FINANCIAL STABILITY REPORT

Turks and Caicos Islands
Financial Services Commission

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Financial Stability Report 2022
Turks and Caicos Islands Financial Services Commission

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PREFACE

The Financial Stability Report describes the overall risks and threats to financial stability in the Turks and Caicos Islands ('TCI') and the resilience of the financial system in the context of those assessed threats. The report is produced by the Turks and Caicos Islands Financial Services Commission ('the Commission'), pursuant to its mandate to monitor financial service businesses conducted in and from the TCI.

This 2022 edition seeks, among other things, to:

(i) describe the overall risks and threats to financial stability in the TCI, and discuss the resilience of the system in the context of those assessed threats;

(ii) review trends of specific risk indicators and the outcome of stress test exercises; and

(iii) discuss emerging risks to system stability and their likely implications.

The report examines developments in the international, regional and domestic macrofinancial environment. It addresses only the domestic financial system which includes banks, investment businesses, domestic insurance companies, trust companies, and money service businesses (MSBs). Primary focus is given to the domestic banking sector which is the main engine of intermediation and is most vulnerable to unexpected shocks through exposure to the rest of the economy. The report excludes financial institutions licensed to conduct business solely outside of the TCI. As at 31 December 2022, the international financial sector was dominated by over 8,000 small international insurers, the overwhelming number of which were Producer Affiliated Reinsurance Companies (PARCs)[1], which primarily reinsured low-value motor and health-related risks for related or affiliated entities. The Commission also supervises a small number of captive insurers. In addition, corporate service providers, non-profit organisations, and designated non-financial businesses and persons are supervised for anti-money laundering (AML) and combating the financing of terrorism (CFT) and proliferation risks.

This document, unless otherwise stated, references data available as at 31 December 2022.

The report is published to promote public understanding and transparency around risks in the financial sector and is available to the public for download at http://www.tcifsc.tc.

[1] Formerly Producer Owned Reinsurance Companies (PORCS)

LIST OF ABBREVIATIONS

AFSI	Aggregate Financial Stability Index
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BSI	Banking Stability Index
CAIR	Caribbean Association of Insurance Supervisors
CAR	Capital Adequacy Ratio
CARTAC	Caribbean Regional Technical Assistance Centre
CPI	Consumer Price Index
FSI	Financial Soundness Index
FVI	Financial Vulnerability Index
GDP	Gross Domestic Product
HHI	Hirschman-Herfindahl Index
IDB	Inter-American Development Bank
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
LAC	Latin American and Caribbean
MaFi	Macrofinancial Index
MSB	Money Services Businesses
NPL	Non-performing Loan
PARC	Producer Affiliated Reinsurance Company
RBA	Risk-based Approach
RBS	Risk-based Supervision
RHS	Right Hand Side
ROA	Return on Assets
ROE	Return on Equity
TCI	Turks and Caicos Islands
UK	United Kingdom
US	United States
WECI	World Economic Climate Index
WEO	World Economic Outlook

1.0 FINANCIAL STABILITY OVERVIEW

Risks to financial stability in the TCI were amplified in 2022. Promising signs of continued economic recovery at the end of 2021 were short-lived amid growing risks in the global environment on account of persisting geo-political tensions, growing inflationary pressures driven by higher food and commodity prices, rapid increases in interest rates, worsening growth prospects and the lingering pandemic. Central banks in advanced, emerging and developing economies accelerated monetary policy tools to slow the rate of inflation resulting in increases in interest rates which tightened global financial conditions due to the increased cost of borrowing and downgraded growth prospects in many economies during 2022 and for 2023. Domestically, inflation became more broad-based and persistent putting pressures on government spending and trade balances which could cause adverse risks in the near-term. Nonetheless, the real economy experienced positive growth supported by a resilient and strong domestic financial system.

1.1 Macroeconomic Environment

Growth in the global economy slowed to 3.2 per cent in 2022 with growth forecasts downgraded in all major trading partners in the second half of the year. High inflation across the global economy has been driven primarily by the impact of the Russia/Ukraine conflict on energy and food prices. Growth expectations in advanced and emerging economies have dampened, with the probability of economic downturns rising across the globe. Downside risks in the UK and US, the TCI's key trading partners, were particularly high relative to similar economies, with direct and indirect financial stability implications for the TCI through interest rate benchmarks and wider economic linkages.

Although domestic economic growth slowed in 2022, the domestic macroeconomic environment was broadly stable during the review period. The annual real growth of quarterly Gross Domestic Product (GDP) declined to a projected 6.2 per cent in 2022, from 9.0 per cent estimated for 2021. The tourism and construction sectors exhibited the strongest performance in the economy. Furthermore, there was an improvement in the current account balance for 2022. The unemployment rate declined to 8.0 per cent from 9.0 per cent in 2021, although remaining above the pre-pandemic level. However, inflationary pressures intensified during the review period, reflected in a projected 6.0 per cent increase in the Consumer Price Index (CPI) in 2022, relative to 4.5 per cent in 2021. The inflationary pressure contributed to a widening of the country's trade deficit on account of higher cost of imports. The TCI government increased spending to alleviate the impact of the inflation on businesses and households which led to a fall in fiscal balance for the period. On the other hand, public sector debt declined for the review period, reflecting the government's consistent efforts to lower the country's debt burden.

