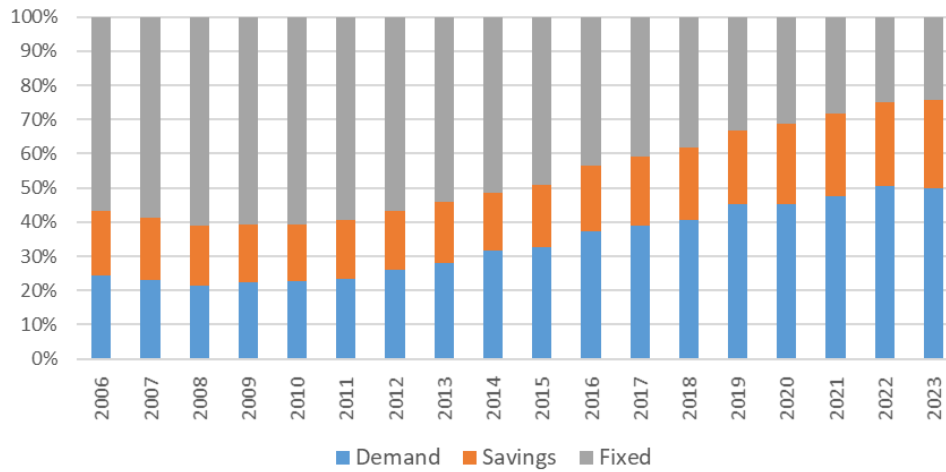
Note: Liquidity is defined as excess holdings of cash and balances at the Central Bank, above the statutory minimum of 5 percent of deposits. Eligible liquid assets are cash, balances at the Central Bank, government issued or guaranteed debt securities and net inter-bank deposits. The regulatory minimum must equal 15 percent of savings and term deposits, plus 20 percent of demand deposits.

Source: Central Bank of The Bahamas

**Chart 3a**  
**Deposit Trends (B\$M)**



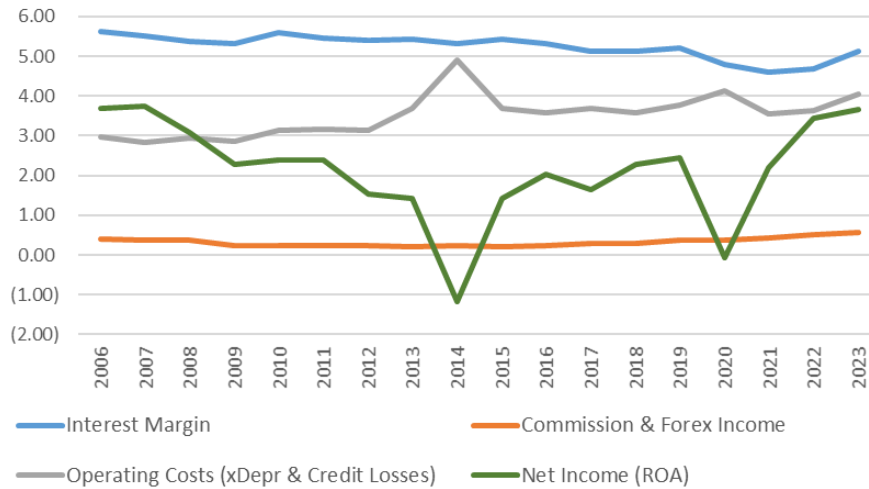
**Chart 3b**  
**Deposit Trends (Distribution)**  
**(Share of Total Funding)**



Source: Central Bank of The Bahamas

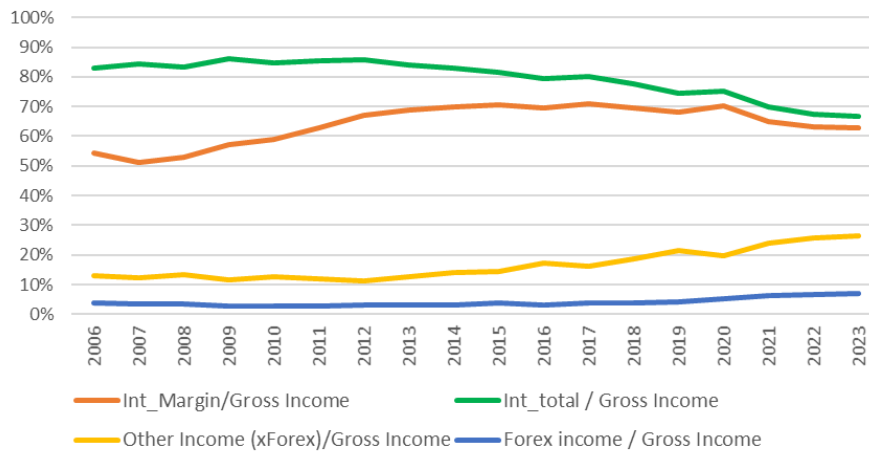


**Chart 4a**  
**Bank Profitability & Efficiency Trends (%)**



Note: Operating cost excludes depreciation and bad debt expenses (xDepr and Credit Losses)

