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BARBADOS

FINANCIAL SYSTEM STABILITY ASSESSMENT

February 2014

This Financial System Stability Assessment on Barbados was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on January 27, 2014.

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FINANCIAL SYSTEM STABILITY ASSESSMENT

January 24, 2014

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This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited Barbados in July and September-October 2013. The FSAP findings were discussed with the authorities during the Article IV consultation mission in December 2013.

- The FSAP team was led by Marco Piñon (IMF, Mission Chief) and Erik Feyen (World Bank, Mission Chief) and comprised of David Grigorian (IMF, Deputy Mission Chief), Steen Byskov (World Bank, Deputy Mission Chief), Claudio Visconti, Nobuyasu Sugimoto, Joonkyu Park, Yugo Koshima, Jiaqian Chen, Kalin Tintchev (all IMF), Craig Thorburn, Pierre-Laurent Chatain, Claire McGuire, Ines Gonzalez Del Mazo (all World Bank), Jonathan Katz, and Jose Tuya (external experts). Kristine Vitola (IMF, WHD) participated in the first mission and supported the FSAP team on macro issues.

- FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- This report was prepared by Marco Piñon Farah and David Grigorian, with contributions from the rest of the FSAP Update team.

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ANNEXES

Glossary

AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
BCP	Basel Core Principles For Effective Supervision
BDIC	Barbados Deposit Insurance Corporation
BDS	Barbados dollar
BNB	Barbados National Bank
BSD	Bank Supervision Department
BSE	Barbados Stock Exchange
CAR	Capital Adequacy Ratio
CARICOM	Caribbean Community
CBB	Central Bank of Barbados
CLICO	Colonial Life Insurance Company
CXN	Caribbean Exchange Network
DIA	Deposit Insurance Act
EIC	Exempt Insurance Company
FCI	FirstCaribbean International Bank
FCIB	FirstCaribbean International Barbados Bank
FIA	Financial Institutions Act
FOMC	Financial Oversight Management Committee
FSAP	Financial System Assessment Program
FSC	Financial Services Commission
FSMP	Financial Stability Management Plan
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IBC	International Business Company
ICP	Insurance Core Principles
IFSA	International Financial Services Act
MCM	Monetary and Capital Market Department
MoF	Ministry of Finance
MOU	Memorandum of Understanding
NIS	National Insurance Scheme
NPL	Nonperforming Loan
PPS	Policyholder Protection Scheme
QIC	Qualifying Insurance Company
RRP	Recovery and Resolution Plan
WEO	World Economic Outlook

EXECUTIVE SUMMARY

Barbados has a relatively well-developed financial system, including a large offshore sector.[1] The onshore system is dominated by large, regionally active banks. Banking services to the population are also provided by the credit union sector. The system also includes a mature but concentrated insurance sector with extensive international affiliates, and other non-bank financial institutions provide credit and other instruments for savers. The offshore sector is financially segregated from the domestic economy and is dominated by international banks mainly conducting treasury and wealth management operations. The financial system has increasingly been funding the government and residential mortgages, reflecting fiscal pressures and the limits imposed by capital controls on investments abroad.

Systemic risks

With a deteriorating fiscal situation and weak growth prospects, Barbados faces considerable macroeconomic vulnerabilities. Sovereign risk is a concern, given a large public debt, high fiscal deficits, and slow growth, and policy options are limited by a fixed exchange rate regime. While long-standing capital controls provide some protection against disorderly scenarios, they are likely to become less effective over time unless fiscal vulnerabilities are addressed. The authorities are committed to the announced fiscal consolidation plan, but full efforts should be deployed to secure timely and successful implementation.

While the financial system does not appear to be a source of immediate risk, its position appears to be deteriorating, with implications for systemic stability. Credit quality of domestic banks and credit unions has weakened considerably since the global crisis and, with growth expected to remain slow in the years ahead, is projected to deteriorate further. Weaker bank balance sheets could dampen credit supply, amplify the economic decline, and exacerbate broader macroeconomic vulnerabilities.

Moreover, stress-tests illustrate that the financial system would be vulnerable in the face of severe shocks. Relatively large capital and liquidity buffers mean that onshore banks can generally withstand moderate shocks without breaching regulatory requirements. However, vulnerabilities emerge in the case of severe shocks, particularly in a branch of a strong foreign bank and in the credit union sector. The latter is also vulnerable to medium-sized liquidity shocks. The offshore financial sector does not appear to be a major source of risk given that it is prevented from carrying out financial transactions with domestic residents, but common ownership links and reputational risks should be monitored closely.

[1] The term "offshore" is used throughout the report for consistency with internationally recognized terminology. However, the term "international bank" is used instead by the authorities as defined in the International Financial Services Act (IFSA) of 2002.

Data limitations prevent a quantitative analysis of the insurance sector, but vulnerabilities are emerging. In particular, the sector's soundness could not be assessed owing to inadequate liability valuation standards and lack of data on foreign affiliates. However, the presence of a major regional holding company based in Barbados and significant expansion of its non-insurance financial operations create the potential for significant vulnerabilities.

Supervision and regulation

Barbados has improved its legal, regulatory, and supervisory frameworks in line with the 2008 FSAP Update's recommendations. On the banking side, consolidated risk-based supervision was introduced along with several formalized supervisory methodologies. Established in April 2011, the Financial Services Commission (FSC), equipped with adequate powers under the FSC Act, took over supervisory responsibilities for the non-bank financial institutions, upgrading substantially regulation and supervision of these sectors.

Nevertheless, there are important areas where regulations and practices need to be strengthened. While bank supervision is generally appropriate, there is a need to strengthen the independence of the Central Bank of Barbados (CBB), enforcement actions and loan loss provisioning, and anti-money laundering/combating the financing of terrorism (AML/CFT) oversight in the offshore sector. Given that the FSC is a recent creation, supervision of credit unions and the insurance sector, as well as data quality and reporting standards remain work in progress. Key areas where further progress is needed in the insurance sector include liability valuations, capital adequacy standards, cross-border group supervision, and risk management. In the credit union sector, there is a need to establish a two-tiered supervisory approach, given the significant heterogeneity of the sector, and to strengthen resolution procedures.

Crisis management and safety nets

Financial safety nets can be strengthened as the deposit insurance fund remains small. There is a need for a deposit insurer strategic plan, a target ratio, and improved payout procedures. Judicial remedies for challenges to decisions to seize a bank should be limited. Across all sectors, efforts should be made to ensure cost effectiveness of resolution and to safeguard the financial condition of entities in the safety net. Credit unions currently fall outside the financial safety net. However, before the safety net is extended adequate prudential oversight should be established.

Given the vulnerabilities identified in the stress testing, there is a need to strengthen group supervision, cross-border coordination, and crisis management. Priority should be given to improving data on cross-border linkages and conglomerates and enhancing supervisory colleges. While there is a legal basis and good cross-border communication within the Caribbean, crisis management plans, including those for internationally active nonbank groups, should be finalized. The mandate and tools of the Financial Oversight Management Committee (FOMC) should be improved.

Table 1. Key FSAP Update Recommendations

Recommendations	Term [1/]	Institution
Bank Supervision and Regulation		
Review and update/adopt: homogenous loan classification approach; substandard definition in the classification regulation; and provisioning requirements	ST	CBB
Include in the CBB Act a provision stipulating conditions under which the Governor can be removed. Revise provisions that allow Ministry of Finance (MoF) to overrule CBB's corrective measures	ST	CBB/MoF
Amend the Financial Institutions Act (FIA) and the CBB Act to further empower the CBB	ST	CBB/MoF
Increase the number of on-site examinations of on-shore banks	ST	CBB
Perform on-site examinations of offshore banks that have not been subject to visits in the past five years	ST	CBB
Insurance Supervision		
Enhance the supervisory colleges and maintain active engagement, particularly for systemic entities and entities where Barbados is a host supervisor. Improve crisis management coordination	ST	FSC
Amend the limitation of FSC Act with regard to information sharing	ST	FSC
Develop internal procedure manual for a financial crisis and require insurers with cross-border activities to establish contingency plans and procedures	ST	FSC
Establish a robust and enforceable valuation standards for technical provisions	MT	FSC
Accelerate the implementation of risk-based capital adequacy requirements covering all insurers and insurance groups and promote ERM frameworks	MT	FSC
Access to Finance and Credit Unions		
Consolidate the current risk-based dual approach to on-site credit union supervision based on well-specified criteria and improve data collection	ST	FSC
Issue guidelines for classification, monitoring, and reporting of non-performing and restructured loans, and write-offs for the credit union sector	ST	FSC
Establish a level playing field for qualifying credit unions by lifting product restrictions, removing corporate tax exemption, and establishing appropriate prudential supervision	MT-LT	FSC, CBB, MoF
Improve credit enforcement through a more effective bankruptcy system and effective mortgage foreclosure procedures	MT	Government, CBB
Establish a credit information function, develop a real estate price index, and introduce a collateral registry for movable assets	MT	CBB/FSC
Safety Net and Crisis Management		
Establish a national crisis management plan for insurance sector	ST	FSC
Enter into agreements for back-up funding for safety net entities	ST	BDIC/CBB/MoF
Continue to improve cooperation with other supervisors for crisis management, particularly in the insurance sector	ST-MT	CBB/FSC
Develop a Strategic Plan, target ratio, and test payout procedures for Barbados Deposit Insurance Corporation (BDIC)	MT	BDIC/CBB
Amend various Acts to ensure consistency and bring resolution powers and process more in line with international good practices and standards	MT-LT	CBB/BDIC/FSC
Macroprudential Policy		
Develop a real estate price index	MT	CBB
Clarify mandate and tools of the FOMC	MT	CBB/BDIC/ FSC

[1] Short term: within one year; Medium term: 1-3 years; Long term: more than 3 years.

MACROECONOMIC AND FINANCIAL ENVIRONMENT

A. Macroeconomic Background

1. Macroeconomic conditions have continued to deteriorate since the beginning of the global financial crisis and policy options are limited. Following a contraction of 4 percent in 2009 and lackluster growth in 2010–12, Gross Domestic Product (GDP) is estimated to have declined by about 0.7 percent in 2013, with weaknesses across both tradable and non-tradable sectors. Unemployment stood at 11¾ percent in September, despite declining labor force participation. Annual inflation fell to 2 percent in September from nearly 11 percent a year earlier. Foreign reserves of the central bank declined considerably in 2013 and policy options are constrained by the fixed exchange rate regime.

2. The fiscal deficit and government debt have increased significantly in recent years, elevating sovereign risk and complicating macroeconomic management. In particular:

- The central government fiscal deficit has remained high (between 8–9 percent) since 2009, with the exception of 2010, where increases in VAT rates and transfer of some public entity expenditures off budget lowered it to 4½ percent. The deficit widened again as expenditures increased (driven partially by increasing interest payments) while revenues remained flat or declined. Tax revenues declined by 6.5 percent in FY2012/13 (April to March) and fell a further 11 percent in the period April-September 2013.

- Public debt increased to 128 percent of GDP at end-September 2013, from 55 percent at end-2007.[2] Although vulnerabilities are tempered by comfortable levels of liquidity in the financial system and capital controls, tensions are emerging in the maturity and the profile of public debt. Domestic financial institutions, including the National Insurance Scheme (NIS) and banks, have been purchasing an increasing share of government securities. Banks have been cautious about taking additional government securities, while capacity of the NIS to absorb additional securities might be limited by balance sheet constraints. High public debt may impair the government's ability to credibly support the financial sector should the need arise.

- Barbados' sovereign rating was downgraded to non-investment grade by Moody's and Standard&Poor's in 2012 and again by two notches (to Ba3 and BB-, respectively) in December 2013, both currently with a negative outlook. These actions were predicated on deteriorating growth prospects, inadequate policies, and fiscal imbalances. A US$500 million Eurobond offering, announced on September 30, was withdrawn in part due to unfavorable market

[2] This includes government bonds held by the National Insurance Scheme (NIS). Domestic currency denominated debt accounts for about 77 percent of public debt, mostly at fixed rates. External debt is mostly long term and with a favorable amortization profile.

conditions, but the government was subsequently able to secure a loan commitment of up to $225 million from Credit Suisse.

3. Liquidity conditions have been loosened considerably by the CBB in response to the government's funding needs. In April 2013, the CBB made the 3-month T-bill rate its benchmark and removed the floor on deposit interest rate (except for savings deposits). Under this policy, CBB purchased about 44 percent of T-bills issued in the first 11 months of 2013 directly in the primary market causing yields to decline by nearly 50 basis points. The lending margin (difference between weighted average loan and deposit rates) has gradually declined by 100 bps to below 6 percent since its peak in 2009, reflecting both supply and demand factors.

4. Capital controls have been in place since the adoption of the Exchange Control Act in November 1967. These include the requirement to register (at the CBB) large capital inflows, including FDI. There are no restrictions on the making of payments and transfers for current international transactions subject to approval under Article VIII. There are exchange controls on some invisibles, but bona fide transactions are approved.

5. The CBB pegs the exchange rate to the U.S. dollar, but external imbalances have widened and foreign reserves declined considerably in 2013. After dipping to US$468 million at end-October, foreign reserves recovered partially owing to the Credit Suisse loan and are estimated to represent 3.2 months of imports at year-end. This reflected a ballooning of the external current account deficit to 11½ percent of GDP in 2013 from 10 percent a year before, itself a function of weak tourism and goods exports due to soft economic conditions abroad and the earlier gradual appreciation of the real effective exchange rate.[3] Private capital inflows (particularly long-term) also declined sharply in 2013 largely associated with weaker business prospects.

B. Macroeconomic Outlook and Risks

6. A major fiscal adjustment package aimed at consolidating fiscal position is a step in the right direction. After consultation with their social partners, the authorities announced consolidation measures in August and more drastic measures in December 2013. These included a reduction in the size of the civil service by about 15 percent in 2014, wage cuts for elected and appointed officials, and a two year nominal wage freeze. The authorities indicated that they are committed to fiscal consolidation, but full efforts should be deployed to address considerable implementation risks.

7. Barbados is facing a challenging medium-term growth outlook. Growth is projected to be sluggish over the medium term, reflecting moderate growth in Barbados' traditional tourism markets, including Canada, the U.K. and the United States; growing competition from other offshore financial centers; and the appreciation of the real effective exchange rate in recent years.

[3] In recent years, tourism arrivals and growth performance in Barbados have lagged behind those in other countries in the Caribbean.

8. There are important further risks to this outlook:

- A sharp increase in interest rates (driven, inter alia, by fiscal pressures or public debt sustainability concerns). Higher sovereign risk premiums would depress the economic value of government securities, adversely affect banks' capital positions, exert pressure on banks' credit quality, and possibly trigger indirect effects via inter-sectoral exposure of institutions.

- A severe slowdown in Barbados' main partners, the U.K., the United States, and Canada. This would have an impact on tourism and employment in Barbados and lead to a deterioration in borrowers' repayment capacity and loan quality.

- A prolonged increase in world oil prices. Given that Barbados is highly dependent on oil imports, this would feed into domestic inflation. Tourism and growth too would be affected through increased travel costs and erosion of Barbados' price competitiveness.

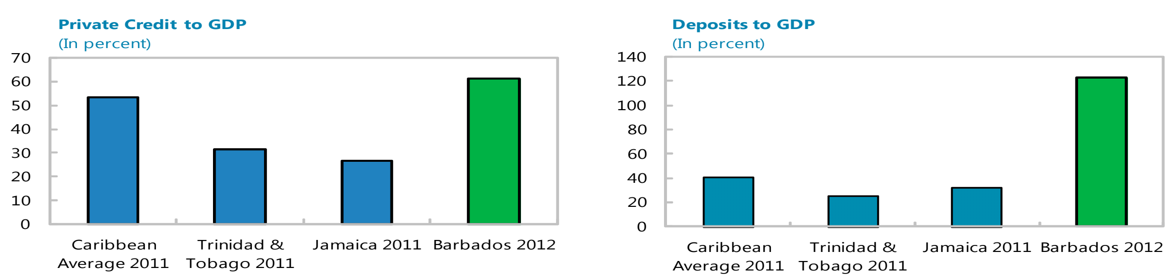
STRUCTURE OF THE FINANCIAL SYSTEM AND KEY VULNERABILITIES

A. Overview of the Financial Sector

9. Barbados has a well-developed onshore financial system and a large, segregated offshore financial system. Both sectors are dominated by international institutions; they serve different clients (residents and non-residents, respectively) and are financially separated for prudential purposes. Barbados also hosts a well-developed insurance sector and a network of credit unions

10. Commercial banks constitute the largest sector in the onshore financial system, with individual institutions owned by international financial groups (Figure 1 and Table 2). Barbados' financial system comprises six commercial banks (66 percent of total onshore financial system assets), 12 trust and finance companies (or Part 3 deposit-taking institutions; 9 percent), 35 credit unions (9 percent), and 23 active insurance companies (17 percent).