1.2 Financial System Soundness and Resilience

Within the context of continued price instability and tightening financial conditions, indicators of financial stress were elevated in 2022, relative to 2021. The Aggregate Financial Stability Index (AFSI), the Macrofinancial Index (MaFI) and the financial risk cobweb showed deterioration in financial stability for 2022, relative to 2021, reflecting mainly a high inflation environment.

Notwithstanding the above, financial institutions remained adequately capitalised and had high liquidity positions in excess of statutory requirements. The banking sector, the largest domestic financial intermediary, remained strong. Stress tests results pointed to a general resilience of the sector to a series of plausible idiosyncratic shocks. The capital and liquidity buffers held by banks were broadly adequate to sustain the stability and resilience of the banking system. At the individual level, some banks displayed weaknesses to specific shocks, particularly under the liquidity scenarios, which indicated elevated liquidity risk exposure.

The banking sector's performance was broadly positive, with banks' balance sheets remaining strong over the review period. There was an expansion in banks' asset bases on account of larger investment holdings. Banks' profitability and asset quality also improved over the review period. In addition, indicators of financial soundness generally pointed to a healthy banking sector from the standpoint of capital adequacy, liquidity, asset quality and profitability.

The performance of the non-bank financial services sector was mixed, but the sector did not pose major risks to the stability of the broader financial system. In the aggregate, assets of non-bank financial institutions contracted by 2.5 per cent during 2022. Investment businesses continued to account for the highest share of assets within this group and recorded a decline in assets of 3.2 per cent during the period. Trust companies' asset base reduced by 15.5 per cent at year-end 2022 but profit reported by the sector increased for the year.

The life and general insurance sub-sectors recorded increases in assets during 2022. The combined profitability for the insurance sector declined over the review period, but there were mixed results for the two sub-sectors. The decline in profits was reflected in the general life insurance sub-sector, driven mainly by the impact of Hurricane Fiona on the Islands in September 2022. Nevertheless, financial soundness indicators point to a stable insurance sector with adequate liquidity and capital levels, in compliance with regulatory requirements.

The MSB sector recorded increases in both assets and profit for the review period. The value of funds transmitted rebounded on account of increased sending activity to the Dominican Republic and Jamaica. There was continued decline in sending activity to Haiti in 2022. Funds remitted to Haiti had declined since 2021 on account of new foreign exchange regulations introduced by the country's central bank, which had implications for Haiti's foreign exchange market.

1.3 Sectoral Exposures

Household credit in the form of personal loans continued to dominate the credit portfolio of banks, growing at a rate of 4.2 per cent during 2022. Meanwhile, credit to the corporate sector declined by 1.6 per cent. While higher interest rates increased overall debt servicing costs, loan quality for both the household and corporate sectors improved. In addition, the debt servicing capacity for households and corporates remained broadly resilient.

Banks' exposure to other financial institutions remained stable with large exposures to parent banks abroad in the form of placements. On the other hand, banks continued to have very little exposure to public debt.

1.4 Outlook for Financial Stability

Given the current financial climate, characterised by sustained inflationary pressures and lower-than-expected economic growth rates, risks to financial stability are likely to stay elevated in the near-term. High inflation and the phasing-out of several policy support measures may amplify financial stress on households and businesses. In addition, persistent increases in interest rates would escalate debt servicing costs thereby exposing banks to distressed borrowers. However, given the capital headroom and strong profitability prospects due to higher interest rates, the financial sector is expected to remain resilient with the capacity to absorb adverse outcomes and continue to support the domestic economy.

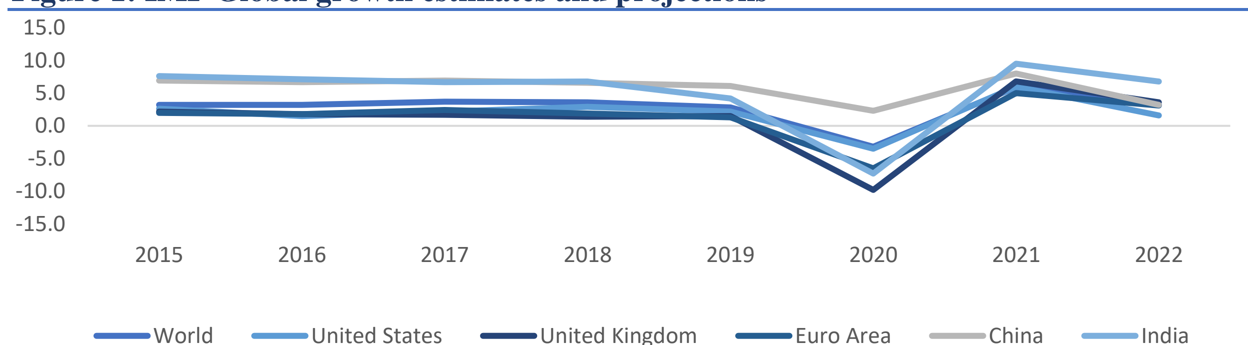
There is also downside risks in the real economy should expectations on economic activity turn out to be worse than expected. Risk of recession looms over several of the major economies, including the US and UK, which could threaten the tourism product locally as seen in past recessions. If further adverse shocks were to be realised, tighter financial conditions may trigger further distress in the form of heightened liquidity risks in the international and domestic environment. Continued economic and financial surveillance will therefore be critical going forward to ensure timely identification of risks and implementation of coordinated and well-informed policy actions to contain the impact.