**Chart 4b**  
**Selected Operating Ratios (%)**

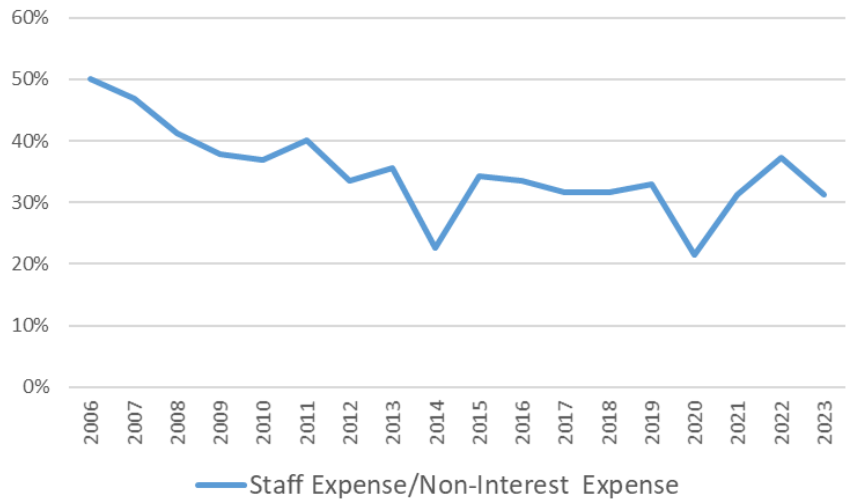


Note: Int\_Margin denotes total interest (Int\_total) less interest expenses. Other Income is excluding foreign exchange income (xForex)

Source: Central Bank of The Bahamas

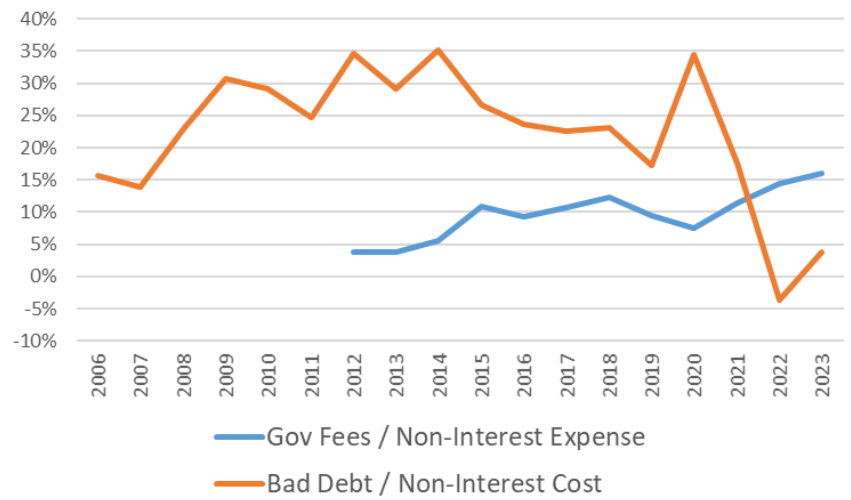
**Chart 5a**

**Staff Expense to Non-Interest Expense (%)**



**Chart 5b**

**Selected Non-Interest Expenses (% of total)**



Source: Central Bank of The Bahamas

## Chart 6: Projected Timelines for Central Bank Initiatives

2024: Interim Directives	<ul style="list-style-type: none"><li>• Interim directives on fee setting practices for disclosures around impact of fee variation</li></ul>
Early 2025: Consultation and Enactment	<ul style="list-style-type: none"><li>• Payment System Act Amendments</li><li>• Basic banking/payments account</li><li>• Fee setting practices on payments products (including deposit services, merchant “convenience” fees practices)</li><li>• Minimum standards for supply of cash and digital money services (including SandDollar)</li></ul>
Mid to Late 2025: Consultation	<ul style="list-style-type: none"><li>• Proposed Financial Services Ombudsman Legislation</li><li>• Consultation on Consumer Financial Protection Framework; Proposed Market Conduct Framework</li></ul>
Late 2025: Fast Payments	<ul style="list-style-type: none"><li>• A Final roadmap for Fast Payments</li></ul>