Figure 1. Barbados: Cross-Country Comparison: Onshore Banking Sector



Source: Finstats World Bank and Central Bank of Barbados.

Table 2. Barbados: Financial System Structure

	2008	2009	2010	2011	2012	H1 2013
Number of Institutions						
Banks						
Domestic banks (foreign owned)	6	6	6	7	6	6
Branches	2	1	1	2	2	2
Subsidiaries	4	5	5	5	4	4
Offshore banks	50	50	50	45	44	45
Non-bank Financial Institutions						
Credit unions	35	35	35	35	35	35
Insurance companies	29		23	23	26	26
Mutual funds	12	15	21	22	23	...
Assets (B$ millions)						
Banks	11,500	11,481	10,993	11,535	11,878	12,194
Domestic banks (foreign owned)						
Branches	4,209	2,225	2,290	2,299	2,616	2,723
Subsidiaries	7,291	9,256	8,703	9,236	9,262	9,471
Offshore banks	86,190	77,636	73,781	82,192	90,912	92,437
Non-bank financial institutions						
Part 3 Institutions	1,710	1,762	1,818	1,925	1,464	1,590
Credit unions	1,202	1,312	1,366	1,460	1,561	1,639
Insurance companies	1,399	...	2,480	2,390	3,040	...
Offshore insurance	48,965.3	...	125,500	133,400	142,600	140,000
Mutual funds (net assets)	782.3	1,015	1,061	2,213	2,470	2,470
Miscellaneous						
Share of the 3 largest banks, percent	73	70	69	71	71	78

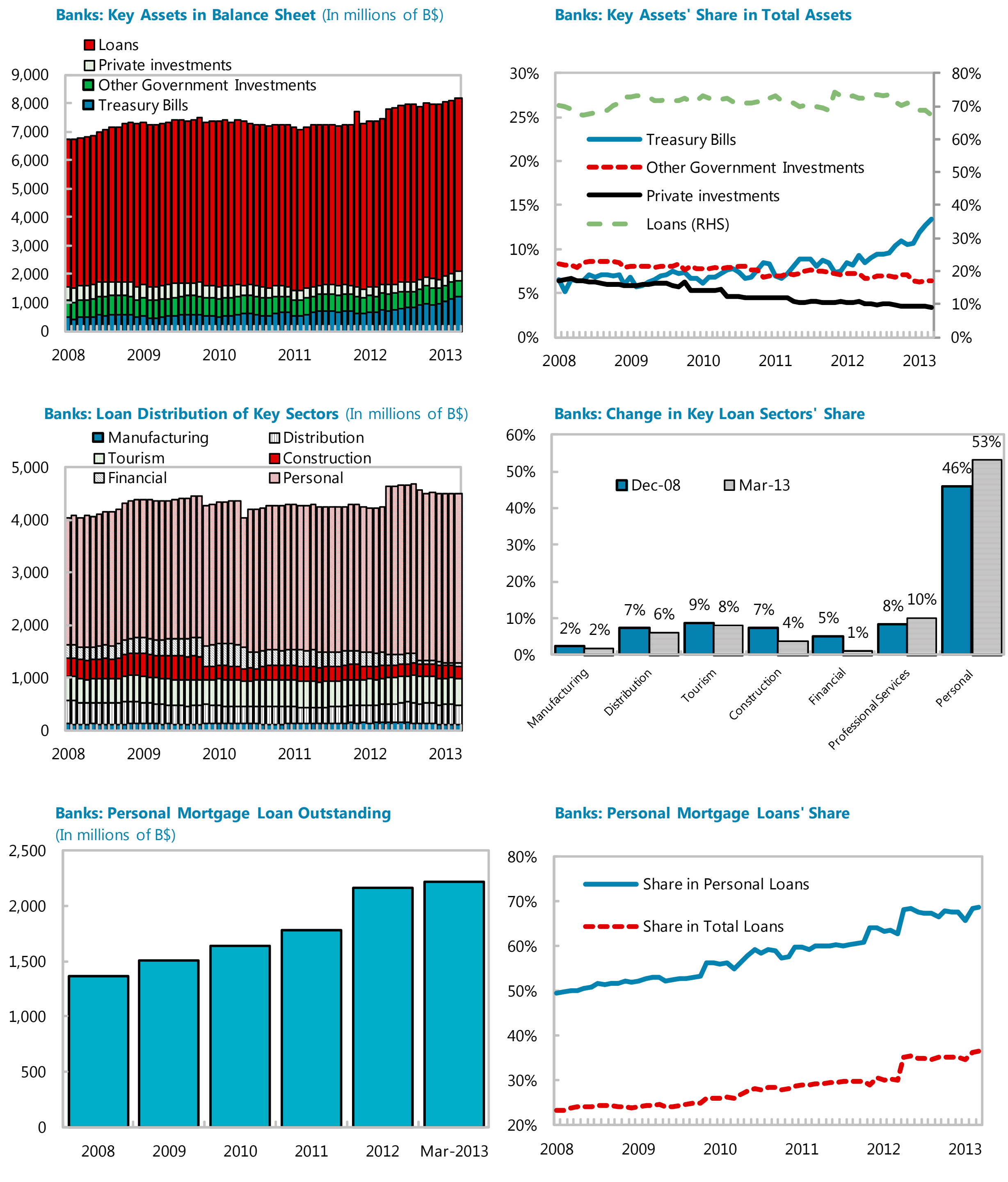
Sources: Central Bank of Barbados; and Financial Services Commission.

Commercial banks

11. With assets at 140 percent of GDP, the onshore commercial banking sector is relatively large (Figure 2 and Table 3). Three banks are subsidiaries/branches of large Canadian banking groups, where Barbados represents a small fraction of their operations. Two banks are from Trinidad and Tobago, with operations predominantly in the Caribbean region.[4] The remaining bank is from the U.S. Major shareholders of all banks are investment grade.

[4] In 2012, First Citizens Bank acquired Butterfield Bank, and Republic Bank took full ownership of Barbados National Bank (BNB).

Figure 2. Barbados: Selected Indicators of Banks' Balance Sheet



Source: Central Bank of Barbados.

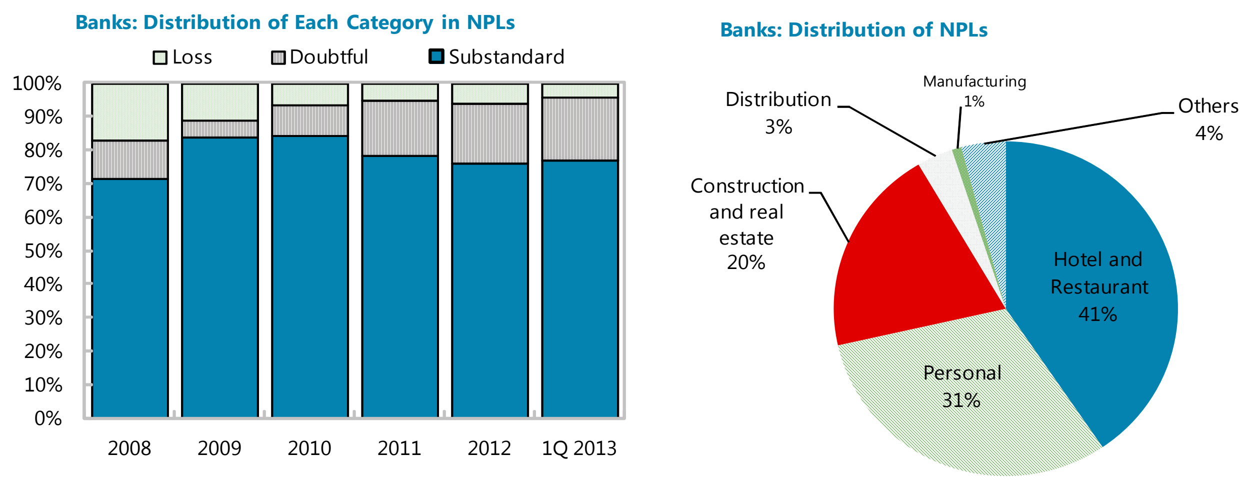
Table 3. Barbados: Financial Soundness Indicators of the Onshore Banking System

	2008	200 9	201 0	201 1	201 2	H1 2013
Solvency indicators						
Capital adequacy ratio[1]	16.1	17.5	17.1	19.3	21.0	21.5
Core capital adequacy ratio[1 2]	13.9	16.3	15.7	18.1	19.5	19.6
Nonperforming loans net of provisions to capital (percent)	5.0	21.0	11.2	11.8	23.0	21.4
Liquidity indicators						
Loan to deposit ratio (percent)	64.0	66.0	67.0	79.2	73.6	71.9
Demand deposits, percent of total deposits	34.9	36.6	35.2	32.0	29.3	29.3
Liquid assets, percent of total assets[3]	9.0	10.8	11.5	12.0	14.6	17.0
Credit risk indicators						
Total assets, annual growth rate[4]	3.9	-5.4	-1.5	-4.7	15.8 *	2.6
Loans and advances (growth rate, percent)[4]	12.4	0.9	0.6	-0.5	6.3*	-3.6
Total mortgage loans, percent of loans and advances	28.0	29.0	31.3	33.7	39.6	41.2
Nonperforming loans, percent of total loans	3.5	7.9	10.8	11.1	12.9	13.9
Provisions to nonperforming loans, percent of NPL	60.1	43.6	37.4	32.9	33.9	36.2
Sectoral distribution of loans to total loans						
Agricultural	1.0	0.9	0.5	0.4	0.3	0.3
Commercial	18.0	19.4	20.5	21.7	16.9	15.7
Construction	8.0	4.5	4.7	4.2	4.1	3.8
Consumer	46.0	46.4	47.3	47.8	52.1	53.9
Industrial	2.0	2.4	2.2	2.5	1.8	1.8
Tourism	9.0	8.4	8.9	8.4	8.2	8.2
Others	16.0	18.1	15.9	15.0	16.6	16.3
Foreign exchange risk indicators						
Share of foreign currency deposits in total deposits[5]	3.6	4.9	4.6	3.2	3.0	3.5
Deposits in foreign exchange, percent of total deposits[6]	14.8	13.3	13.6	6.6	4.9	4.8
Net foreign assets, percent of total assets	3.3	3.1	4.1	2.8	-2.5	...
Profitability indicators						
Return on Assets[7]	1.4	1.6	1.2	1.0	1.1	1.0
Return on equity[7]	17.3	15.6	11.3	6.1	4.9	3.8
Profit before tax, percent of total assets	1.8	2.0	1.5	1.3	1.3	1.2
Total noninterest expense, percent of total assets	2.7	2.6	3.1	3.4	3.0	3.0
Spread between lending rate and deposit rate[8]	6.2	7.0	6.7	6.1	5.9	6.0
Operational efficiency						
Nonfinancial expenditure to total revenues	57.1	54.3	63.3	64.2	51.3	...
Nonfinancial expenditure to total revenue-generating assets	5.4	5.3	5.3	6.1	5.0	...

Source: Central Bank of Barbados.
[1] Does not include branches of foreign banks.
[2] Tier-I capital.
[3] Includes cash balances, amounts due from the CBB and commercial banks in Barbados, and Treasury Bills.
[4] Values for 2012 include effect from merger between financial companies.
[5] Foreign currency deposits of residence to total domestic deposits.
[6] Total foreign currency deposits to total deposits (including resident and non-resident deposits in foreign currency).
[7] ROA is based on all institutions, while ROE excludes branches.
[8] Does not fully reflect the intermediation margin due to fees, commissions, etc.

12. The deteriorating macroeconomic and business environment have impacted negatively credit quality and profitability of the banking sector. The nonperforming loan (NPL) ratio has risen from 3½ percent in 2008 to nearly 14 percent in June 2013. NPLs are concentrated in hotels and restaurants, personal loans, and commercial real estate (Figure 3). Provisions have declined from 63 percent to 36 percent of NPLs during the same period. Banks' return on assets (ROA) deteriorated from 1½ percent in 2008 to 1 percent in June 2013. The decline reflects a reduced share of loans in assets, increased provisioning costs, and lower spread between average lending and deposit rates.

Figure 3. Barbados: Distribution of Banks' NPLs



Source: Central Bank of Barbados; and staff calculations.

Credit unions

13. Credit unions play an important role in the financial system, with 76 percent of the economically active population as members (Table 4). Most members are from low- and middle-income households. The sector is concentrated and very heterogeneous with two large sized institutions, ten mid-sized institutions mostly serving employees of firms, and several community-based institutions (average assets of BD$2 million). The size and sophistication of their services and risk management processes also vary substantially. The two largest credit unions combined account for 73 percent of the total assets, 78 percent of loans, and 75 percent of members. The wide reach and the (social) functions they perform make the stability of credit unions very important.

14. While most institutions meet capital requirements, prudential norms are less strict than for banks. The sector's capital adequacy ratio (CAR) stood at 11¼ percent in June 2013, up from 8¾ percent at end-2008, above the 10 percent regulatory minimum. Although this minimum is based on an unweighted measure of assets, thus providing a more conservative measure of solvency

Table 4. Barbados: Financial Soundness Indicators of Credit Unions

	2008	2009	2010	2011	2012	Q1 2013	Q2 2013
I. Structure							
Number of Institutions	35	35	35	35	35	35	35
Number of Members	148,604	129,476	146,162	157,198	148,744	150,527	157,921
Share of the 3 largest credit unions, percent	84	83	85	86	85	86	86
Assets (In BD$ million)	1,202	1,312	1,439	1,513	1,579	1,617	1,639
Share of the 3 largest credit unions, percent	71	73	79	79	78	79	79
Loans (In BD$ million)	965	1,042	1,132	1,206	1,245	1,239	1,246
Share of the 3 largest credit unions, percent	81	82	82	83	83	83	83
II. Selected Financial Soundness Indicators							
Solvency							
Reserves to total Liabilities (percent)	10.3	10.5	10.4	10.7	11.4	11.5	11.4
CAR	8.8	9.2	9.2	9.4	11.6	11.2	11.2
Liquidity							
Loan to deposit ratio (percent)[1]	96.4	102.6	114.8	113.6	117.1	93.3	93.0
On-call deposits, percent of total deposits[2]	100.0	100.0	73.0	72.2	70.7	69.7	68.7
Profitability							
Return on Equity	21.5	16.9	12.7	12.4	13.1	2.3	3.1
Return on Assets	2.0	1.6	1.2	1.2	1.3	0.2	0.3
Credit risk							
Total assets, annual growth rate (percent)[3]	7.4	9.1	9.7	5.1	4.4	2.4	0.9
Loans, annual growth rate (percent)[3]	10.4	8.0	8.6	6.5	3.2	-0.5	0.5
Total mortgage loans, percent of loans (percent)	33.7	39.9	40.2	42.5	43.6	44.2	44.4
Nonperforming loans, percent of total loans (percent)	5.3	6.5	7.2	6.9	8.2	8.3	8.2
Provisions for Nonperforming loans, percent of Total loans (percent)	1.8	1.9	2.2	2.8	3.2	3.1	3.2

Source: Central Bank of Barbados for pre-2010 data; Financial Services Commission for 2010-13.
[1] Amendments to Act and by-laws have resulted in funds previously treated as equity shares being classified as deposits (shares).
[2] This figure is overstated as there are some funds, which are pledged as loan security and should not be classified as demand deposits.
[3] 2013 outcome is not annualized.

than for banks, loan classification and provisioning are materially less strict.[5] Furthermore, unrecoverable loans are not adequately provisioned and rarely written off, and collateral values are not updated. Moreover, NPLs have increased from 5¼ percent of total loans in 2008 to about 8¼ percent in June 2013, and a few small entities do not meet the minimum CAR.