2.0 MACROFINANCIAL ENVIRONMENT

2.1 Global Macroeconomic Developments

The global environment experienced tightened economic conditions in 2022 on account of geo-political tensions brought on primarily by the Russia/Ukraine conflict, higher cost of living caused by persistent inflation and the declining growth in China on account of the COVID-19 pandemic response. The International Monetary Fund (IMF) in its October 2022 World Economic Outlook (WEO) projected global growth to decline to 3.2 per cent in 2022, from 6.0 per cent in 2021. For advanced economies, growth is projected to slow from 5.2 per cent in 2021 to 2.4 per cent in 2022. The projection is concentrated in the United States and European economies where inflationary pressures remain high on account of global supply pressures and monetary policy tightening resulting in increased wages, higher real estate rental prices and reduced consumer spending and investment. China's growth is projected to decline from 8.1 per cent to 3.2 per cent in 2022, owing to the pandemic containment measures and the slowdown in the housing market (see figure 1 and table 1).

Figure 1: IMF Global growth estimates and projections



Source: IMF World Economic Outlook October 2022

Table 1: WEO estimates and projections for GDP growth

		WEO Oct 2022 Projections		Change from Jul 2022 Projections	
	2021	**2022**	**2023**	**2022**	**2023**
World	6.0	3.2	2.7	0.0	-0.2
Advanced	5.2	2.4	1.1	-0.1	-0.3
United States	5.7	1.6	1.0	-0.7	0.0
United Kingdom	7.4	3.6	0.3	0.4	-0.2
Canada	4.5	3.3	1.5	-0.1	-0.3
Euro Area	5.2	3.1	0.5	0.5	-0.7
Emerging and Developing	**6.6**	**3.7**	**3.7**	**0.1**	**-0.2**
China	8.1	3.2	4.4	-0.1	-0.2
India	8.7	6.8	6.1	-0.6	0.0
Mexico	4.8	2.1	1.2	-0.3	0.0
Brazil	4.6	2.8	1.0	1.1	-0.1
Latin America & Caribbean	6.9	3.5	1.7	0.5	-0.3

Source: IMF World Economic Outlook October 2022

The Russia/Ukraine conflict caused a severe energy crisis in Europe. West Texas Intermediate (WTI) oil prices increased by 38.8 per cent to an average US$94.3 per barrel in 2022 relative to an average cost of US$68.1 per barrel in 2021. Higher food prices on world markets, caused primarily by the significant drop in supply from Ukraine, led to hardships for low-income households worldwide.

In China, COVID-19 outbreaks and renewed lockdowns under the country's zero-tolerance COVID-19 strategy significantly disrupted production and distribution, destabilising economic activity in the country. Importantly, given the size of China's economy and its importance in the global supply chains, global trade and economic activity were adversely impacted.

Global inflation is projected to rise from 4.7 per cent in 2021 to 8.8 per cent in 2022. In an environment of persistently high inflation, central banks around the world continued to tighten monetary policy, via increases in central banks' policy rates in 2022, in a bid to fight the acceleration in inflation. Consequently, this has spurred higher rates of interest. Global financial conditions tightened as equity markets declined as a result of falling investor confidence and mounting concerns of a global recession.

Risks in the global environment are expected to rise further, resulting in a downward revision of growth for 2023 (see table 1). According to the IMF, global growth is projected to decline further to 2.7 per cent in 2023, driven mainly by lower economic activity for the world's four largest economies – US, UK, Euro area and China. In addition, the Fund forecasts that one-third of the world's economies will experience a recession in 2023 (WEO, October 2022). The expectation is particularly underpinned by the continued influence of high inflation and the energy and food supply difficulties caused by the continuing Russia/Ukraine conflict. While global inflation is projected to decline to 6.5 per cent in 2023 as monetary policy tools take effect in restoring price stability, risks are expected to remain high as tightened financial conditions could depress global economic activity further.

