Joint Press Release

of the

Central Bank of The Bahamas, the Securities Commission of the Bahamas and the Insurance Commission of the Bahamas on the outcome of the IMF's 2012 Financial Sector Assessment Program conducted in respect of The Bahamas

16th April, 2013

The International Monetary Fund (IMF) has concluded that "… there has been clear and material progress in key areas of [The Bahamas'] financial sector oversight" and that the oversight of the financial system has greatly improved since the IMF 2004 OFC assessment of the jurisdiction. These findings are contained in the IMF's Financial System Stability Assessment (FSSA) on The Bahamas which was published by the IMF on its website on Thursday 11th April, 2013. The FSSA summarizes inter alia the outcome of the Financial Sector Assessment Program (FSAP), carried out by the IMF from 17th – 31st July, 2012 in The Bahamas, to assess financial sector performance and soundness and financial sector oversight.

The objectives of an FSAP assessment are to identify the strengths, vulnerabilities and risks of a country's financial system; help the jurisdiction to design policy responses to improve the stability and resiliency of their financial system and strengthen their financial system's contribution to economic growth and stability; foster international cooperation on issues of systemic importance; share financial surveillance and stress test methodologies and assess a country's observance of relevant international standards, codes and guidelines. The following standards were included in the FSAP assessment of The Bahamas:

- the Basel Core Principles for Effective Banking Supervision
- the International Organization of Securities Commissions' Objectives and Principles of Securities Regulation
- the International Association of Insurance Supervisors' Core Principles

Stress Testing

It was observed by IMF assessors that the Bahamian financial system faces no threats to near term financial stability with stress tests showing that domestic banks can withstand severe shocks to solvency and liquidity. Top-down (TD) and bottom-up (BU) stress tests were used to assess seven of the commercial banks' solvency and liquidity risks. Solvency stress tests, which covered credit risk, credit concentration risk and market risk suggest that the banking system as a whole is in a position to withstand various adverse scenarios including a slowdown in tourism as a result of a global recession or a large-scale hurricane; a substantial and prolonged increase in oil prices leading to both a slowdown in tourism receipts and a negative effect on non-performing loans as a result of a decline in disposable income; and a slowdown in foreign direct inflows.

Sensitivity analysis revealed credit risk as a key source of risk for the banking system. The banking system is fairly robust against concentrations in mortgage lending. Market risk is limited, with only modest risk arising from fluctuations in interest rates. Banks' liquidity positions are more sensitive to deposit outflows than wholesale funding shocks due to their dependence on customer deposits.

Spillover risks are generally insignificant as international banks transact with overseas counterparties with no material exposure to commercial entities within the jurisdiction and because the financial safety net is restricted to the onshore banking sector. Vulnerabilities are mitigated for offshore institutions by the Central Bank's supervision of their governance, data retention, and know-your-customer activities. Risks from a foreign parent would appear to be mitigated by the high capitalization of onshore banks.

Crisis Management

The IMF found that the Bahamian financial system experienced only indirect spillovers from the global financial crisis and consequently the crisis management, resolution, and safety net frameworks were not tested. The financial safety net consists of the Central Bank's authority to extend emergency liquidity assistance to eligible banks; a Deposit Insurance Corporation (DIC) which has authority to provide financial assistance to troubled institutions; and access to the payment system. The IMF recommended that The Bahamas prepare and implement a national financial crisis management plan, develop a category of systemic banks narrowed to those eligible for solvency support or extraordinary intervention, consistent with international practice and develop a target ratio for the DIC's equity capital and determine primary and secondary borrowing sources.

Since the FSAP assessment, the Central Bank, Securities Commission and the Insurance Commission partnered with the Toronto Center to host a crisis management workshop for staff of each of these financial sector regulators and the Ministry of Finance. The Central Bank has drafted a project plan for implementing a National Financial Crisis Management Plan, inclusive of proposed timelines, which is under review, with implementation expected in the medium term. The Bank has also developed a website for the Deposit Insurance Corporation which will be launched in mid-April, 2013. An assessment of the adequacy of the deposit insurance fund was carried out in November, 2012 with assistance from the Canadian Deposit Insurance Corporation and an independent technical consultant. A draft report on the outcomes of the assessment is being considered by the Central Bank.

Efforts are also underway to develop a Financial Stability Report (FSR) which will be published biennially beginning in June, 2013. The Central Bank obtained the assistance of consultants to develop the FSR, through the auspices of the Caribbean Regional Technical Assistance Centre. In January 2013, the consultants began the process of gathering the data which would inform the Financial Stability Report.

Reports on Standards and Codes

The FSAP report noted that banking supervision is strong and the jurisdiction has good compliance with the Basel Core Principles for Effective Banking Supervision, with a supervisory framework that covers significant banking risks. A risk assessment process was introduced by the Central Bank in the last quarter of 2010. This process involves the review of all risk areas and assigns ratings to aid in establishing supervisory priorities.