[5] With the exception of the largest credit union, they reclassify loans as performing immediately after restructurings.

Insurance companies

15. The insurance sector represents a considerable part of the financial system and is highly concentrated, especially life insurance (Table 5). It consists of 23 active companies, six of which provide life and related health insurance policies, 16 offer general insurance focus (on property and commercial insurance contracts), and one company conducts both businesses. With the collapse of Colonial Life Insurance Company (CLICO) in 2009, a regional group based in Trinidad and Tobago, the life insurance sector became further dominated by the second largest insurer, which now accounts for 83 percent of the total assets of the life insurance industry.

Table 5. Barbados: Key Indicators of Insurance Companies

	2008	2009	2010	2011	2012	Q1 2013	Q2 2013
Domestic sector							
General Insurance							
Gross written premia BD$ million	478.7	…	515.2	499.5	512.6	117.2	121.5
Investment assets BD$ million	266.5	…	675.6	718.6	726.3	725.1	725.7
Life Insurance							
Gross written premia BD$ million	135.5	…	170.3	163.7	190.8	43.8	39.0
Investment assets BD$ million	868.9	…	1,387.0	1,345.0	1,391.0	1,434.0	1,431.0
Offshore Sector							
Number of active companies	…	223	225	223	221	…	…
Net premiums (BD$ billion)	9.0	…	31.2	56.2	61.3	16.8	16.8
Assets (BD$ billion)	49.0	…	125.5	133.4	142.6	142.7	140.4

Source: Office of the Supervisor of Insurance for pre-2010; and Financial Services Commission for 2010-2013.

16. The insurance sector faces challenges. Premiums (net of reinsurance ceded) of life insurers have declined in recent years due to the weak regional economy and weakened public confidence. Although low and stable claims ratios have helped ensure profitability, assessing the soundness of general insurers is difficult owing to the absence of a robust liability valuation framework. An insurance-based group faces increased risk due to expansion in non-insurance businesses, reflected partly in a significant increase in holdings of Caribbean government debt securities.

Offshore financial sector

17. The offshore sector plays an important role in the Barbadian economy but is segregated from the domestic financial system.[6] It comprises banks, insurance companies, and International Business Companies (IBCs).[7] Most institutions have parent companies in Canada and the United States. The sector's financial transactions are restricted to non-residents. Offshore banks do not take resident deposits and mostly perform treasury and trust management operations.

18. Barbados has offered an attractive environment for offshore companies for several years, but faces challenges. It has a legal framework for tax incentives (such as, low corporate taxation and double tax treaties with several countries, including the U.S. and Canada), relatively few regulatory restrictions, quality professional services, and a reputation as a stable financial center. Nonetheless, it faces challenges of maintaining its competitive edge with other jurisdictions, particularly in terms of efficiency and timeliness of procedures.

19. Barbados has the third largest offshore banking center in the Caribbean and the tenth largest globally. Assets of the 45 offshore banks licensed in Barbados amount to BD $89 billion, or over 1,000 percent of GDP. The four largest banks hold 74 percent of the assets of the sector, while the twelve large banks account for 91½ percent of the total.

20. Barbados is home to a large number of offshore insurance companies. By end-2012, there were 222 offshore captive insurers (which provide insurance and re-insurance for the risks of their owners, subsidiaries, and affiliates) and 39 others (including 16 holding companies and 23 management companies). These companies usually take the form of exempt insurance companies (EICs), licensed under the Exempt Insurance Act, in the business of insuring risks located outside Barbados, and with the respective premiums originating outside Barbados.

21. The legal framework segregates offshore and onshore operations. Provisions under the IFSA aim to establish an effective "Chinese wall" by restricting the offshore institutions' financial services to non-residents. Existing ties between the on- and offshore sectors are in the form of common parent institutions, and in some cases shared infrastructure. Although the offshore banks can lend to non-residents for projects in Barbados, these transactions require CBB approval. As a result the main risk to the onshore sector appears to be reputational.[8]

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[6] The sector contributes 20 percent of tax revenue (as of 2010) of which 11 percent originated in offshore banks. Employment in offshore banks represents 1 percent of the labor force (as of 2009).

[7] IBCs are licensed to conduct international manufacturing, trade, and commerce activities. Some 3,945 IBCs are licensed in Barbados.

[8] A Background Note on "Financial System Linkages in Barbados" discusses this issue in detail.

B. Financial System Resilience

Domestic and external interconnectedness[9]

22. Financial institutions in Barbados are interconnected through both financial and ownership linkages inside and outside the country. While relatively limited, financial linkages among domestic financial institutions are growing as the system becomes more sophisticated. External linkages in some cases too are considerable. Common ownership linkages are observed both among domestic and foreign-owned institutions.

23. Even when financial linkages between financial institutions appear to be small relative to their size, they can amplify shocks. Financial linkages between institutions can create second-round effects from common shocks. For instance, a sovereign shock can affect directly all institutions holding government bonds but also have second-round effects via inter-sectoral exposure. Reputational consequences too can be significant. The collapse of CLICO (a Trinidad and Tobago-based insurance company) in 2009 shows how shock can spread from a troubled parent to an otherwise healthy subsidiary.

24. Two Barbados-based financial conglomerates have substantial external linkages. Their operations include commercial banking, life/non-life insurance, asset management and offshore activities in and outside of the Caribbean region. One entity has become the largest insurer in the Caribbean with operations in 22 countries, including in the U.S. and Europe. The group's assets are equivalent to about 120 percent of GDP of Barbados and its operations expand across a wide spectrum of financial services, including life and non-life insurance companies, commercial banks, asset management, and broker dealers. The other entity owns a bank that represents 35 percent of the Barbadian banking sector (in addition to owning an offshore bank as well as a Part 3 bank in Barbados) and via its subsidiaries in the region conducts a wide range of commercial banking activities in 17 countries in the Caribbean.

Stress testing[10]

25. The projections and macro stress tests assessed the resilience of the banking system under the baseline and four adverse scenarios during 2013–17. The baseline assesses the likely evolution of banks' key financial indicators under the current outlook. The adverse scenarios illustrate the impact of negative shocks on banks' health using econometric, statistical, and balance sheet methods. Shock calibration was based on data for Barbados and informed by past FSAPs and research (e.g., Hardy and Schmieder, 2013). The magnitudes of the medium and severe shocks roughly correspond to one and two standard deviations of the historical data for the last 11 years,

[9] A Technical Note on this issue offers more detail on interconnectedness of the financial sector in Barbados and provides a framework for assessing related vulnerabilities.

[10] A Technical Note on stress testing contains the details of the analysis presented in this section.

respectively, and are in line with the shocks experienced during the 2007-09 crisis (see Appendix I for further details).

26. In the baseline, the loan quality deteriorates significantly, but capital adequacy for the system as a whole remains well above the regulatory minimum. Barring major government/ parent institutions actions, the system's NPL ratio would increase to 19½ percent by 2017 from the current level of 13.8 percent, largely owing to expected continued economic weakness in the years ahead and lagged effects. Aggregate CAR in turn would decline to 10.1 percent, from 16.6 percent at end-June 2013.[11] All institutions would see their capitalization decline markedly under the baseline, and one (a foreign branch) would drop below the (notional) requirement.[12]

27. With buffers eroding in the baseline, vulnerabilities to adverse scenarios will grow. The scenarios, which broadly correspond to the key risks identified in the risk assessment matrix (Appendix IV), include two versions with medium and severe shocks (see Table 6). Under the most severe shocks:

- Lower tourism growth drives the system's NPL ratio up to 26 percent and the CARs of two banks (39 percent of total assets) below the regulatory benchmark (8 percent).
- Higher oil prices drive up inflation and reduce growth. The system's NPL ratio reaches 24 percent, with one bank's CAR (21 percent of total assets) falling below the requirement.
- Geopolitical tensions drive up oil prices and reduce growth. The system's NPL ratio increases to 33 percent. Three banks (59 percent of total assets) become undercapitalized by some 4.8 percent of GDP. Excluding the foreign branch, recapitalization needs drop to 0.7 percent of GDP.
- Sovereign risks lead to a sharp increase in the sovereign risk premium. Higher interest rates reduce the economic value of banks' bond holdings and drive up NPLs. Two banks (39 percent of total assets) fall below the capital requirement.

Sensitivity tests for solvency risk

28. Most banks would withstand a moderate downgrade of their NPLs, but several banks would be affected by a severe downgrade. A migration of adversely classified loans by one

[11] These estimates are based on provisioning the existing and new NPLs at a cumulative rate of 50 percent. This is equivalent to assuming that NPLs are distributed evenly across the substandard, doubtful, and loss categories. In practice, NPLs are rarely downgraded below "substandard" and are provisioned at 10 percent.

[12] The notional CAR of two branches was estimated by the authorities. The capital allocations took into account the size of the local operations of the groups and accumulated retained earnings. Formally, the branch does not have to comply with this capital requirement since its requirements are governed at the group level by its home supervisor.

Table 6. Barbados: Macro Stress Tests[1]

(In percent unless indicated otherwise)

	Banking System NPL Ratio[2]	Banking System CAR	Banking System CAR (excluding branches)	Distribution of Bank CARs: Number of Banks			Distribution of Bank CARs: Percent of Bank Assets			Potential Recapitalization Needs (Percent of GDP)	
				Below 8 Percent	Below 10 Percent	Above 10 percent	Below 8 percent	Below 10 percent	Above 10 percent	All Banks	Excluding Branches
Initial position (June 2013)	13.8	16.6	19.4	0	0	5	0.0	0.0	100.0	0.0	0.0
Baseline (2017)	19.6	10.1	14.8	1	1	4	21.4	21.4	78.6	2.1	0.0
Tourism shock[3]											
Medium shock	22.5	7.6	12.3	1	1	4	21.4	21.4	78.6	2.5	0.0
Severe shock	26.5	5.7	10.6	2	2	3	39.0	39.0	61.0	3.2	0.1
Oil price shock[4]											
Medium shock	21.7	8.0	12.7	1	1	4	21.4	21.4	78.6	2.4	0.0
Severe shock	24.0	6.9	11.6	1	2	3	21.4	39.0	61.0	2.7	0.0
Geopolitical risk shock[5]											
Medium shock	26.2	5.9	11.0	1	2	3	21.4	39.0	61.0	3.1	0.0
Severe shock	33.4	2.5	8.0	3	3	2	59.2	59.2	40.8	4.8	0.7
Sovereign risk shock[6]											
Medium shock	24.3	5.9	10.1	2	3	2	39.0	74.7	25.3	2.6	0.1
Severe shock	27.1	3.9	8.0	2	3	2	39.0	74.7	25.3	3.6	0.6

[1] The table reports the maximum deterioration in the indicators over the 2013-17 stress test horizon.

[2] Existing and new NPLs are provisioned at 50 percent; 25 and 30 percent of special mention loans transition to NPLs in the medium and severe shock scenarios, respectively.

[3] Declines of 15 percent and 30 percent in tourism revenues relative to the baseline.

[4] Increases of 25 percent and 50 percent in oil prices relative to the baseline.

[5] Combines the shocks to oil prices and tourism revenues.

[6] Increases of 350 bps and 500 bps in the sovereign risk premium driving up interest rates with negative repercussitons for the economic value of bond holdings and credit quality.

category would drive the CAR of the foreign branch below the regulatory limit.[13] In the event of a severe downgrade of all NPLs to loss, fragilities appear also in two other banks.[14] Three banks (59 percent of total assets) fail to meet the capital requirement.

29. Despite high credit concentrations, most banks could withstand large corporate default episodes. The foreign branch has large credit concentrations and its (notional) CAR would fall below the requirement if its largest borrower defaults.[15] Other banks also have credit concentration risk but can withstand plausible shocks without breaching the requirement. Defaults of the three largest exposures would lower the system's CAR by about 5 percentage points but most banks would remain above the required minimum.[16]

30. Banks are able to absorb a doubling of the NPLs of key sectors. Banks' portfolios are concentrated in loans to tourism, construction and real estate, and households, whose quality has deteriorated considerably since the global crisis. The system's CAR would fall by about 4 percentage points after a doubling of the NPLs in each of these sectors.[17]

31. Banks are generally resilient to direct interest rate and currency risks. Most banks do not have large maturity mismatches and interest rate shifts of up to 500 bps have little impact on the system's CAR. Currency risk is limited given tight foreign exchange controls and banks' small net open positions. Banks gross exposure to unhedged borrowers is limited and currency-induced credit risk is therefore contained. However, the regression analysis indicated that banks' loan quality is (indirectly) sensitive to shifts in interest rates.

32. The two largest credit unions have overall less solid capital buffers and would fall below the capital requirement under moderate shocks to credit quality. The CARs of the largest credit unions would fall below the requirement after a 50 percent increase in NPLs. The tests were carried out for the two largest credit unions representing approximately 75 percent of total assets; and against a 10 percent requirement on the unweighted capital to asset ratio.

Liquidity risk

33. Liquidity tests simulated cumulative outflows of up to 25 percent of total deposits. Banks were allowed to use either their "core" liquid assets (i.e., cash, reserves, and T-bills) or "broad"

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[13] Under the shock 10 percent of standard loans migrated to special mention, 50 percent of special mention to substandard, and 100 percent of substandard and doubtful are downgraded to the next category

[14] Under the shock, 50 percent of the new special mention loans migrate to doubtful; substandard and doubtful loans are downgraded to loss.

[15] The fact that these risk exposures are backed by the capital of the parent provides risk mitigation.

[16] Concentrations appear high relative to the (notional) capital allocated to the branch. However, the exposures represent only a small fraction of the capital of the group, which is backing its credit portfolio.

[17] Assuming a 50 percent provisioning rate.

liquid assets (i.e., long-term government bonds, after a haircut of 25 percent) to meet the outflows. The results suggest the following:

- Most banks could withstand medium liquidity shocks but severe deposit outflows would strain their liquidity buffers. Banks liquidity buffers can absorb outflows of up to 15 percent of total deposits and remain above the reserve requirement. If banks use their "broad" liquid assets, they will meet the outflows and still remain above the 15 percent reserve requirement. If banks are allowed to use only "core" liquid assets, four banks would drop below the requirement. The system's liquidity ratio would drop below 15 percent under an outflow of 25 percent of total deposits.

- The two credit unions' liquidity buffers would be insufficient to absorb medium-sized liquidity shocks. An outflow of 15 percent of total deposits would reduce the average liquidity ratio to 7 percent, with both credit unions falling below the 15 percent benchmark. More severe shocks (such as, a 25 percent outflow) would drain entirely their liquid assets.

Sovereign risk and bottom-up stress tests

34. The impact of sovereign risk was assessed using bottom up detailed bank-level data on government bond holdings. The tests involved simulating a revaluation of banks' holdings of domestic government bonds in response to an increase in the sovereign risk premium of up to 500 bps. These showed that the impact on capital adequacy would be manageable, owing to the relatively short maturity of banks' holdings. The shock would drive the system's CAR down by about 2½ percentage points, to 13¾ percent, but all banks remain above the regulatory minimum.

35. The bottom up sensitivity tests performed by the five onshore banks covered also credit, market, and liquidity risks. The tests were based on banks' own data and used a methodology and templates provided by the FSAP mission. The results are qualitatively consistent with the top-down sensitivity analysis. They point to risks from severe credit shocks and large exposures, and more limited market and liquidity risks.

MITIGATION OF RISK IN THE FINANCIAL SECTOR

A. Regulatory and Supervisory Framework

36. Since the 2008 FSAP Update, Barbados has substantially improved its legal, regulatory and supervisory frameworks across all sectors of the financial system, but significant scope for improvement remains.

Banking sector

37. The Bank Supervision Department (BSD) of the CBB supervises both the offshore and onshore commercial banks and Part 3 institutions. The CBB is self-funded and determines how it manages the BSD. As such, it has operational independence. BSD's financial resources have allowed for the hiring of sufficient staff with skills commensurate with the banking system's risk profile.[18] However, going forward, the current headcount might not suffice as Barbados plans to transition to Basel II by 2015. The CBB is equipped with sufficient discretionary powers to address areas of weaknesses in banks or their non-compliance with applicable laws, regulations, or supervisory instructions.