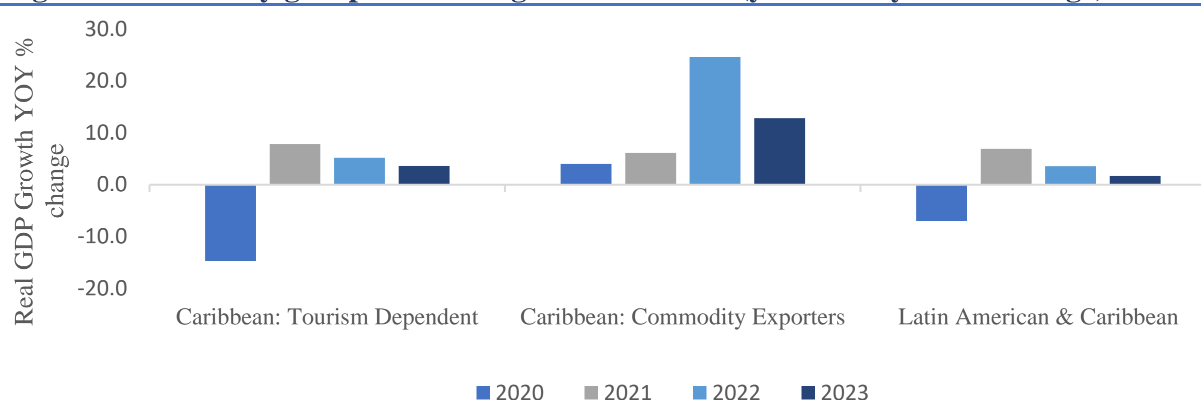
2.2 Regional Macroeconomic Conditions

Despite an adverse global environment, growth in the Latin American and Caribbean region was better than expected for 2022. After a strong recovery in 2021, aided by the global recovery, in April 2022 the IMF forecasted the year's growth at 2.5 per cent, however, in October, the forecast was upgraded to 3.5 per cent for the region. The improvement was partially attributed to the impact of higher commodity prices, which benefitted commodity exporters in the region. Near-term growth forecasts for the region is expected to be impacted by global projections, particularly those for the United States, the region's main trading partner. In the April 2022 World Economic Outlook, the IMF indicated U.S. growth would be 2.3 per cent in 2023 but later downgraded that forecast to 1.0 per cent in October of 2022. Therefore, as external conditions in the US and other advance economies turn less favourable, tighter financial conditions is expected to weigh on

regional economic activity through lower capital inflows, higher interest rates and a slowdown in private and residential credit. Consequently, the IMF forecasts that growth in 2023 will fall to 1.7 per cent (see figure 2a).

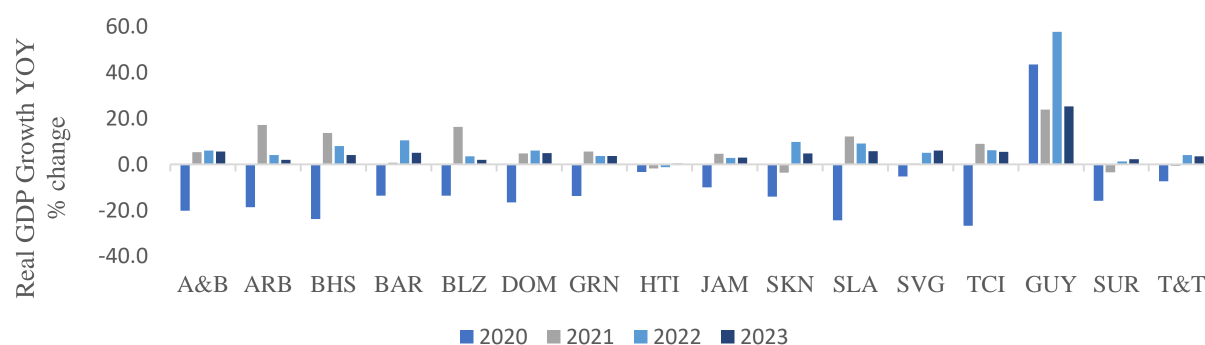
Tourism-dependent Caribbean territories saw weaker tourism levels in 2022 owing mainly to the economic contraction in the US and European countries, and the impact of the inflation shock on real incomes globally (IMF Regional Report October 2022). On the commodity side, Caribbean commodity exporters (Guyana, Suriname and Trinidad and Tobago) experienced increased growth due to high global commodity export prices. Of note, Guyana's growth is projected to remain in double digits for 2022 and 2023 as oil production in the country continues to increase.

Figure 2a: Country group real GDP growth estimate (year-over-year % change)



Source: Financial Services Commission elaboration based on IMF Regional Economic Outlook 2022

Figure 2b: Select territories real GDP growth estimate (year-over-year % change)



Source: Financial Services Commission elaboration based on IMF Regional Economic Outlook 2022[2]

Inflation in the region continued to follow the global trend at elevated levels. High global food and fuel prices increased transportation costs and the price of imported goods, which put upward pressure on domestic prices and threatened food and energy security, as most countries in the

[2] The list country abbreviations can be found in Appendix A.

region rely on imported fuel and food (IDB Latin American and Caribbean Macroeconomic Report 2023[3]). Central banks and monetary authorities in the region continued their contractionary monetary policies in an effort to ensure that inflation did not become entrenched. Forecasters expect that policy rates will likely remain high in 2023, which may prompt a slowdown in economic growth.

For the external sector, current account deficits are projected to widen on average for 2022. This increase may reflect rising import prices associated with higher global fuel and food prices, increasing transport costs, and higher interest payments due to the global response to the inflationary outburst (see table 2). However, for commodity exporters, higher prices of export commodities is projected to boost current account balances.

Table 2: Main economic indicators for selected Caribbean territories

	Percent Inflation End of period			External Current Account Balance as a % of GDP		
	Estimate	Projection		Estimate	Projection	
	2021	2022	2023	2021	2022	2023
Caribbean: Tourism Dependent	**5.4**	8.3	4.3	**-9.7**	**-10.7**	**-8.7**
Antigua & Barbuda	1.2	10.5	2.7	-15.0	-19.0	-14.7
Aruba	3.6	7.7	3.0	1.4	2.9	3.3
The Bahamas	4.1	7.2	3.4	-23.1	-18.2	-14.1
Barbados	5.2	10.0	6.7	-11.5	-10.0	-8.7
Belize	4.9	8.0	2.5	-6.7	-7.3	-7.1
Dominica	3.5	3.5	4.9	-32.5	-30.6	-28.1
Grenada	1.9	5.4	2.3	-24.2	-24.5	-19.8
Haiti	13.1	31.5	14.8	0.5	0.8	-0.5
Jamaica	7.3	9.5	5.5	0.9	-6.0	-5.2
St. Kitts & Nevis	1.9	3.4	2.2	-5.0	-5.3	-4.0
St. Lucia	4.1	5.5	2.3	-11.0	-6.0	-0.1
St. Vincent & the Grenadines	3.4	8.0	2.1	-22.6	-26.5	-27.6
Turks and Caicos Islands	**4.5**[4]	**6.0**[5]	**3.5**[6]	**21.9**	**34.8**	**-**
Caribbean: Commodity Exporters	**11.0**	**10.8**	**6.8**	**2.0**	**22.5**	**19.8**
Guyana	5.7	9.4	6.0	-25.5	43.5	30.4
Suriname	60.7	35.2	22.9	5.8	-2.0	-0.9
Trinidad & Tobago	3.5	6.5	3.8	10.4	14.3	15.9