Compliance with the International Organization of Securities Commissions (IOSCO) Principles is generally high and the new Securities Industry Act, 2011 has dealt effectively with most of the issues identified in the 2004 OFC assessment.

Insurance supervision in The Bahamas has significantly improved in the past few years with the enactment of new insurance legislation in 2009 which established the Insurance Commission of The Bahamas (ICB) giving them robust supervisory powers. The ICB's actions have positively impacted the insurance market, resulting in (i) a major clean up of non active insurers; (ii) the dramatic drop in overdue premium receivables with the introduction of a penalty for receivables beyond 30 days; (iii) the institution and enforcement of financial requirements for insurers, brokers and agents; (iv) quarterly supervisory meetings with insurers; and (v) annual stress testing requirements for life insurers.

IMF Recommendations

The FSAP report includes several recommendations highlighting areas for The Bahamas to improve compliance with international standards and codes. These recommendations have been acknowledged by the Bahamian authorities as being consistent with a number of initiatives already underway to strengthen the jurisdiction's financial sector:

- *Stagger terms for Board members of financial sector regulators.*

- *For banking sector supervision:*

    - *increase staffing in some specific areas of expertise;*
    - *implement, as planned, draft guidance on bank responsibilities for managing operational, interest rate and market risk;*
    - *develop guidelines on the scope and methods of consolidated supervision;*
    - *finalize and implement onsite examination templates to reflect the Risk Based Supervision approach;*
    - *the Central Bank should include in its supervisory process as a matter of urgency an examination of compliance with the following recently introduced requirements: (i) transactions with related parties and the write-off of related exposures exceeding specified amounts or otherwise posing special risk be subject to prior approval by the bank's Board, (ii) Board members with conflicts of interest be excluded from the approval, and (iii) banks have policies and processes in place to prevent persons benefiting from the exposures and/or persons related to such a person from being part of the process of granting and managing the exposure;*
    - *a requirement should be introduced for banks to inform the Central Bank if they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of senior management.*

Since the FSAP, the Central Bank has carried out an assessment of the staffing needs of the Bank Supervisory function and is taking steps to identify suitable expertise to augment this function. Guidelines on the Management of Interest Rate Risk were issued in August, 2012 and Guidelines on the Management of Market Risk were issued in December, 2012. Efforts are underway to complete the review of examination templates and a consultant is being identified to assist with the finalization of the templates. In July 2012, the Bank issued a Notice on the Reporting of Material Events and Incidents of Fraud requiring licensees to immediately notify the Inspector of Banks and Trust Companies if they become aware that a material event which could have a significant adverse impact on the licensee's safety and soundness or reputation has or may have occurred or may occur in the foreseeable future. In October, 2012 a Notice on Related Party Transactions was issued to emphasize and clarify the broad expectations of the Central Bank's Large Exposure Guidelines, the Banks and Trust Companies (Large Exposures) Regulations (as amended) and the Central Bank's Corporate Governance Guidelines in addressing conflicts of interest that may arise regarding the approval, management and oversight of related party exposures and write-offs.

- *For the securities sector, replace the Investment Funds Act, 2003 and its regulations with new legislation, to achieve international best practice in the regulation of investment funds.*

  In September, 2012 the Securities Commission established an Investment Funds Act Technical Team (IFATT), to steer development of modern investment funds legislation. The work of the Task Force is on-going.

- *For the insurance sector:*
  - *introduce a standard methodology for the valuation of long term insurer liabilities;*
  - *implement fully the 3 year plan towards risk-based supervision and initiate onsite comprehensive examinations without delay;*
  - *develop support for consumer complaint handling;*
  - *consider establishing an ombudsman;*
  - *develop regulations for appropriate group supervision, corporate governance and risk management standards, processes and procedures and conduct onsite reviews in accordance with Insurance Core Principles; and*
  - *amend legislation to specifically require intermediaries to establish a premium payment trust account separate from the intermediary's account.*

  The Insurance FSAP report identified certain key recommendations that are tied to certain key initiatives of the Insurance Commission of The Bahamas:

  - The Insurance Commission has commenced its risk-based capital review with preliminary guidance issued to long-term insurers with a projected timeframe for full implementation in the near to medium term.
  - The Implementation of a risk based supervisory methodology is underway and onsite reviews commenced in 2012.
  - A complaints process has been established with further enhancements to be made in the near to medium term; agents and brokers have been informed that they are required to establish a premium payment trust account separate from the intermediary's account.
  - A supervisory framework and criteria for best practices and assessment with regard to group supervision and corporate governance have been developed and are scheduled to be communicated to industry in the second quarter of 2013.