38. Several detailed guidelines have been issued or updated. The guidelines outline the responsibility of banks for managing and controlling exposure to several types of risks and describe the CBB's expectations in relation to the minimum standards to be applied by banks. These guidelines include operational risk management, liquidity, AML/CFT, credit risk, corporate governance, and measuring capital adequacy for market risks. Other guidelines are to be issued soon (e.g., on large exposure limits and interest rate risk in the banking book). In February 2013, the CBB revised its Corporate Governance Guideline in line with the enhanced international standards by the Basel Committee on Banking Supervision.

39. The CBB conducts supervision on a consolidated basis and has expanded its information sharing network since 2008. All banks in Barbados (both onshore and offshore) are foreign-owned, necessitating collaboration with home regulators. The CBB has close relations with the Caribbean Group of Banking Supervisors and sponsors a college for FirstCaribbean International Barbados Bank (FCIB) for which it acts as a regional consolidating supervisor. The CBB participates in colleges for the other banks and signed a Memorandum of Understanding (MOU) with the Canadian supervisor in 2009 and conducts annual meetings with their Canadian counterparts.

40. However, despite significant progress, more work needs to be done to strengthen the CBB's regulatory power. Approval of the amendments of the CBB Act and the FIA by the end of 2013 as expected is important to provide the CBB with explicit powers to issue regulations. Under the current regime, the power to issue regulations is granted to the MoF in conjunction with the CBB. The amendments to the acts will lift any doubt on the enforceable nature of the CBB guidelines since the latter will be given the force of law. The amendments will also broaden the scope of the Bank's supervisory powers, inclusive of consolidated supervision, allowing the CBB to impose specific target capital ratios and administrative penalties for non-compliance with the FIA and other related norms[19], and expand the scope of remedial actions.

41. There is a need to strengthen CBB independence. The exact conditions under which the Governor can be dismissed or removed should be clearly specified in the CBB Act. In the same vein, even though current provisions contained in the FIA §50 (4) and the CBB act §49 (1) that empower

[18] Currently, 34 banking supervision professionals are assigned to supervise 19 onshore and 46 offshore entities.

[19] The draft is being reviewed by the Chief Parliament Counsel under the Attorney General's Chamber and the amendments are expected to be passed by end-2013.

the Minister of Finance to overrule policies or corrective measures taken by the CBB[20] have not been used, they should be removed to assuage concerns about the independence of the CBB.

42. The CBB should take more forceful actions towards financial institutions in cases of serious deficiencies or breaches of regulatory norms, beyond moral suasion. Under current practice, when the CBB identifies situations of a particular concern (breaches of laws or regulation), it advises the licensee to submit a corrective action plan to address the situation. Once approved by the CBB, the plan must be implemented by the bank within a given time frame. However, in case of serious breaches,[21] it would be advisable to take more forceful enforcement actions, which will also help prevent similar breaches from reoccurring.

43. Supervision of AML/CFT compliance in banks should be strengthened. Not all banks in the offshore sector have been examined and there is an urgent need to perform inspections in offshore banks from countries having a higher risk profile, which have not been inspected over the past five years.[22] It is also recommended to increase the number of onsite examinations in onshore banks.[23] While CBB adopted a risk-based approach to supervision in response to the recommendations of the 2008 FSAP update, the low levels of AML/CFT on-site examinations raises doubts about the effectiveness with which the oversight of ML/TF risks has been integrated into the risk-based framework. It is recommended that CBB ensure that issues related to ML/TF risk are adequately integrated into its risk based supervisory framework.

44. CBB's loan provisioning guidelines should be reviewed and a real estate price index should be developed. While banks can follow IFSR or CBB regulations, the CBB requirements are lower than those observed in other countries using a similar framework.[24] The CBB provisioning guidelines do not ensure timely write-offs. A review of real estate values available to offset provisioning requirements should be conducted in light of current market conditions to determine the net realizable value of the collateral.

The Financial Services Commission

45. The FSC regulates and supervises the insurance and pensions, credit union, and securities sectors. These functions were previously discharged by the Supervisor of Insurance and Pensions, the Co-operatives Department, and the Securities Commission. The FSC is headed by a seven-person Commission, appointed by the Minister of Finance, who also designates a Chairman

[20] In that case, banks that are aggrieved by the decision of the CBB can appeal to the MoF whose decision is final.

[21] At least in two cases examined by assessors, CBB staff identified situations of serious violations with the AML/CFT Act that would have merited, in the assessors' opinion, more forceful action as allowed by the MLTF act.

[22] Only offshore banks from Canada have been inspected.

[23] Since 2008, only 2 onshore banks (out of total 6) have been visited in connection with the AML/CFT.

[24] The CBB requires provisions of 100 percent for loss, 50 percent for doubtful, 10 percent for substandard, none for special mention and does not have a general provision for unclassified credits. The CBB requires a one percent provision for credits that have not been reviewed in the past 12 months.

and Vice Chairman. Members are appointed for fixed three-year terms (or the expiration of a remaining term). Members may be reappointed and the Minister may dismiss members for good cause. It is managed by a Chief Executive Officer, who is selected by the Commission and approved by the Minister.

46. The FSC Act provides the FSC with appropriate investigative and enforcement powers and has improved supervisory independence. It provides the FSC with budgetary independence and limits ministerial authority over supervisory functions, although room for improvement remains.[25] The Act also offers a range of powers for (onsite) investigation and intervention as well as to reorganize or wind-up an insurer or credit union, guarantees the enforceability of guidelines through compliance directives, and provides current staff and agents with general protection in the good faith performance of their duties.[26] The FSC Act also includes a mandate to promote competition in the financial services sector. This, however, conflicts with its stability objective and should be removed.

47. The onsite supervisory function needs strengthening and specialization. The FSC currently consists of three sectoral departments: Insurance and Pensions (15 staff), Credit Unions (four staff), and Securities (four staff). It also has two functional divisions: Examinations (six staff) and Policy & Research (two staff). The Examinations Division does not have specialists assigned to specific sectors and conducts onsite supervision overseeing institutions across all sectors under the purview of FSC. To offset this lack of specialization, onsite supervisors are often assisted by specialized offsite supervisors during onsite examinations.

48. As a relatively new agency, the FSC's supervisory effectiveness remains largely untested and further capacity building is necessary. Progress made to date is encouraging, as, for example, evidenced by the issuance of various guidelines across all sectors. However, the FSC faces a challenge in developing the capacity of its staff, developing and enhancing its internal processes, and building a clear understanding of its supervisory approach to regulated entities. However, difficult challenges still lie ahead given the heterogeneity and vulnerability of the credit union sector, the need to establish and implement significantly more sophisticated regulatory requirements in the insurance sector, and the increasingly complex cross-border linkages of domestic and international insurance groups.

49. The FSC should expand the information that it provides to the public. In addition to providing access to the applicable laws, and its recent Guidelines, all applicable regulations should be available. Publication of statistical data should be improved.

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[25] Ministerial roles are limited to those in the FSC Act. The role of the minister in the Insurance Act and the Exempt Insurance Act have been superseded by the FSC (FSC Act §57). However, the FSC may only adopt a binding regulation with the approval of the Minister (FSC Act §54). Also the Minister may, after consultation with the FSC Chairman, provide general policy direction to the Commission, which it must follow (FSC Act §30). The Minister may set limits on hiring and on salaries and retain final approval authority for personnel appointed to senior positions.

[26] Legal protection should be clarified and extended to former employees and commissioners for actions taken whilst commissioners or employees.

Insurance sector

50. The regulatory and supervisory framework for the insurance sector has improved with the creation of the FSC. The FSC oversees both onshore and offshore insurers and reinsurers, and insurance distributors, a responsibility previously carried out by the Supervisor of Insurance and Pensions, which resided under the MoF and lacked budgetary independence. The FSC Act also allows the FSC to determine reporting requirements, request information more generally, and carry out offsite and onsite inspections. As such, the Act has enhanced the independence and capacity of the insurance supervisor. Moreover, the Act and various new guidelines have eliminated important regulatory gaps between the offshore and onshore sectors.[27]

51. Despite progress, the FSC needs further improvement. The main areas requiring additional effort include hiring and training of staff, further elaborating the practical application of current high-level guidelines (including specifying when and what remedial actions the FSC should take), ensuring the new onsite inspection program becomes institutionalized, and taking appropriate enforcement actions.

52. Importantly, there is a need to introduce robust prudential standards, including valuation, capital adequacy, and Enterprise Risk Management (ERM). Currently, there is no specified actuarial standard, which results in inconsistent valuations among insurers. Current capital requirements are too crude to capture relevant risks (such as, credit, market, and underwriting risks). Risk management requirements are not comprehensive and not proportionate to risks that Barbadian insurers face, such as, group and catastrophic risks. The FSC should establish robust and enforceable valuation standards for technical provisions, introducing risk-based capital requirements and expanding risk management requirements to make sure that the industry manages its own material risks.

53. Given the presence of regionally active and systemically relevant groups, there is also an important need to implement group supervision and crisis management. Group supervision is critical to the oversight of regionally important insurers. The FSC is responsible for group supervision as a home supervisor of a major regional insurance group and a main host supervisor of two large regional insurance groups. The FSC should enhance its regulatory framework and supervisory practice to ensure sound operations of the insurance groups. Efforts to enhance emerging supervisory colleges, develop approaches to group-wide solvency assessment, risk management and governance, and develop effective group resolution plans should be high on the agenda.

[27] In addition, the FSC is in the process of hiring and training new staff, improving reporting frameworks and requirements, further developing the regulatory framework by issuing guidelines such as for corporate governance, internal control and risk management, and introducing risk-based supervision and onsite examinations from 2012 including the largest insurance group in Barbados.

Credit unions

54. The recent issuance of several guidelines represents an important step to improve supervision, but important steps lie ahead. The issuance of a guideline regarding loan loss provisioning is still pending. These recent guidelines on governance, market risk, and credit risk are general in nature and need to be further specified.[28] It is recommended that FSC revise the guidelines for loan classification, monitoring and reporting (especially for restructured loans), define rules to write off loans more precisely, and undertake efforts to harmonize the classification of liquidity, equity and other accounts. In addition, issuing a dedicated Credit Union Act may help avoid possible inconsistencies between the different Acts that may have adverse legal consequences.

55. There is a need to strengthen onsite supervision. Only two onsite inspections have been carried out since the inception of FSC in 2011, and both were undertaken in the second largest credit union. There is currently no schedule for regular onsite inspections of credit unions.[29] The FSC has introduced additional reports and increased frequency of reporting for the two largest credit unions and some medium-sized credit unions. The weaknesses in the oversight of credit unions, particularly the larger entities, could represent vulnerability in the context of ML/FT risks.

56. Auditors have been assigned an auxiliary role in supervising credit unions, particularly on onsite supervision of small and medium sized credit unions. FSC currently intervenes if irregularities are reported and has already issued directives to five small credit unions. The audit reports showed problems such as insufficient liquidity or capital, high delinquency and failure to convene annual general meetings. In response, the FSC has suspended the license of one of these entities and communicated to the board of the other four the measures to be taken to address the deficiencies. FSC has the ability to monitor the auditing firms closely as these have to be accredited yearly at the FSC.

57. The substantial heterogeneity of the sector poses supervisory challenges which warrant adopting a two-tiered approach. Given their size and level of sophistication, the two large credit unions merit "bank-like" supervision in terms of frequency and detail which requires the strengthening of the onsite supervision departments at FSC. The medium- and small-sized entities would be subject to less frequent onsite supervision with further reliance on offsite reports, building on the audit reports of qualified auditors.

[28] For example, the credit risk guideline allows credit unions to decide on the recording and management of refinanced loans and the management of delinquent and doubtful loans.

[29] Currently the CBB and the FSC only jointly carry out supervision of the biggest credit union. FSC supervises the credit union and the securities branch of the finance company of the group while the CBB supervises the finance company itself.

B. Financial Safety Nets and Crisis Preparedness

Overview

58. **The Recovery and Resolution Plans (RRPs) for banking sector and other sectors with systemic importance (e.g., insurance) is in the pipeline.** Such plans would identify core functions and critical shared services as outlined in the growing body of international guidance. It would be important for the authorities to engage home and other significant host authorities in the preparation of such plans.

59. **There is a need to rationalize and ensure consistency among the various laws addressing different parts of the financial sector, with varying provisions governing resolution.** For example, provisions addressing legal protection in the Deposit Insurance, Central Bank and FSC Acts are not identical, thereby creating the possibility that a court could make findings that do not provide the necessary legal protection for some of those working on behalf of the safety net during a financial crisis.

60. **Establishing robust cross-border cooperation among regulators and deposit insurers remains a work in progress.** Despite ongoing discussions about the establishment of a Caribbean Region Financial Crisis Management Plan to address the banking sector, no agreement on a plan has been reached, nor is there advanced planning on addressing the possibility of a crisis in the nonbank sector. Importantly, discussions on a regional crisis plan have not included the Canadian authorities, who would be important in any regional crisis response.[30]

Deposit insurance and consumer protection

61. **The deposit insurer, BDIC, is a paybox-plus[31] with the responsibility of paying depositors in the case of a winding-up and liquidating or managing member institutions under the FIA.[32]** BDIC was formed in 2006 and began its operations in 2007 and has a fund of BD$38.8 million.[33] There are thirteen members of the Fund including six banks and seven deposit taking NBFIs. Annual premiums are 0.05 percent of average insured deposits. BDIC is required to meet its objectives of insuring deposits in a manner so as to minimize its exposure to loss, but it

[30] There is a regional group of deposit insurers, but no crisis management plan has been drafted for the group. Moreover, the BDIC has not entered into sharing agreements with any other deposit insurer to allow coordinated communication in the event of a regional crisis.

[31] Pay-box plus is a deposit insurer that has powers in addition to the reimbursement of insured deposits (e.g., powers in support of resolution functions, such as, ability to make a financial contribution to a resolution, etc.).

[32] The BDIC is led by a Board of Directors consisting of the Governor of the Central Bank, the Director of Bank Supervision of the Central Bank, the Chief Executive Officer of the BDIC, a representative of the Minister of Finance and three other qualified persons appointed by the Minister of Finance. The Minister appoints the Chairman and Deputy Chairman from the directors. A quorum of the Board can only be made up of non-ex-officio members. BDIC has two professional employees.

[33] At its current level the fund is not sufficient to pay insured depositors at any of its member institutions.

does not have the power to provide financial support for a purchase and an assumption transaction. Back-up funding is to be borrowed from the CBB or the government, as per the Deposit Insurance Act (DIA), although the high level of public debt now leaves in question the government's ability to support the BDIC and the financial sector.

62. The deposit insurance framework should be strengthened. The BDIC Board needs to adopt a Strategic Plan that would guide its operations and inform its decision-making. The legal framework governing the payout procedure for BDIC needs to be strengthened to give it the ability to conduct prompt payouts of insured depositors. There is also need for explicit legal protection for persons acting on behalf of the deposit insurer for former employees.

63. Consideration should be given to the establishment of a policyholder protection scheme (PPS) for insurance. A privately-financed PPS could help secure continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or third party and to compensate policyholders for their losses in liquidation. In order to establish a PPS, further discussions would need to be undertaken by the authorities about its governance, coverage level, funding arrangements, and position within the resolution framework.

64. Credit unions do not have deposit insurance or access to central bank liquidity. There is an ongoing effort by credit unions to become part of the deposit insurance system. However, the authorities' view (supported by staff) is that the credit unions' joining of such a system should follow the establishment of a robust regulatory framework.

Resolution framework

Banking sector

65. The bank resolution regime contemplates both going-concern and gone-concern procedures under the FIA and DIA. It includes the procedure for seizing management and control of a bank (the seizure procedure) and the winding-up procedure, with the BDIC being appointed as a liquidator. The following improvements to the legal framework for bank resolution could be made to bring it more in line with international good practices**:**

- **The judicial remedy for aggrieved parties should be limited to monetary compensation.** Under the FIA, the courts can reverse the CBB's decision to seize a bank, set aside the MoF's license revocation decision, and alter a re-organization plan drawn by the CBB/manager. However, judicial actions should not constrain the implementation of measures taken by the resolution authority. Instead the FIA should establish ex-post compensation procedures with a "no worse off than in liquidation" safeguard.[34]

[34] KA 5.2 and 5.5 of FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes).