Source: IMF Regional Economic Outlook 2022 and TCI Department of Statistics

The IDB reported that more than three-quarters of counties in the region improved their fiscal balances in 2022 as total average balance increased by 1.6 percentage points, reaching -3.2 per cent of GDP, that is 0.2 percentage points above 2019 figures. The outturn was attributed mainly to average decline in total spending of 1.5 percentage points of GDP as most countries in the region

[3] Available at https://flagships.iadb.org/en/MacroReport2023/preparing-the-macroeconomic-terrain-for-renewed-growth
[4] Represents CPI growth for 2021. Source: TCI Statistics Department.
[5] Represents projected CPI growth for 2021. Source: TCI Statistics Department.
[6] Represents projected CPI growth for 2023. Source: TCI Statistics Department.

ended the fiscal stimulus implemented during the pandemic. However, there was moderate fiscal spending mainly during the second and third quarters as countries implemented measures such as cash transfers and subsidies on energy and fuel to compensate for the decline in purchasing power of households and businesses due to high inflation. Average debt-to-GDP ratios continued to decline from 67[7] per cent in 2021 to 64 per cent of GDP in 2022. However, higher interest payments in the context of contractionary monetary policies may offset the gains and lead to increase public indebtedness in the near-term.

The medium-term outlook for the region presents challenges, given the complexities of the global scenario and its significant uncertainties. As growth prospects in the global environment weaken and given the need for continued curtailment of inflation, interest rates are expected to remain higher, constraining consumption and investment. As a highly integrated and open region, the global cycle will influence the region in the form of depressed aggregate demand and high financing costs. This combination may contribute to a significant slowdown in growth and higher probabilities of recession. Additionally, while the region has benefited from a solid financial sector, rising global financing costs and lower economic activity may stress financial markets and institutions. Therefore, prudential measures that limit the exposure of financial firms to systemic risks will be paramount. How potential risks materialise will depend on how well monetary policy, or fiscal policy in the case of TCI, is coordinated with other key economic policy measures.

2.3 The Domestic Economy

The TCI economy is projected to have grown by 6.2 per cent in real terms in 2022, a deceleration from the previous year's growth of 9.0 per cent. Nominal GDP is projected to have risen to $1.14 billion in 2022 from an estimate of $1.04 billion in 2021. The growth in the economy was underpinned by growth in the tourism, construction and real estate sectors. The successful vaccination programme enabled the authorities to ease entry requirements for incoming visitors to the TCI. As a result, tourist arrivals and revenues, the main income earner for the country, improved in 2022. Concurrently, labour market conditions improved as the unemployment rate fell to 8.0 per cent in 2022 from 9.0 per cent in 2021 (see table 3).

For the external sector, the current account balance improved by 66.1 per cent in 2022 on account of higher service balance driven by increased tourism activity. Conversely, the country's trade deficit widened by 43.0 per cent due mainly to the higher cost of imports (see table 3).

Inflationary pressures, induced by rising food and fuel cost on account of the continued Russian/Ukraine conflict, intensified during the review period. The CPI grew steadily to 6.0 per cent, compared to 4.5 per cent in 2021 (see table 3). While the absence of a central bank constraints the implementation of monetary policy tools to help curtail the rise in inflation, the government

[7] IDB revised estimate.

implemented a number of fiscal measures to limit the rapid erosion of purchasing power. Some of the measures included[8]:

(i) a one-off stimulus payment to assist residents with cost of living;

(ii) reduction in fuel tax from 85 cents per gallon to 64 cents per gallon for the period 1 April 2022 to 31 March 2023;

(iii) reduction in custom fees from 7.5 per cent to 5 per cent for the period 1 August 2022 to 31 March 2023;

(iv) removal of import duties on essential basket items for the period 1 August 2022 to 31 March 2023;

(v) subsidies on electricity bills for residents for the period October to December 2022.

Table 3: Domestic macroeconomic indicators

	Actuals			Estimates	Projections	
Indicators	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Nominal GDP (bil. US$)	1.1	1.2	0.9	1.04	1.14	1.23
Real GDP growth (%)	5.6	5.3	-26.8	9.0	6.2	5.5
Unemployment rate (%)	7.0	7.0	11.0	9.0	8.0	7.0
Current Account Balance (mil. US$)	221.9	343.4	-50.4	238.7	396.5	-
Balance of Merchandise Trade (bil. US$)	-477.9	-482.3	-345.8	-474.7	-678.8	-561.2
CPI growth (%)	2.1	2.2	2.3	4.5	6.0	3.5

Source: TCI Department of Statistics

Figure 3: TCI tourist arrivals and tourism earnings[9]

Source: TCI Statics Department

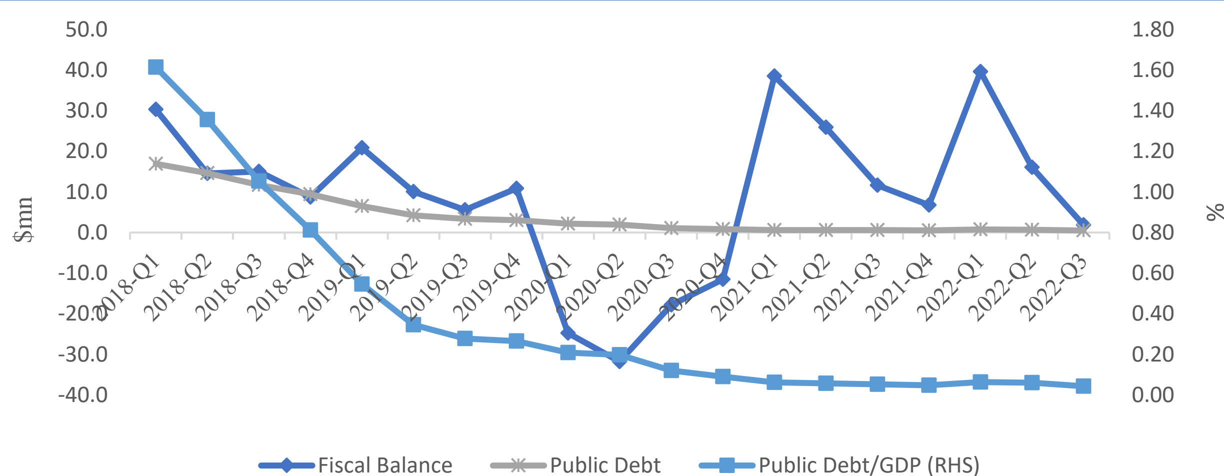
[8] TCI Treasury Department Quarter 3 2022/2023 financial report available at https://www.gov.tc/treasury/publications/reports/quarterly/2022-quarterly-financial-reports

[9] Tourist arrivals include both cruise ship passenger arrivals and stayover arrivals. Tourism earnings represent taxes on hotel and restaurants.

Despite the higher cost of living experienced globally, the TCI government maintained a positive fiscal balance of $1.8 million for the third quarter of the 2022 financial year, compared to a balance of $11.6 million for the previous year. This represents an 84.1 per cent decline for the period, which is believed to have been driven by increased government expenditure on inflation relief programmes.

The government recorded public debt of $0.5 million as at 31 December 2022, compared to $0.6 million for the previous period. The government reported that there were no new borrowings during the financial year. The debt servicing capacity of the domestic economy, measured by the ratio of public debt to GDP[10], also improved over the review period. Within the context of the strong economic activity and fiscal policy efforts to lower the debt burden, public sector debt to GDP declined from 0.05 per cent at year end 2021 to 0.04 per cent at year end 2022 (see figure 4).

Figure 4: TCIG fiscal balance and public debt performance (2016 – 2022)



Source: TCI Government Treasury Office and FSC

In light of the expected ongoing challenges in the global environment, the TCI economy is likely to experience a further slowdown in growth from a projected 6.2 percent in 2022 to 5.5 per cent in 2023. Should recession expectation for major economies materialise, the domestic economy could be impacted by reduced tourism activity due to harsher economic climate, especially in the US and Europe. While inflation levels are expected to wane globally, domestic CPI is projected to fall to 3.5 per cent in 2023; however, domestic interest rates may remain elevated causing further stress in the economy as current debt obligations and the cost of borrowing increase for households and businesses.

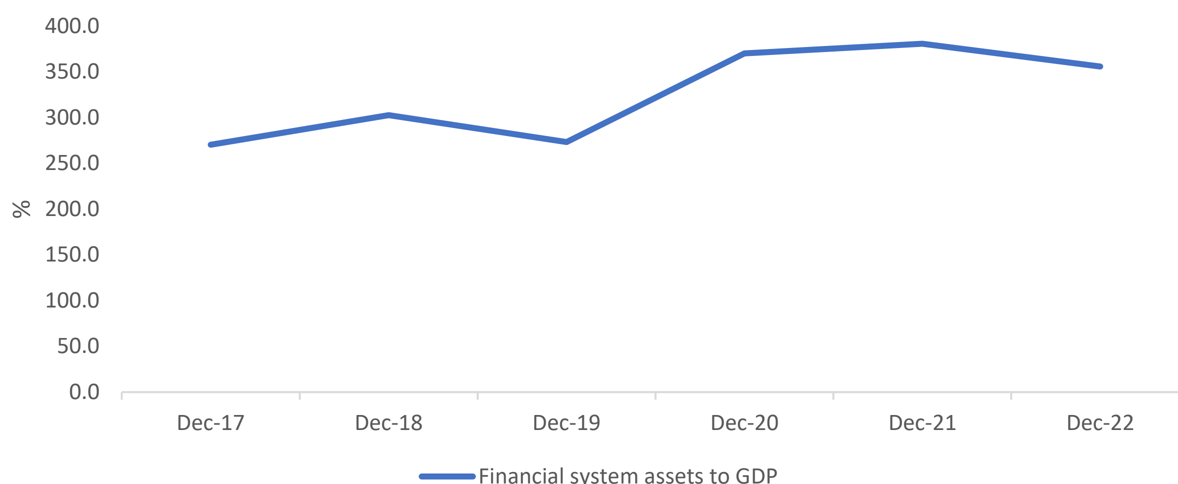
[10] Annual GDP was converted to a quarterly series using the cubic last method.