- **The FIA is in need of strengthening in several areas.** In particular, it should provide powers for recapitalization under the seizure procedure for the cancellation of existing shares and the overriding of pre-emptive rights of existing shareholders; for the transfer of part of banks' business, as it currently[35] provides only for amalgamation or merger; and for the establishment of a bridge banks.

Credit unions

66. **Credit unions resolution procedures are addressed under the FSC Act.** The FSC has the power to revoke the license of a credit union and seize management and control of an institution or reorganize or wind-up a financial institution. However, any person aggrieved by a decision of the FSC can appeal first to an administrative tribunal and then to the court of appeals, either of which can reverse the FSC's decision.

Insurance companies

67. **The existing legislation provides for the basic elements of a resolution regime for systemically significant insurers, but needs to address the issues with respect to a bridge insurer and public funding.** In particular:

- The laws do not stipulate the terms and conditions under which a bridge insurer will be established. Therefore, the court is left to determine these issues on its own, without guidance from the legal framework, including a time limit for its existence.

- Similarly, the laws are silent on the power and process for the recovery from the insurance industry of any public funding used to resolve an insurer.

Cross-border coordination of resolution of banks and insurers

68. **The legal framework and ongoing close communication among Caribbean authorities provide for a solid basis for cross-border coordination within the Caribbean.** For example, the coordination arrangements for the resolution of CLICO (Barbados) included the regional advisory committee, the appointment of the same persons as office holders in different jurisdictions, and the recognition by the foreign court of the decision of the Barbadian court.

69. **In contrast, the coordination with non-Caribbean jurisdictions for resolution planning and crisis management is yet to be established.** Although the CBB takes part in supervisory colleges regarding Canadian banks operating in Barbados, the existing coordination with Canadian authorities focuses on supervisory issues, and Barbados has not been involved in the RRP for Canadian banks. Likewise there is insufficient coordination outside of the Caribbean for those insurance companies with extra-regional operations.

[35] KA 3.3 of Key Attributes.

70. Going forward, the modalities of coordination for resolution planning and crisis management, including coordination with non-Caribbean jurisdictions, should be formalized in the Financial Stability Management Plan (FSMP). Regarding banks, the FSMP should spell out possible options of coordination arrangements with the Office of the Superintendent of Financial Institutions of Canada and Canada Deposit Insurance Corporation for resolution of Canadian banks. Regarding the insurance, any FSMP for the sector could formalize the procedures for cross-border coordination for resolution.

Appendix I: Macro Scenarios for Stress Testing

71. The macro baseline is based on the September 2013 World Economic Outlook (WEO). It projects a domestic contraction during 2013–15 between 0.8-1.8 percent annually, and a sluggish recovery in 2016. Under this anemic growth outlook, inflation is forecast to decline to 2½ percent in 2013 and to remain broadly in that range through the end of the period. The T-bill rate is expected to stay between 3.4–3.7 percent.

72. Four negative scenarios broadly follow the risks identified in the risk-assessment matrix:

- **The tourism scenario envisages a shock to tourism receipts.** Under the scenario, a deterioration in the world economy leads to a permanent decline in tourism revenues of 15 percent (medium shock) and 30 percent (severe shock) relative to the baseline. The drop in output is hence between 3.4–7.3 percent more severe than in the baseline, while inflation and interest rates remain the same.[36]
- **The oil price scenario simulates a permanent increase in oil prices.** The scenario assumes that oil prices increase by 25 percent (medium shock) and 50 percent (severe shock). The shock pushes up inflation and interest rates, hurting competitiveness and tourism. Inflation is 1.6–2½ percent higher and GDP growth is by 0.4–0.8 percent lower than in the baseline.
- **The geopolitical risks scenario assumes deterioration in international oil markets triggered by geopolitical tensions.** A sharp increase in oil prices leads to a global slowdown, pushing up domestic prices and hurting tourism and income. This is the most adverse scenario since it combines the shocks to tourism and oil prices.
- **In the sovereign risk scenario** a sharp increase in the sovereign risk premium of 350–500 bps relative to the baseline has a negative impact on the economic value of banks' sovereign bond holdings and credit quality.

73. The impact of the scenarios on banks' NPLs and capital was assessed using econometric, statistical and balance sheet methods. Existing and projected NPLs were provisioned at 50 percent. The tests assumed that between 30–35 percent of special mention loans transition to NPLs in the medium and adverse scenarios, respectively.

[36] The shocks result in lower GDP growth in 2014, which afterward reverts to the rates in the baseline. Tourism revenues and GDP do not catch up to the baseline levels over the stress test horizon. The impact of the tourism shock on output was gauged using econometric and statistical analysis performed by the mission.

Appendix II: Follow-Up on Key Recommendations of the 2008 FSAP

Recommendation	Progress
Banking	
Strengthen cross-border consolidated supervision, including establishing a clear legal framework for the consolidated supervision of banking groups and enhancing home/host cooperation (H).	The consolidated supervision and cross-border collaboration frameworks have been significantly strengthened. Consolidated supervision guidelines have been issued and implemented. MOUs have been signed with key regulators and active collaboration is taking place.
Update regulations on capital adequacy, asset classification and loss provisioning to ensure their effectiveness after the last ten years of structural changes in the banking industry (H).	Credit risk management guidelines have been implemented and asset classification/provisioning procedures for analysis of bank practice have been adopted for inspectors to use. Further enhancements are recommended in CP18 to further strengthen provisioning such as updating the provisioning regulation.
Strengthen regulation and supervision for large exposures and related-party exposures, including setting up the regulatory aggregate limits on total large exposures and related-party exposures on a consolidated basis, and defining the related party in a comprehensive way.	Progress is underway. The CBB Guideline on large exposure limits is still in draft. It contains an aggregated limit on the sum of large exposures exceeding 600 percent. A Credit Risk Management Guideline has also been issued. The revised FIA will contain a comprehensive definition of Related Parties and Groups.
Based on a quantitative impact study, make adjustments to the timetable of adoption of Basel II, including by delaying the implementation schedule, and strengthening the Pillar 2 framework.	Adjustments have been made. Barbados is planning to achieve its transition towards Basel II by 2015. A Basel II Implementation Roadmap was submitted to the industry in February 2012 detailing the methodology for the calculation of capital in a 3-phased approach and the timeline. Phase 1, which has already commenced, will focus on strengthening compliance with Pillar 2 of Basel II (e.g., issuance of industry risk management guidelines); Phase 2 which is also in progress seeks to implement the Market Risk Amendment and Phase 3 will implement Pillars 1 and 3. Basel II compliance forms will adopt the standardized approach for credit risk and market risk and the basic and standardized approach will be used for operational risk.
Financial Services Commission	
Resolve promptly the mandate and structure of the FSC so as to help advance the planned improvements in the supervision of both the Credit Union and Insurance sectors (H).	The regulatory and supervisory framework, including the mandate, power, independence and resource, has been improved after the establishment of the FSC.
Insurance	
Develop standards on corporate governance, market conduct, internal controls (including asset and derivative controls, particularly in	Legally binding guidelines for corporate governance, market conduct, risk management, and valuation of assets have been issued and implemented. However, developments of standards

the case of the offshore market), asset and liability valuation, and a solvency standard for life insurers with a view to enhancing the observance of the International Association of Insurance Supervisors (IAIS) principles. (H).	for liability valuation and solvency requirements for life insurers have not yet progressed.
Improve the timeliness of supervisory returns, and redesign processes for onsite inspection, and offsite analytical support (H).	Quarterly reporting format with more granular financial information has been issued. Late submission of the return would be enforced by a monetary penalty. Development of risk based supervision and on-site examinations are in progress.
Collaborate with the Trinidadian authorities in the supervision of larger cross-border groups.	Negotiation with other regional supervisors (including the Trinidadian authorities) to establish MOUs are on-going. However, information exchange is limited due to the current FSC Act. The FSC proposed to amend the Act to enhance its capacity to exchange information and collaborate with relevant authorities.
Credit Unions	
Increase the frequency of joint (Cooperatives Department and Central Bank) on-sight examinations (H).	Not done.
Consider issuing a specialized Credit Union Law (H).	Not done, although some progress achieved in the FSC Act and the issuance of guidelines.
Securities Markets	
Provide the Securities Commission with statutory power under the Mutual Funds Act and SA to make legally binding rules, inspect and access all information at regulated firms at any time, share information and otherwise cooperate with domestic and foreign supervisors (H).	The FSC law empowers the FSC to issue guidelines, and directives requiring compliance, to conduct inspections and demand information from regulated persons and entities, and share information with other regulators.
Develop and implement a regular inspection program for regulated firms under both Acts and require firms to have adequate internal control and risk management policies and procedures (H).	The FSC plans to begin on-site inspections in 2013. The FSC has issued a Guideline that requires all financial institutions to institute internal control programs.
Update and harmonize takeover bid rules across the region at the exchange and statutory levels; consider an update of bankruptcy and other commercial legislation.	No action taken to date.
Require timely disclosure by mutual funds, public companies and insiders of public companies; consider raising penalties for statutory offences.	Mutual funds and public companies must publicly disclose material events within 24 hours. No changes on securities holding disclosure by insiders. The FSC provides a series of penalties for types of violations, including fines up to $100,000.

Deposit Insurance Scheme	
Formalize early warning and prompt corrective action systems (H).	The early warning and prompt corrective action systems have been provided by the Intervention Policy Framework, but a license suspension should be a measure not at Stage 3 (high solvency risk/severe regulatory breaches) but at Stage 4 (imminent insolvency or non-viability), since a bank whose license is suspended would generally need to be brought to resolution.
Expand and improve the level of public awareness about the characteristics of the new deposit insurance scheme.	There is no public awareness strategy in place for the deposit insurer and there has been no measurement of public awareness to inform the development of such a strategy.
Financial Stability Report	
Consider enhancing the financial stability report by supplementing the CBB's macro model with a banking credit-risk model.	A model for credit risk has been developed and is referenced in the financial stability report.
Other	
Revisit the NIS' investment strategy.	No progress.

H = Highest priority

Appendix III: Detailed Recommendations of FSAP Update

Recommendations	Term	Priority	Institution
Bank Supervision and Regulation			
Amend credit guidelines to include managing risk of borrowers' unhedged foreign exchange exposures; issue the Large Exposure Guideline	ST	H	CBB
Review and update/adopt: homogenous loan classification approach; amend the substandard definition in the 1998 classification regulation to remove or amend the statement "several renewals with capitalization of interest"; provisioning requirements as they are lower than those observed internationally for countries using the same system; and determine whether there should be haircuts to the value of the real estate collateral given the current state of the market and the lack of market data on real estate values	ST	H	CBB
Include in the CBB Act a provision stipulating clearly the conditions under which the Governor can be removed from his position; and revise the provisions that allow the MoF (i) to give written orders to the CBB or (ii) to overrule its corrective measures, for example by replacing the MoF by a Court as the appeal authority	ST	H	CBB/MoF
Amend the FIA and the CBB Act to further empower the CBB	ST	H	CBB/MoF
Amend the FIA as planned to promote a stricter definition of related parties	ST	H	CBB/MoF
Increase the number of on-site examinations in on-shore banks	ST	H	CBB
Perform on-site examinations in international banks that have not recently been subject to any on-site visits over the past five years	ST	H	CBB
Issue supervisory guidance to aid examiners in the analysis of new areas such as banks' capital planning, market risk capital requirements, model review stress testing and interest rate risk	MT	M	CBB
Amend the FIA so that the CBB can issue administrative penalties	MT	M	CBB/MoF
Issue the Large Exposure guideline so that its principles can be implemented as soon as possible, and in particular the aggregated limit on the sum of large exposures exceeding 600 percent	ST	H	CBB
Ensure that issues related to AML/CFT risk are adequately integrated into the risk-based supervisory framework and the number of AML/CFT onsite examinations, particularly in the offshore banking sector, are increased	MT	M	CBB
Take more forceful action in case of serious breaches with AML/CFT obligations	MT	M	CBB
Insurance Supervision			
Develop an internal procedure manual for a financial crisis and require insurers with cross-border activities to establish contingency plans and procedures	ST	M	FSC
Establish a PPS for insurance	ST	M	FSC
Amend the limitation of FSC Act with regard to information sharing	ST	H	FSC
Enhance or actively involve the supervisory colleges for internationally active groups. Continue to improve the cooperation with other supervisors for crisis management	ST-MT	H	FSC
Work closely with the Caribbean Association of Actuaries to establish robust and enforceable valuation standards for technical provisions. Continue and accelerate the development and implementation of risk	MT	H	FSC

Recommendations	Term	Priority	Institution
based capital adequacy requirements, which cover all insurers and insurance groups. Educate the industry regarding the need for an ERM framework			
Accelerate the implementation of risk-based capital adequacy requirements covering all insurers and insurance groups and promote ERM frameworks	MT	H	FSC
Improve overall regulatory framework and supervision capacity, in particular, continue to hire and train staff, elaborate further the practical application of current high-level guidelines, ensure that new on-site inspection and risk based off-site monitoring becomes institutionalized and take appropriate enforcement actions	MT	M	FSC
Enhance independence regarding the supervisory decisions and staff hiring and compensation	MT	M	FSC
Access to Finance and Credit Unions			
Consolidate the current risk-based dual approach to on-site credit union supervision based on well-specified criteria	ST	H	FSC
Issue guidelines for classification, monitoring and reporting of NPLs, restructured loans, and write-offs	ST	H	FSC
Establish a level playing field for qualifying credit unions by lifting product restrictions, removing corporate tax exemption and establishing appropriate prudential supervision	MT-LT	H	FSC, CBB, MoF
Improve credit enforcement through a more effective bankruptcy system and effective mortgage foreclosure procedures	MT	H	Government, CBB
Consider establishing a credit information function	MT	H	CBB/FSC
Safety Net and Crisis Management			
Establish a national crisis management plan for insurance sector	ST	H	FSC
Develop and adopt a Strategic Plan for BDIC	MT	H	BDIC
Enter into agreements for back-up funding with the Central Bank and the MoF	ST	H	BDIC
Develop a target fund ratio for the deposit insurance fund	MT	H	BDIC
Amend the DIA to provide legal protection for former employees and those acting at the direction of the BDIC and to simplify payout processes	MT	M	BDIC
Develop and test payout procedures and processes that would allow direct access to depositor level data at member institutions	MT	M	BDIC/CBB
Stipulate in the FSMP that the CBB should obtain government guarantees or compensation for any solvency support it provides	ST	M	CBB
Amend the FIA, DIA, FSC Act, and Insurance Act to ensure consistency among them and bring the resolution powers and process for a bank, credit union, and insurer more in line with international good practices and standards	MT-LT	M	CBB/BDIC/ FSC
Capital Market Development			
Require mutual funds to provide the FSC with periodic information on portfolio holdings and provide expanded information to investors on fund performance and core holdings	ST	H	FSC
Examine valuation policies	ST	H	FSC
Finalize regulatory agreements with regional regulators for the Caribbean Exchange Network (CXN) to facilitate cross-listing of companies and mutual recognition of licensed firms	MT	H	FSC
Complete ongoing review of Barbados Stock Exchange (BSE) rules	ST	M	FSC

Recommendations	Term	Priority	Institution
Enable public electronic access to listed company annual reports and other filings either on the FSC or the BSE website	ST	H	FSC
Consider revising capital adequacy standard for securities firms	MT	M	FSC
Seek authority to second FSC staff to the private sector for training purposes and to hire financial sector professionals on term appointments	MT	H	FSC
Promote greater use of private placement offerings by adopting reporting requirements consistent with the needs of sophisticated investors	MT	H	FSC
Increase public free float minimums for listed companies	ST	H	FSC
Require all pension funds, including the NIS, to publish promptly annual reports that accurately states the Fund's investment strategy, its significant holdings, provides a commentary on the fund's performance and contains audited financial statements	ST	H	FSC
Consider listing benchmark Barbados government debt on the BSE in denominations that would encourage retail investors to purchase and trade	MT	M	FSC
Explore the viability of mortgage-backed and other asset-backed securities	LT	M	FSC
Macroprudential Policy			
Develop a real estate price index	MT	H	CBB
Clarify mandate and tools of the FOMC	MT	H	CBB/BDIC/ FSC

Appendix IV: Risk Assessment Matrix[37]

Nature/Source of Main Threats	Likelihood of Realization of Threat (in the next 2 years)	Expected Impact on Financial Stability if Threat is Realized
A severe slowdown in tourism triggered by a protracted recession in Barbados' main partners, the United Kingdom, the United States and Canada.	*MEDIUM/HIGH* High economic uncertainty and the adverse impact of the ongoing public and private sector deleveraging exert downward pressures on growth, labor markets and consumer confidence in the U.K., the U.S. and Canada, Barbados' main partners.	*HIGH* • Barbados' growth and employment prospects are heavily dependent on tourism revenues, which will be depressed in a prolonged global recession. • As the U.K., U.S., and Canada account for the bulk of tourist arrivals, a prolonged slowdown in these countries would have a considerable impact on tourism and employment in Barbados and lead to a deterioration in borrowers' repayment capacity and loan quality.
A global oil shock triggered by geopolitical events.	*LOW* • Developments in the Middle East could sharply reduce global oil supply, leading to a price of $140 per barrel.	*MEDIUM* • Barbados is highly dependent on oil imports. Higher oil prices will feed into domestic inflation and weaken the external balances and growth. • Tourism and growth would be affected through various channels: (i) increased travel costs; (ii) further erosion of Barbados' price competitiveness; and (iii) reduced consumer confidence of major partners (the U.K., the U.S., and Canada). • Although Barbados specializes in the high end of the market, competitive pressures from other countries in the region have been growing. A prolonged slump in the tourism sector would increase downside risks to banks' credit quality and profitability.
Fiscal pressures and downside risks to public debt	*MEDIUM* • Public sector debt remains	*MEDIUM* • Government debt is held mainly locally

[37] Threats 1, 2, and 3 will be assessed using macro scenario analysis, whereas threats 4 and 5 will be evaluated using sensitivity tests for currency risk and interbank contagion. The assessment of currency risk in a macro scenario framework is complicated by the long history of the peg, which precludes its use in a regression model.

Nature/Source of Main Threats	Likelihood of Realization of Threat (in the next 2 years)	Expected Impact on Financial Stability if Threat is Realized
sustainability.	high at about 125 percent of GDP, and the central government runs a deficit of nearly 8 percent of GDP. Direct fiscal cost of CLICO failure. • Fiscal imbalances and weak growth prospects triggered a downgrade of Barbados' sovereign credit rating to non-investment grade. • Continued fiscal pressures and sovereign downgrades would drive up the sovereign risk premium.	by the domestic banking sector and the NIS. The financial sector may be vulnerable to increased sovereign risk from a further deterioration in the government's fiscal position. • Banks have increased their government debt holdings in the current slowdown. Higher sovereign risk premiums would depress the market value of government securities and adversely affect banks' capital positions. • Higher interest rates would exert pressure on banks' credit quality and profitability through knock-on deterioration in the repayment capacity of private sector borrowers. • Rollover risk is mitigated by favorable funding structure. Domestic debt accounts for about 70 percent of public debt, mostly at fixed rates. External debt is mostly long term and with a favorable amortization profile.
A devaluation triggered by increased competitiveness pressures or the need to reduce sovereign debt overhang.	*MEDIUM* • Reduced price competitiveness would depress tourism revenues and lead to devaluation pressures.	*MEDIUM* • The balance sheet impact on the banking system would be mitigated by relatively low foreign currency exposure. • Nonetheless, the banking system would be affected by indirect effects from increased sovereign risk and reduced repayment capacity of private borrowers. • A devaluation and subsequent inflation would be one channel of reducing Barbados' high debt overhang in real terms.
Regional contagion with implications for both assets and liabilities of the financial sector.	*MEDIUM* • Regional developments may result in investors leaving Caribbean region, resulting in both asset values dropping but also in large-scale deposit withdrawals in Barbados.	*MEDIUM* • A confidence-induced simultaneous impact on asset prices and a deposit run may have sizable implications for the banking sector.

Appendix V: Offshore Sector: Tax Benefits and Regulatory Threats

74. **The offshore sector is important for Barbados, supported by tax exemptions, reduced local taxes, and tax treaties with major jurisdictions.** Most offshore entities are affiliated with parent companies domiciled in Canada or the United States.

75. **Offshore banks and companies pay corporate taxes on profits from 0.25 percent to 2.5 percent of taxable income.** Exemptions include income tax, capital gains tax or other direct taxes, withholding taxes on dividends, interest, royalties and fees, and foreign exchange controls. A foreign tax credit for taxes paid outside Barbados can be used to reduce the total tax payable to a minimum of 0.5 percent. In addition, offshore companies are exempted from taxes and import duties on materials, machinery, plant and equipment used by the business.

76. **Offshore insurers, both EICs and Qualifying Insurance Companies (QICs) are taxed as follows:** EICs are fully exempt from taxes for the first 15 years of operation. After that, they are taxed at a rate of 2 percent on the first $125,000 of taxable income with any amounts earned above that amount remaining exempt. QICs are taxed on all income at the corporate tax rate, but receive a foreign income tax rebate that effectively reduces the overall tax rate to around 1.75 percent of all income. There are no withholding tax on dividends, interest or management fees. Capital gains are also tax exempt.

77. **In terms of tax treaties, Barbados currently has 33 double taxation agreements (DTAs), including 10 with the CARICOM area countries while several agreements with other countries are waiting for either ratification or signature.** Barbados has three tax information exchange agreements (TIEAs) and others are waiting for either ratification or signature.

78. **DTAs provide relief from double taxation through the use of either tax credits in Barbados or exemptions elsewhere on income taxed in Barbados.** Under Canadian tax law, countries signing TIEAs with Canada receive a similar tax benefit. Canada first signed a TIEA in 2009. As a result, jurisdictions offering low-tax or no-tax regimes and that do not have DTAs with Canada, but have signed TIEAs, such as the Bahamas, Bermuda, and the Cayman Islands, now could pose a direct challenge to Barbados as potential locations for Canadian offshore holding companies. However, the long-term impact of this change is not clear, notably until experience is gained with the repatriation of profits to Canada by companies in TIEA jurisdictions, at which point the Canada Revenue Agency will determine whether those profits are indeed non-taxable.

79. **The Foreign Account Tax Compliance Act was enacted in 2010 by the U.S. Congress to target non-compliant taxpayers using foreign accounts.** When implemented (in 2014), it will require foreign financial institutions to report to the IRS on financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Jurisdictions entering into an intergovernmental agreement (IGA) with the U.S. to implement the Act may have the reporting and other compliance burdens on the financial institutions they host simplified. Barbados is expected to enter into an IGA and has established a working group under the joint leadership of Invest Barbados and the CBB to follow up on related issues.

Annex I. Report on the Observance of Standards and Codes—Basel Core Principles—Main Findings

Responsibility, objectives, powers, independence, accountability and cooperation (CPs 1–3)

80. The Central Bank is the primary authority for the supervision of the financial institutions which is implied in the purpose in the CBB Act "to promote a sound financial structure." The CBB oversees banks operating in and from Barbados and has the power to fully access banks and banking group's information for supervisory purposes, irrespective of their status (i.e., international or domestic). Its responsibilities and objectives are clearly disclosed on its website. However, the authority to licence banks is entrusted to the MoF.

81. The CBB is vested with a series of discretionary powers to address areas of weaknesses in banks or their non-compliance with applicable laws and regulations. The conditions under which these powers are exercised have been recently clarified in the so-called Intervention Policy Framework dated April 2012. Over the past years, the CBB instructed two banks to raise their CAR above the minimum threshold of 8 percent or required banks to cease certain activities or to stop paying dividends. However, in a few instances, the CBB has not always been as forceful as the law allows, in utilizing these powers, particularly in the area of AML/CFT.

82. Under the current regime, the regulatory power is entrusted to the MoF but the CBB can issue guidelines that are enforceable on general provisions contained in the Laws. As mentioned above, Barbados is a common law country and in conducting supervision the CBB relies on enforcing its guidelines on provisions in the FIA and the IFSA. This framework will be reinforced by the introduction of amendments to the law thereby CBB's guidelines will acquire the status of "subsidiary laws." Moreover, the CBB will be able to issue administrative penalties.

83. The CBB is self-funded and considers existing resources as adequate resources to perform its duties. The budget allocated to the BSD is determined by the board of directors, after discussion with the CBB's Budget Committee. The CBB also determines how it will manage the supervisory function and the BSD directly. In terms of budget, the current financial resources provide for staff in sufficient numbers and with skills commensurate with the risk profile. As of today, 36 people are assigned to supervisory activities but two positions are still vacant. 34 staff for supervising on-site and off-site 6 domestic banks; 46 international banks and 12 Part III companies seems to be adequate considering the risk profile of banks and their concentration. The three largest on-shore banks account for about 71 percent of the sector's assets and are branches or subsidiaries of Canadian banks. Moreover, the international sector is dominated by Canadian institutions, four of which representing over 70 percent of the assets of the international banking sector. Since these banks are under close scrutiny of their home supervisor (OSFI), this gives a good level of comfort to the CBB. There are also strong provisions in the law to ensure credibility and professionalism of CBB staff. However, while conflicts of interest are covered by the CBB act, there is no sanction in case of breach.

84. The CBB independence would merit strengthening. The independence of the CBB is not as strong as it should be. First, the conditions under which the Governor can be removed from his position (e.g., in the case of misconduct or incapacity) are not stipulated in the law.[38] Second, the MoF can overrule corrective measures taken by the CBB;[39] third, even though this power has never been exercised, the MoF can issue written orders to the CBB when in its opinion, the policies pursued by the CBB are not adequate for, or conducive to, the achievement of the purposes of the CBB.

85. There is a need for more explicit arrangements for handling a system-wide banking crisis, including a formal financial sector contingency plan to, *inter alia*, address a systemic banking crisis. In effect, the mechanism for resolving a problem bank in an orderly manner with cooperation mechanisms among all relevant stakeholders, including the BDIC, is still being revisited. The authorities are in the process of establishing a National Crisis Management Plan setting out the conditions to resolve problem banks. The different options would include: (i) private sector purchase, (ii) bridge bank, and (iii) temporary public ownership that would involve Government taking control and ownership of a failing bank through share transfers.

Ownership, licensing, and structure (CPs 4–7)

86. The licensing process has been improved since 2008 through the recent issuance of a new framework for market entry. At the time of the previous Basel Core Principles (BCP) assessment, Barbados was lacking a formalized licensing process. In February 2013, the CBB published the so-called "Framework for Licensing of Financial Institutions (FLFI)" that sets out the licensing process and in particular the conditions against which applications are assessed. This document is detailed and aligned with the most recent BCPs and subsequent criteria. It has been documented and posted to the CBB's website.

87. The legal provisions for major acquisitions can be found in the FIA which stipulates that a Barbados bank shall not, without the written approval of the MoF, purchase or otherwise acquire the business of any other licensee. In assessing the application for major acquisitions, the CBB considers in particular the nature of the business and the ownership structure; the feasibility of the business plan and financial projections are also assessed.

Methods of ongoing supervision (CPs 8–10)

88. A risk-based supervisory system has been implemented that greatly enhances the CBB supervision from the approach in place in 2008. In 2008 there were insufficient guideline issued to banks and examiners on supervisory risks and the methodology was a compliance approach.

[38] One of the most recent Governors was removed from office by the MoF and the reason disclosed by the Minister was that it was "*in the best interest of all concerned.*"

[39] In that case, banks that are aggrieved by the decision of the CBB can appeal to the MoF whose decision is final.

Currently significant guidance has been issued and a well-documented risk approach implemented. The BSD was reorganized to more effectively supervise the banks. The BSD is divided into five examination teams. Each team is tasked with supervising a portfolio of onshore/international banks and developing activities through onsite/offsite reviews based on the risk profile of each individual bank.

89. The supervisory framework and the implementation procedures are detailed and results of analysis fully documented. During the review the assessors were provided with numerous documents to demonstrate the CBB process to verify that banks comply with guidelines and operate in a sound manner. The onsite process produces work papers (WP), completed by the examiner, that reflect the extent of the review, deficiencies, and follow-up. The offsite process also produces notes on the quarterly review to document follow-up and update on the condition of the bank.

90. Offsite and onsite supervision are consolidated under a relationship officer responsible for a portfolio of banks. The consolidation of both functions in the same team results in a seamless process from supervisory activity→ follow-up→ correction. Additionally, the risk assessment process results in a risk assessment summary (RAS) that is discussed within the BSD to ensure consistency and consensus that the recommended supervisory activities are adequate for the bank's risk profile.

91. The CBB supervisory framework continues to undergo revisions, including the development of an Internal Supervisory Guide compendium to assist examiners in assessing key areas. In 2013, the CBB issued internal guidance on assessing effectiveness of Boards of Directors and senior management. Consideration is being given to issuing additional internal guidance; areas that would benefit from internal guidance are market/IRR.

Corrective and sanctioning powers of supervisors (CP 11)

92. The CBB is equipped with sufficient discretionary intervention powers to address areas of weaknesses in banks or their non-compliance with applicable laws, regulations or supervisory instructions. Both the FIA (Section 50) and IFSA (Section 57) grant very general powers to the CBB though these broad enabling provisions do not itemize every possible circumstance that may require the Central Bank to take action against a licensee. As indicated in a written opinion prepared by the legal department of the CBB at the request of the Team, "*it is (…) a matter of the regulator's interpretation as to whether a particular action on the part of the licensee is captured by these provisions.*"

93. The proposed amendments to the laws seek to broaden the scope of CBB's enforcement powers and are a welcome development. The CBB has prepared two sets of draft bills that will amend the FIA Act with the view to expand its capacity to impose specific target capital ratios, specify remedial action and impose non-financial penalties for non-compliance with law and related regulations. In addition, the amendments will provide the CBB with explicit power to make guidelines.

94. The CBB is also encouraged to take more forceful actions in case of serious deficiencies or breaches, beyond the moral suasion exercised through its on-going oversight. In the current practice, when the CBB identifies situations of a particular concern (breaches of laws or regulation), it advises the licensee—via a letter signed by the Head of the BSD—to submit a corrective action plan to address the situation. Once approved by the BSD, the action plan detailing corrective measures should be implemented by the bank within a given time frame. Examiners will then ensure—through quarterly reporting—that the deficiencies are addressed to the satisfaction of the CBB. Nonetheless, in case of serious breaches,[40] it would be advisable to take more forceful and adequate actions, which will also help prevent similar breaches from occurring in the future (i.e., moral hazard).

Consolidated and cross-border banking supervision (CPs 12–13)

95. The CBB conducts supervision on a consolidated basis and has issued detailed supervisory guidelines to banks; proposed amendments to FIA will enhance the legal framework. All banks in Barbados (onshore and international) are foreign-owned requiring collaboration with home regulators. The CBB is home supervisor for a Part III licensee and serves as home supervisor for the regional operations of a Canadian subsidiary. Amendments to the FIA are pending that will expand the definitions of control and associate and will enhance the regulatory framework for consolidated supervision.

96. As a major host supervisor with no domestically-owned licensees, the CBB has expanded its information sharing network since 2008. The CBB has close relations with the CGBS and sponsors a college for which the CBB acts as a regional consolidating supervisor. Given that Canadian banks hold over 75 percent of banking assets in Barbados, the CBB participates in supervisory colleges for those banks and in addition, meets with the Canadian supervisor on an annual basis. The current situation is greatly improved as the CBB now has an MoU with Canada.

97. The supervisory colleges have greatly improved the information available to the CBB to conduct consolidated supervision and to supervise the local operations as host. At the **meetings** the banks make presentations and are questioned by the supervisors and later the supervisors exchange views on the condition of the institutions and plan supervisory activities. In-between meetings there are conference calls and cross-border joint activities.

98. Processes for collaboration in a systemic crisis and resolution and recovery planning (RRP) have not been finalized. The CBB has not participated in RRP on a cross-border basis, this is an important aspect given the fact that banks in Barbados are foreign-owned.

[40] At least in two cases examined by assessors, BSD staff identified situations of serious violations with the MLFTA that would have merited, in the opinion of the assessors, more forceful action as allowed by the MLTFA.

Corporate governance (CP 14)

99. The CBB issued a Corporate Governance Guideline in 2006 and this guideline was amended in February 2013 to take account of enhanced international requirements. The guideline details the responsibilities of the Board and Senior Management in establishing the operational environment conducive to safe and sound practices.