3.0 FINANCIAL SYSTEM DEVELOPMENT

3.1 Overview

Financial intermediation, measured as the share of total financial system assets[11] to GDP, declined slightly by 24.7 percentage points to 356.0 per cent at year-end 2022 (see figure 5). This decline reflected stronger growth in GDP relative to growth in financial system assets.

Figure 5: Financial intermediation in the TCI

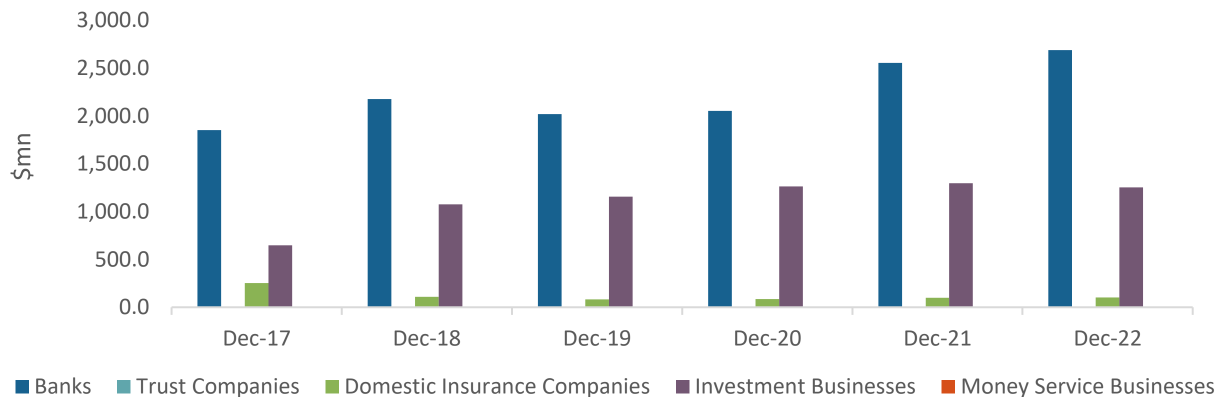


Source: TCI Financial Services Commission

Despite the global inflationary pressures which led to falling assets prices in several jurisdictions, the financial sector remained buoyant in the TCI. Total financial sector assets grew by 2.5 per cent to $4,057.9 million as at December 2022, reflected in expansions in the asset bases of the banking, money services and domestic insurance sectors. Conversely, total assets declined in the trust and investment sectors at year-end 2022 (see figure 6). The structure of the TCI domestic financial sector remained unchanged in December 2022, relative to December 2021, with the banking and investment sectors[12] collectively accounting for over 90 per cent of total domestic financial system assets. At the end of December 2022, the TCI financial system comprised six (6) banks, eighteen (18) domestic insurance companies, five (5) investment dealers, eight (8) mutual fund administrators, seven (7) trust companies, and four (4) money service businesses.

[11] Total financial system assets comprise of on-balance sheet assets at the following institutions: banks, trust companies, domestic insurers and money service businesses. Assets for investment businesses and mutual fud operators represent clients' investment products being managed by these institutions.
[12] The investment sector is comprised of investment advisers and dealers, fund managers and mutual fund administrators.

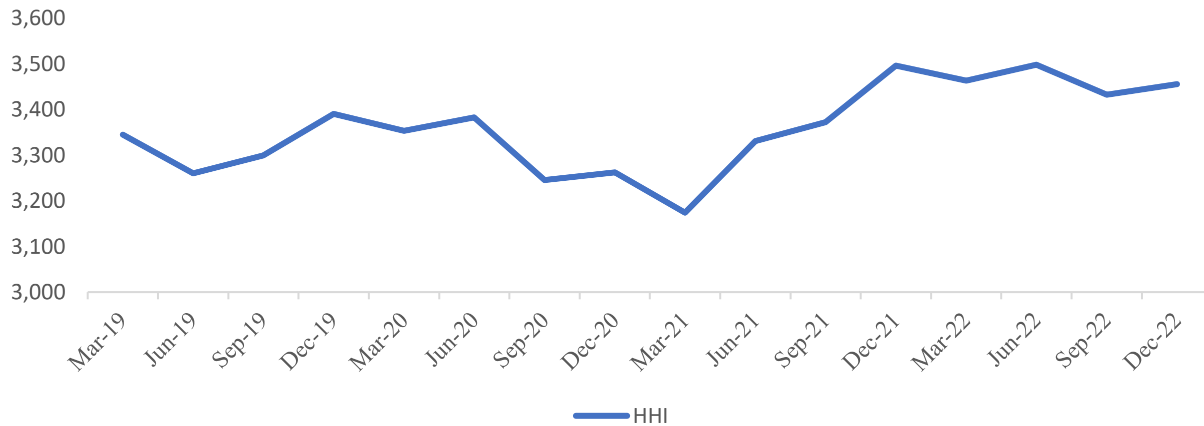
Figure 6: Financial institutions' assets



Source: TCI Financial Services Commission

Aggregate assets of the banking sector amounted to 235.8 per cent of GDP at year-end 2022, relative to 245.7 per cent the previous year. Banking assets concentration, measured by the Hirschman-Herfindahl Index (HHI)[13], declined by 1.1 per cent to 3,456 as at December 2022, compared to December 2021 (figure 7). The outturn signals a marginal reduction in asset concentration risk in the sector. TCI's baking sector assets remained highly concentrated in the three Canadian-owned banks, accounting for approximately 97 per cent of total market share.