100. The CBB places significant emphasis on corporate governance. Corporate governance is reviewed both onsite and offsite and the reviews are documented. Intervention letters often focus on corporate governance deficiencies and CBB follow-up is thorough to ensure correction takes place.

Prudential requirements, regulatory framework, accounting and disclosure (CPs 15–29)

101. The CBB has developed a comprehensive compendium of risk management guidance for domestic/international banks. The guidance has been issued in the past few years and covers all risk elements. The guidance is accompanied by WPs to direct examiners through all the factors and issues to be reviewed.

102. Under the Capital Adequacy Regulation 1998, the minimum capital requirement is established at 8 percent of risk-weighted assets in line with the Basel I standard. The CBB has the authority to impose a higher minimum capital ratio and has already used this power in two occurrences. It is noteworthy that over the past years commercial banks have consistently surpassed the regulatory requirement for capital adequacy. As of September 2012, the average CAR was calculated at 19.6 percent compared to 19.3 percent, recorded one year earlier.

103. Barbados is planning to achieve its transition towards Basel II by 2015. A Basel II Implementation Roadmap was submitted to the industry in February 2012 detailing the methodology for the calculation of capital in a 3-phased approach and the timeline. Phase 1, which has already commenced, will focus on strengthening compliance with Pillar 2 of Basel II (e.g., issuance of industry risk management guidelines); Phase 2 which is also in progress seeks to implement the Market Risk Amendment; and Phase 3 will implement Pillars 1 and 3. Basel II compliance forms will adopt the standardized approach for credit risk and market risk and the basic and standardized approach will be used for operational risk.

104. The CBB Country Risk Management Guideline 2008–13 requires banks to have policies and processes to identify, monitor, and report country and transfer risks. Even though CBB perceives the level of exposure of Barbadian banks to country risks to be low, it is advisable to adjust the guideline to ensure that policies and processes to deal with country risks are fully integrated into the bank's overall risk management process. It is also recommended to update the methodology used by CBB staff to ensure that banks have information systems, risk management systems, and internal control mechanisms that accurately aggregate, monitor, and report country exposures on a timely basis.

105. The CBB closely monitors banks' credit risk management and has issued detailed guidelines; systemic enhancements that would facilitate risk management would be the institution of credit bureaus and a real estate price index. In reviewing credit applications banks survey each other to determine credit outstanding in the system for prospective borrowers. There are independent real estate appraisers to value bank collateral, however, without a national price index it is difficult for the CBB to gauge banks' valuations on a systemic basis.

106. Loan provisioning by banks can be effected using IFRS rules or CBB guidelines; however, the CBB requirements are lower than observed in countries using the same framework. The CBB provisioning guidelines do not include a common treatment for homogenous portfolios to ensure timely write-offs. A review of the provisioning requirements may be warranted to provide new data to update the guideline based the historical losses for the various classification categories and migration of loans between categories since 1998 (when the current guideline was issued). The CBB requires provisions of 100 percent for loss, 50 percent for doubtful, 10 percent for substandard, none for especially mentioned and does not have a general provision for unclassified. The CBB requires a one percent provision for credits that have not been reviewed in the past 12 months.

107. Exposures (any advance or credit, financial guarantee or liability) to a single person or group are limited to 25 percent of the licensee's stated capital and reserves, and 10 percent of the licensee's stated capital and reserves for unsecured exposures. As for the consolidated LEL, there are contemplated in the CBB draft guideline on Large Exposure (2012) and the proposed FIA amendment that stipulate that the aggregate of all non-exempt large exposures (i.e., exposures to a person or group which are equal to or exceed 10 percent of the capital base) may not exceed 600 percent of the capital base. Authorities are encouraged to issue the guideline as soon as possible.

108. The FIA restricts unsecured lending or guarantee to each of the related parties (including a bank's directors, holding company, subsidiary, or affiliate or any director thereof) up to $40,000 or 1 percent of the stated capital of the licensee (whichever is the greater). Also, the FIA requires that credit facilities to the related parties should not be granted on more favorable terms and conditions generally applicable to borrowers. However, there is no comprehensive and detailed definition of "related parties" in the FIA. In addition, there is need to place aggregate limit on the total exposures to the related parties. The authorities are encouraged to pass the draft amendments to the FIA as planned in order to better prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties.

109. Guidelines to monitor market risk were recently enhanced by the issuance of the measuring capital adequacy for market risk guidelines; but examiner guidance has not been

issued. The existing WP for market risk will have to be expanded to include guidance on measuring compliance with the recently issue bank guideline on capital adequacy for market risk.[41]

110. IRR guidelines have been drafted but additional guidance for examiners and expanded bank reporting will be needed to monitor compliance. IRR is an area where the CBB is expanding its focus. The new bank guidance is comprehensive and will require the attendant development of examiner guidance to aid supervision. Currently the CBB reviews bank stress test results and banks' internal risk measurement and limit reporting. There is no granular information received from banks to enable CBB to conduct offsite monitoring independent of bank internal reports.

111. The Operational Risk (OR) Management regime in Barbados appears to be comprehensive. The CBB has established a series of detailed guidelines and WPs in relation to the OR. The authorities are encouraged, however, to better follow the risk of concentration for outsourcing activities. It would also be advisable to complete a horizontal examination of OR in order to obtain a better knowledge of the distribution of OR exposure across all sectors. More on-site targeted examinations particularly in on-shore banks would be recommended as well.

112. Banks in Barbados follow IFRS and banks disclose based on international accounting standards (IAS). They publish their audited annual statements and quarterly condensed information.

113. The CBB is the primary authority to oversee compliance with AML/CFT in the banking industry. A comprehensive AML/CFT guideline has been issued in cooperation with the AML Act that sets out the expectations of the supervisor in relation to the prevention of ML/TF risks. In addition, the ML/TF Act provides the CBB with a wide range of tools to enforce compliance with AML/CFT requirements, including, but not limited to, warning, reprimand, pecuniary sanctions and revocation of the licence. Nonetheless, progress could be made to foster the prudential response when serious breaches are detected, with the view to instill better market discipline. Also, the main focus of AML on-site surveillance has been so far in the area of international banks, only from Canada. It is highly recommended to perform on-site visits in international banks from countries having a higher risk profile and also to increase the number of on-site examinations in domestic banks.

[41] WPs are internal documents and as such are not issued to the industry.

Annex Table 1. Recommendations to Improve Observance of BCPs and and the Effectiveness of Regulatory and Supervisory Frameworks

Reference Principle	Recommended Action
Principle 1	Amend the FIA and the CBB Act as planned so that there are explicit provisions empowering the CBB to "make guidelines." Ensure full alignment between FIA and IFSA on sanctions; the nature of enforcement powers is not the same when it comes to international banks. Make the necessary adjustments to the law in order to make it clear that International banks have to comply with all norms under FIA; as of today, according to the interviews with the CBB, this general principle is implicit. Complete the National Crisis Management Plan in order to ensure orderly resolution of problem banks.
Principle 2	Include in the CBB act a provision stipulating clearly the conditions under which the Governor can be removed from his position. Reconsider the provisions that allow the MoF (i) to give written order to the CBB or (ii) to overrule its corrective measures, for example by replacing the MoF by a Court as the appeal authority.
Principle 5	Include in the licensing due diligence a procedure to determine whether the bank's board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks. Include a requirement thereby applicants should provide information on their in-house mechanisms to detect and prevent criminal activities as well as on the oversight of proposed outsourced functions. Align IFSA and FIA so that CBB due diligence is consistently applied regardless of the type of candidate (on or international applicant). The IFSA seems more prescriptive than the FIA when it comes to the examination of the applicants.
Principle 6	Include in the FIA and IFSA a provision requiring banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Principle 11	Take more forceful action in case of serious regulatory breaches Permit the CBB to issue administrative penalties; this power is only contemplated in the ML/TF Act.
Principle 13	Coordinate with CGBS and OSFI on the development of recovery and resolution of cross-border banks.
Principle 15	Issue supervisory guidance to aid examiners in the analysis of new areas

	such as banks' capital planning, market risk capital requirements and stress testing. Issue detailed guidelines on banks' use of models outlining the expectations from the CBB on documentation, testing, validation, approval and detailed examiner guidance for performing review of models.
Principle 17	Amend guidelines to include requirements for managing risk of borrowers' with significant unhedged foreign exchange exposure and requiring significant/high risk exposures to be approved by the Board. Issue guidelines on bank use of internal models and examiner guidance for their review. Consider discussions with licensees to encourage continuing the planning to establish credit bureaus.
Principle 18	Review and update/adopt: the homogenous loan classification approach referred to in EC-5; amend the substandard definition in the 1998 classification regulation to remove or amend the statement "several renewals with capitalization of interest"; provisioning requirements as they are lower than those observed internationally for countries using the same system; and determine whether there should be haircuts to the value of the real estate collateral given the current state of the market and the lack of market data on real estate values. Consider developing index for real estate valuation.
Principle 19	Issue the LE guideline so that its principles can be implemented as soon as possible, and in particular the aggregated limit on the sum of large exposures exceeding 600 percent. Change the title of the guideline to include the concept of Concentration Risk. Amend the Instructions for completing the prudential quarterly returns, particularly for LEL so that banks can include in their returns exposure to off-balance sheets.
Principle 20	Amend the law as planned in order to promote a stricter definition of related parties. Set up an aggregate limit on the total exposures to the related parties. The current limit ($40,000 or 1 percent of the stated capital) on unsecured lending applies to only each person or company. Define better the concept of "more favorable terms" as contemplated in criteria 2 and especially under which circumstances these terms apply, for example in credit assessment, tenor, interest rates, fees, amortization schedules, requirements for collateral. Include a provision in the CBB guideline on Corporate governance requiring that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board (this is mentioned in the RM guideline only). Include in the law an explicit provision that would allow the CBB to require collateralization of exposures to related parties.

	Determine in the law sanctions that may be applied to directors and management on a personal basis for violations of the rules regulating lending to related parties.
Principle 21	Amend the Country Risk Management Guideline to include explicitly “transfer risks” as a standalone concept. Adjust the same guideline to ensure that policies and processes to deal with country risks are fully integrated into the bank’s overall risk management process. Update the WP #37 on international lending-country to bring it in conformity with the guideline.
Principle 22	Update work paper to aid examiners in monitoring implementation and compliance with recently issued capital requirements for market risk.
Principle 23	Issue the draft guidelines on IRR and enhance existing work program to aid examiners in monitoring of implementation and compliance with the new guideline.
Principle 25	Complete a horizontal examination of operational risks in order to obtain a better knowledge of the distribution of OR exposure across all sectors. Perform more on-site targeted examinations particularly in on-shore banks. Do a stock taking of the Self-assessment questionnaires for ORM. These documents are not produced on a regular basis. Some of them might be outdated.
Principles (multiple)	Adopt and implement the FIA/IFSA amendments.
Principle 29	Take more forceful action in case of serious breaches with AML/CFT obligation. Increase the number of on-site examinations in on-shore banks Perform on-site examinations in international banks that have never been subject to any on-site visits over the past five years.

The Authorities' Response

114. The Barbadian authorities are heartened by the overall tone of the report which, in their view, reflected that Barbados is a well regulated and supervised jurisdiction and commit to continue their efforts to enhance the financial system. Below are the authorities' detailed comments on the BCP assessments:

- Principle 1: The CBB had already started the process of strengthening its supervisory powers well ahead of the start of the FSAP mission and will continue this process.
- Principle 2: The CBB has started the process of addressing these issues by proposing further legislative amendments to the Central Bank Act.
- Principle 6: An appropriate amendment to the legislation is under review.
- Principle 11: We will review our approach in this area.
- Principle 13: This will be pursued.
- Principle 15: This process has already commenced and will be pursued expeditiously.
- Principle 17: We will make the appropriate amendment.
- Principle 18: The project to review the Regulations is well advanced and we will incorporate your comments, as appropriate.
- Principle 19: We expect this Guideline will be issued by year end in line with the proposed timing for the finalization of the legislative amendments
- Principle 20: An aggregate limit on total exposures to related parties is included in the amendments to FIA and IFSA. We will make the additional amendment as recommended.
- Principle 21: We will make the necessary amendments as we continue to enhance our supervisory processes.
- Principle 22: We will continue to update our existing working paper to effect enhancements such as these to our supervisory processes.
- Principle 23: The draft IRR guideline was issued in October and we continue to enhance our internal processes supporting this area.
- Principle 25: The BSD commenced a horizontal review of operational risk in Q1, 2013 and this will continue into 2014. Reviews will include the requests for and review of ORM self-assessments for all licensees.

- Principle 29: The CBB had already started the process of enhancing this area. This includes the rollout of a risk-based AML tool to accelerate a comprehensive assessment of ML/FT risks in all licensees. This spans processes at licensing through to examinations, corrective action and enforcement.

- Recommendations to adopt and implement the FIA/IFSA amendments (referred to in multiple Principles): Noted.

Annex II. Observance of IADI Cores Principles

A. Introduction and Scope

115. This assessment provides an update on the significant regulatory and supervisory developments in the insurance sector of Barbados since 2008. The assessment was conducted by Craig Thorburn (Lead Financial Sector Specialist, World Bank) and Nobuyasu Sugimoto (Financial Sector Expert, IMF) from July 3 to 16, 2013. Barbados first participated in the Financial Sector Assessment Program (FSAP) in 2002 and then had a follow up FSAP in 2008, which included a formal assessment and follow up of its observance of the Insurance Core Principles (ICPs) issued by the IAIS.

116. The current assessment is benchmarked against the ICPs issued by the IAIS in October 2011 and revised in 2012. The ICPs apply to all insurers, whether private or state-owned. Specific principles apply to the supervision of intermediaries. The assessment covers the supervisory practices of the FSC. The assessment covers both the domestic sector and the exempt insurance sector.

B. Information and Methodology Used for Assessment

117. The assessment uses the version of the IAIS Insurance Core Principles (ICPs) adopted in October 2012. The revised ICPs reflected a range of revisions from the earlier versions issued in 2011, 2003 and 1999. Whilst some of the revisions were aimed at further clarifying certain terms and definitions, others represent a significant increase in expectations of supervisory and regulatory requirements compared to the earlier versions, especially those that were introduced in the aftermath of the financial crisis of 2007–08.

118. The IAIS prescribes a methodology for assessing the ICPs that has been followed in this assessment. The methodology is substantially unchanged since the first version of the ICPs was prepared. The assessment considers regulatory requirements and supervisory procedures as well as actual outcomes in practice based on observed experience. That is, for example, a well-designed comprehensive law would not be sufficient of itself to secure observance of principles. The IAIS Thematic Peer Reviews also provide additional guidance on consistent interpretation of the ICPs for assessment purposes. The assessment methodology also addresses definitions of gradings and the treatment of proposed reforms.

119. The level of observance for each ICP reflects the assessment of the various standards there under. Each ICP is rated in terms of the level of observance as follows:

- **Observed**—whenever all the standards are considered to be observed or when all the standards are observed except for a number that are considered not applicable.
- **Not Applicable**—when the standards are considered to be not applicable.

- **Largely Observed**—where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
- **Partly Observed**—where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
- **Not Observed**—where no substantive progress toward observance has been achieved.

120. The assessment is based solely on the laws, regulations, and other supervisory requirements and practices that were in place at the time of assessment. The assessment is specific to the date of the analysis. Ongoing regulatory initiatives, new practices that are proposed, or other potential influences on ratings in the future are noted by way of additional comments. The assessment drew upon copies of laws and regulations, financial statistics, publications and other market information including material issued by industry associations, insurers and other stakeholders, relevant to the insurance sector in Barbados.

121. Importantly, assessments of the ICPs examine the legal requirements and obligations as well as the actual supervisory practices. Legal requirements usually need to be supported by supervisory procedures and supervisory activity to provide an adequate assurance that the principles have been implemented to a sufficient degree to justify a conclusion of observance. This is an important driver of the results of this particular assessment given that the authority responsible for insurance supervision is relatively new. As a consequence, future assessments can be expected to show improved observance as the supervisory function is elaborated and implemented more fully.

122. The assessment has been informed by discussions with regulators and market participants. The assessors met with staff from FSC, various insurers, industry associations, and professionals. The assessors had access to a complete self-assessment on the ICPs and responses to a detailed questionnaire that had been provided by FSC prior to the commencement of the exercise. The assessors are grateful for the full cooperation extended by all. The efforts required by FSC to prepare the self-assessment, as well as its support during the mission, are especially appreciated.

C. Overview—Institutional and Macroprudential Setting

Industry structure and recent trends

123. The insurance sector in Barbados has long been one of significance in the financial sector in the country. Total premium stood at BBD 643 million (US$322 million) in 2011. Insurance premium, compared to GDP, stood at 7.2 percent.

124. There are total of 285 insurers operating in Barbados market as of the end 2012. Those include 9 domestic life insurers, 16 domestic non-life insurers, 222 offshore captive insurers, 22 offshore holding companies and 16 other offshore insurers. There is only one insurer (entered into the market in 2012) which is owned by a banking or securities group and no insurer has a stake in a local banking operation.

125. Insurance market concentration is high and increased sharply after the collapse of the regional CLICO group. The life insurance sector is dominated by one life insurer which accounts for 83 percent of the total assets of the life industry. In the non-life sector, 4 large insurers account for more than 60 percent of the premium incomes although their individual market shares are in the range from 21 percent to 11 percent.

126. The insurance market in Barbados is dominated by traditional pure insurance products. The main products are traditional life products (such as non-participating term insurance, endowment and whole-life insurances) in the life sector. In the non-life sector, motor and property insurance are the main products and the industry uses reinsurance to diversify and mitigate the risk (ceding as much as 80 percent of premium in property and 30 percent in motor).

127. Insurance policies are distributed mainly through agents and salespersons, and brokers, all of whom are licensed both at the level of companies and individuals. Direct sales account for small share of life insurance but sizable share in non-life insurance. There is no bancassurance activity in the market. There are 22 registered insurance brokers, 38 registered insurance agents and 475 salespersons registered to sell on behalf of insurers.

Operating performance, assets and liabilities, and solvency position

128. Due to the lack of disclosure requirements and incomplete submission of regulatory returns by the industry, available industry statistics have historically been quite limited.

129. Available data suggests that premiums (net of reinsurance ceded) of life insurers have been declined in the recent years due to the weak regional economy and challenges to public confidence. For non-life industry, a low and stable claim ratio (32 percent in non-life sector in 2012) helps non-life industry generally to be financially profitable while soundness of the industry is difficult to judge due to the absence of a robust liability valuation framework.

130. The business model of domestic insurers at their entity level seems to remain conservative. However, riskier/unconventional products are entering the market that may be a source of disproportional risk. Insurers are becoming increasingly complex as they expand operations outside Barbados.

131. The investment portfolios of domestic insurers are concentrated in the Government Bonds of Barbados. Investment limits are applied to statutory funds of domestic insurers, such as a 20 percent limit on overseas investment, 20 percent limits on real estate and a 25 percent limit on equities. However, there is no requirement on diversification or counterparty concentration. Capital markets in Barbados are not mature and liquid and long term investments are limited. As the result, investments are highly concentrated in the Government Bonds of Barbados with short to middle term maturity, and the industry is vulnerable to concentration, sovereign credit, ALM mismatch and liquidity risks. Guidelines on Valuation require insurers to use a market valuation, although the availability of market values is limited due to the lack of liquidity in the domestic capital markets.

132. While the capital positions of the onshore insurance industry are well above the minimum regulatory requirement, the requirement does not capture the risks of the insurers appropriately, especially underwriting risks. The current requirement for onshore life insurers is that admissible assets must exceed liabilities and that for onshore non-life insurers is that asset minus liabilities must exceed the greater of BD$500,000 or 25 percent of net premiums written. Capital requirement applied to off-shore insurers is lower than onshore insurers, e.g., the capital requirement for offshore non-life is that asset minus liabilities must exceed the greater of BD$ 250,000.

Risks and vulnerabilities

133. In the past five years, there have been two insurer failures (CLICO International Life Insurance Company and the affiliated British American Insurance Company). These companies are still under active judicial management processes. While the main products are saving type, the main products of Barbadian domestic insurers are pure insurance, such as non-participating term policy which does not have saving feature. Therefore the business model and industry characteristics of Barbadian domestic insurers are significantly different from these two failed companies. Premiums and persistency of business was negatively influenced by a drop in public confidence and it will take time to be fully restored, particularly in the life sector.

134. One insurance group dominates the life insurance sector, which has expanded to international and cross sectoral operations. The headquarters of the Sagicor group are located in Barbados and its local operations account for more than 80 percent assets in the life industry and 10 percent of premium in the non-life industry. The group has expanded its business gradually, now has including life and non-life insurance businesses in the Caribbean and the U.S., participating in a Lloyds syndicate in the U.K., and banking and broker-dealer business in Jamaica.[42]

135. The exposure to natural disasters in the Caribbean region is an important, but long understood challenge for the insurance sector. Given the geographical location of Barbados, the most probable catastrophic event is a hurricane. Other events, such as tsunami, earthquake and volcanic eruptions are also possible although considerably more remote. While historical occurrences of these types of events have been very small, the industry manages such catastrophic risk by arranging reinsurance, and building up catastrophic reserves. The FSC monitors such arrangements through offsite monitoring and onsite examinations.

[42] The international operations of Sagicor represent 72 percent (34 percent in Jamaica, 13 percent in Europe and 20 percent in the U.S., measured by assets held in the subsidiaries) at the end 2011.

Regulatory development since the previous FSAP

136. Supervision of the insurance industry in Barbados is the responsibility of the FSC established in 2011. As a result, the processes and capacity of supervision is developing. The FSC oversees both domestic and offshore insurers and reinsurers, and insurance distributors. There are no reinsurers in Barbados licensed to serve the domestic market. In addition, they also have responsibilities for credit unions, capital markets and other non-bank financial sector oversight.

137. The FSC has increased its capacity by hiring and training new staff and has developed number of binding guidelines, circulars, examination manuals, reporting forms and a risk based supervision framework. It recently issued guidelines for corporate governance, internal control and risk management, aiming to improve the regulatory frameworks significantly if implemented effectively. However, some recommendations of FSAP 2008 pertaining to the introduction of risk based solvency requirements has not yet been advanced by the FSC.

D. Preconditions for Effective Insurance Supervision

Sound and sustainable macroeconomic and financial sector policies

138. The slowdown in economic growth in Barbados and the Caribbean region does pose challenges to overall insurance industry. The failure of CLICO (Barbados) had a negative impact on public confidence in the insurance sector and the industry is not yet fully recovered due to the adverse macroeconomic condition. However, natural disasters have not occurred in the recent years, which help the insurance industry to be generally sound and profitable.

A well-developed legal regime

139. The Barbados legal framework is generally sound and continuously improved. It was not part of the mandate of this review to assess the suitability of Barbados's legal infrastructure. However, the mission is not aware of any significant deficiencies in the business law system in Barbados. Relevant legislations, such as corporate law, are easy to understand. The risks of corruptions seem to be low. In addition, the legal framework is continuously improved. For example, in 2008, new Civil Procedure Rules were implemented which were aimed at improving the efficiency of the judicial system in civil matters. In addition, there is a system of continuous assizes which improves the efficiency of the criminal jurisdiction of the court.

140. The Barbados accounting and audit framework follows international standards. Barbados has adopted IFRS and IFRS for SMEs. The Institute of Chartered Accountants of Barbados (ICAB) promotes, fosters and maintains the highest standards of accounting in public practice, the public service and commercial and industrial spheres. The Company Act provides for independent audits for companies, that companies over a certain size are audited annually, and that auditors should possess the necessary qualifications. ICAB conducts on-going monitoring of Auditors and assess their practices (methodology, sampling, files, etc.) against international standards and best practice. This framework is further supported by legislation such as the FIA CAP 324A which requires that companies under that Act must submit annual audited financial statements to the CBB. The

Auditors report to the financial statements attests to the fairness of the financial statements. While there is no actuarial association in Barbados, the actuarial experts seems to be reasonably available by relying on actuaries with major foreign qualifications.

141. Mechanisms for consumer protection are still at early stage of the development. A convenient resolution regime for policyholders, such as ADR, is not available and the capacity of FSC's function of an arbitrator is limited. A policyholder protection fund has not been established and there is no plan to establish it at this time, therefore the benefits of policyholders of failed insurers are subject to the outcome of its resolution process, substantively leaving them with limited priority should an alternative judicial management resolution not be possible.

142. Domestic capital markets are not well developed, which restricts the ability of insurers to diversify their domestic investment portfolio. Inevitably, insurers have a concentrated investment portfolio into the Government Bonds of Barbados and high asset concentration exposures generally.

143. Financial Markets in Barbados are under stress due to low economic growth, widening fiscal and external imbalances, and growing public debt. The creditworthiness of the Government is on the decline and the government bonds of Barbados have been downgraded to non-investment grades. Barbados has been affected by the global economic crisis, which has curbed tourism and offshore activity with a broader impact on other sectors. Economic activity is estimated to have contracted by a cumulative 5 percent between 2008 and 2010. Public debt to GDP ratio in Barbados has reached nearly 115 percent of GDP in 2012 and recent placements of government securities were conducted via heavy reliance on non-market methods and Central Bank interventions. Insurers hold 12.3 percent of the total outstanding stock of government bonds.

Annex Table 1. Recommendations to Improve Observance of ICPs

Insurance Core Principle	Recommendations
1 - Objectives, Powers and Responsibilities of the Supervisor	The proposed amendment to the FSC Act to delete the objective relating to increasing the competitiveness of the financial sector should be adopted. The FSC has also proposed that the limited references to ministerial approval should be deleted and this should also be adopted.
2 - Supervisor	The FSC should continue its efforts to develop and detail its operating procedures, enhance technical capacity of staff, and build its supervisory reputation. The initiative to revisit fees and charges so that the FSC can achieve the ultimate objective of covering its costs and should be finalized. Public consultation can be further enhanced by including a wider pool of stakeholders. Legal protection should usefully be clarified to extend to former employees and commissioners for actions taken whilst commissioners or employees. The ministerial roles regarding remuneration should be reduced or eliminated.
3 - Information Exchange and Confidentiality Requirements	Limitations in the FSC Act regarding exchange of information with a wider group of counterparties, and without the need for a defined request, the prior consent of the insurer, an existing branch or local operation, or an MoU, should be implemented. In finalising the MoUs that are under development, the FSC needs to avoid requirements that include strict reciprocity.
5 - Suitability of Persons	The proposed amendments to include significant owners under the scope of suitability requirements and to broaden the scope of information exchange powers should be enacted and implemented. Assessments should be extended to cover significant owners, actuaries and the collective capacity of boards. An ongoing obligation on insurers to monitor suitability of their own officers through corporate governance processes should be added to the corporate governance guideline and to report changes to the FSC.
6 - Changes in Control and Portfolio Transfers	The FSC needs to introduce requirements for approval of change of control as proposed.
7 - Corporate Governance	The guidelines for corporate governance should be deepened and further elaborated following the findings of the supervisory review initiatives and inspections.

Insurance Core Principle	Recommendations
8 - Risk Management and Internal Controls	The guideline on Internal Control and Risk Management should be deepened and further elaborated further. The FSC should follow up the survey results through offsite monitoring and/or onsite examinations to encourage the whole industry to improve their internal control and risk management in accordance with the nature, scale and complexity of their risk profile.
9 - Supervisory Review and Reporting	The FSC priority to develop staff capacity is supported as a priority by this assessment.
11 - Enforcement	The FSC should ensure that prompt enforcement actions can be taken when it is necessary to protect policyholders. The FSC's proposal to amend the FSC Act to introduce late filing fees is a welcome step forward.
12 - Winding-up and Exit from the Market	The FSC should specify a point at which it is no longer permissible for an insurer to continue it business by introducing risk based capital requirements for all insurers. In addition, legislative amendment is recommended to provide legal priority to the policyholders in the event of winding-up proceedings of insurers. The authorities may, alternatively, establish a policyholder protection fund to provide similar protection.
13 - Reinsurance and Other Forms of Risk Transfer	The FSC should take into account quality of supervision of the home supervisor and require insurers prompt documentation of reinsurance transactions.
14 - Valuation	The FSC should work closely with the Caribbean Association of Actuaries to establish robust and enforceable valuation standards for technical provisions. The FSC should enhance its offsite monitoring and onsite examinations to ensure sound valuation of assets and liabilities.
15 - Investment	The investment requirements should be improved to take into account the degree of concentration. They should also be expanded to cover all insurers and all investment activities. Introduction of a risk based capital requirement may supplement and complement the investment requirements.
16 - Enterprise Risk Management for Solvency Purposes	The FSC should educate the industry regarding the needs of an ERM framework through an industry wide survey, regular dialogue, and reinforcing implementation of the guideline of Internal Control and Risk Management. The FSC should also consider expanding the guideline to cover risk tolerance statements, feedback loops and ORSA requirements, and make sure that the industry manages their own material risks, including the risks from the group and cross-sectoral operations, and catastrophic risks.
17 - Capital Adequacy	The FSC should continue and accelerate the development and implementation of risk based capital adequacy requirements. It should cover all insurers and insurance groups. The FSC should

Insurance Core Principle	Recommendations
	enhance its dialogue with the industry and encourage the industry to prepare for the introduction by conducting impact assessments and qualitative surveys.
18 - Intermediaries	The FSC should impose requirements to ensure and improve the integrity of intermediaries. The FSC should develop effective reporting requirements for intermediaries.
19 - Conduct of Business	The guideline on Market Conduct should be deepened and elaborated. The FSC should conduct offsite monitoring and/or surveys to encourage the industry to improve practices of market conduct.
20 - Public Disclosure	Disclosure requirements should be expanded in terms of the coverage of insurers and detail of information so that policyholders and market participants can have a clear view of business activities. Disclosure should be made in a format readily available to policyholders as well as market participants generally, for example in insurers' websites as well as the FSC's website.
21 - Countering Fraud in Insurance	The FSC's proposal to amend the FSC Act to allow it to exchange confidential information with other competent agencies is a welcome step forward. The FSC should have mechanisms to access more information relevant to monitoring fraud.
22 - Anti-Money Laundering and Combating the Financing of Terrorism	The guideline regarding money laundering should be deepened and elaborated. The FSC should conduct offsite monitoring and/or survey to encourage compliance.
23 - Group-wide Supervision	The FSC should enhance the role of the supervisory college for the Sagicor Group and maintain an active engagement with the colleges for other entities where it is a host supervisor. In particular, with the other college members, it should develop a defined understanding of the entities and group structure and definition, including insurance and non-insurance entities, ensure communication protocols between supervisors are effective, and examine how the group assesses group-wide solvency, governance, risk management and internal control. Rather than develop a broader group supervision policy, the college should be charged with developing, under FSC leadership, approaches to meet the ICP more fully that specifically reflect the nature of the one group that falls to the FSC to lead. It is recommended that the FSC secure additional facilitative assistance to support the deepening of the college.
24 - Macroprudential Surveillance and Insurance Supervision	The FSC should develop a deliberate macroprudential assessment, extending analysis beyond trends in insurance sector aggregates to more forward looking analysis of the impacts of developments outside the insurance sector. Published sector data should be made more detailed. The FSC should develop a process and appropriate measures to

Insurance Core Principle	Recommendations
	give specific attention to potentially systemically important insurers both in the domestic context and, in consultation with other supervisors through supervisory colleges, for those of systemic relevance in the region.
25 - Supervisory Cooperation and Coordination	The FSC should proactively manage the supervisory colleges for those groups for which it would be the group wide supervisor and utilise that forum to develop group supervisory activities for those groups.
26 - Cross-border Cooperation and Coordination on Crisis Management	The FSC's proposal to amend the FSC Act to allow it to exchange confidential information with other supervisors is a welcome step forward. The FSC should continue to improve the cooperation with other supervisors by leading and participating in supervisory college and crisis management groups. The FSC should develop internal procedure manual for a financial crisis. It should require insurers (particularly large insurers with cross-border activities) to establish contingency plans and procedures based on their specific risk for use in a going- and gone-concern situation.

E. The Authorities' Response

144. The authorities agree with the recommendations as detailed and the recommendations are in line with the existing development priorities of the FSC.