Figure 7: Banking sector concentration as measured by the HHI



Source: TCI Financial Services Commission

[13] The HHI is defined as the sum of the squared share of all banks' assets. It takes into consideration each bank's share of assets within the sector and is an indication of the degree of asset concentration. Am market with an HHI of less than 1,500 is considered a competitive, an HHI of 1,500 to 2,500 is moderately concentrated, and an HHI of 2,500 or greater is highly concentrated.

Financial Soundness Indicators (FSIs) pointed to a relatively stable banking sector with high capital buffers and a sound liquidity position. There were improvements in the sector's profitability and asset quality as at December 2022, relative to the previous year's outturn (see table 4 below).

Table 4: Banking sector's annual financial soundness indicators

Ratios	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Capital Adequacy					
Regulatory Capital / Risk-weighted Assets	27.6	31.9	29.6	25.4	31.4
Regulatory Tier I Capital / Risk-weighted Assets	29.0	28.7	27.3	24.2	28.4
Total Capital / Net Assets	14.6	16.8	15.6	13.2	13.5
Asset Quality					
NPLs / Gross Loans	5.4	5.4	6.0	4.5	3.0
NPLs net of Provisions for Loan Losses / Total Capital	6.9	6.0	1.1	1.0	-0.8
Provision for Loans Losses / Gross Loans	2.9	3.1	5.6	4.1	3.4
NPLs net of Provisions for Loan Losses / Paid-up Capital	23.3	21.1	3.5	3.4	-3.1
Earning and Profitability					
Return on Assets (Net profit / Average Net Assets)	2.1	2.5	0.5	1.6	2.0
Return on Equity (Net profits / Average Total Capital)	15.4	17.2	3.4	12.0	16.3
Net Interest Income / Gross Income	65.2	65.0	69.1	55.3	62.1
Non-interest Expenses / Gross Income	46.4	41.0	81.5	46.7	45.9
Liquidity					
Liquid Assets / Total Assets	53.9	50.3	55.4	62.2	61.0
Liquid Assets / Short-term Liabilities	82.9	60.5	65.4	72.6	70.8
Gross Loans / Customers Deposits	66.7	63.0	59.2	42.5	39.1
Liquid Assets / Total Deposits + Borrowings	63.9	61.6	66.6	73.8	71.3

Source: TCI Financial Services Commission

3.2 Banking Sector Performance

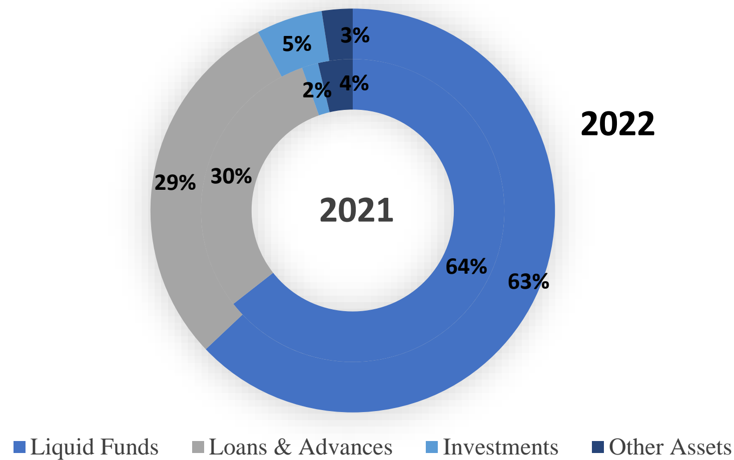
3.2.1 Balance Sheet Position

Banking sector assets grew at a decreasing rate over the review period. Total sector assets increased by 5.2 per cent to $2,668.1 million as at 31 December 2022, relative to 24.5 per cent at year-end 2021. The slowdown in asset growth was reflected in slower growth in liquid assets. Liquid assets grew by 3.1 per cent during 2022, relative to 39.9 per cent in 2021. The portfolio of *Loans and Advances* grew moderately by 1.7 per cent in 2022. A sectoral breakdown of banks' credit portfolio revealed that *Public Utilities* and *Construction and Development* economic sectors had the largest impact on the aggregate portfolio growth, increasing by 49.9 per cent and 7.9 per cent, respectively. In addition, loans to households (personal loans) increased by 4.2 per cent during the review period. Of note, investment assets grew by 217.1 per cent to $145.2 million at year-end 2022, relative to $46.0 million at year-end 2021.

There were moderate shifts in banks' asset composition during the review period. *Liquid Funds* and *Loans & Advances* continued to account for the largest share of banks' assets, representing 63.0 per cent and 29.0 per cent, respectively (see figure 8). Placement of funds with financial

institutions both in and outside of the TCI, the largest share of liquid assets, increased by 2.0 per cent as at end 2022. On account of higher interest rates, banks deployed funds to higher income-generating assets. As a result, the share of investment holdings increased to 5.0 per cent at year-end 2022, compared to 2.0 per cent the previous period.

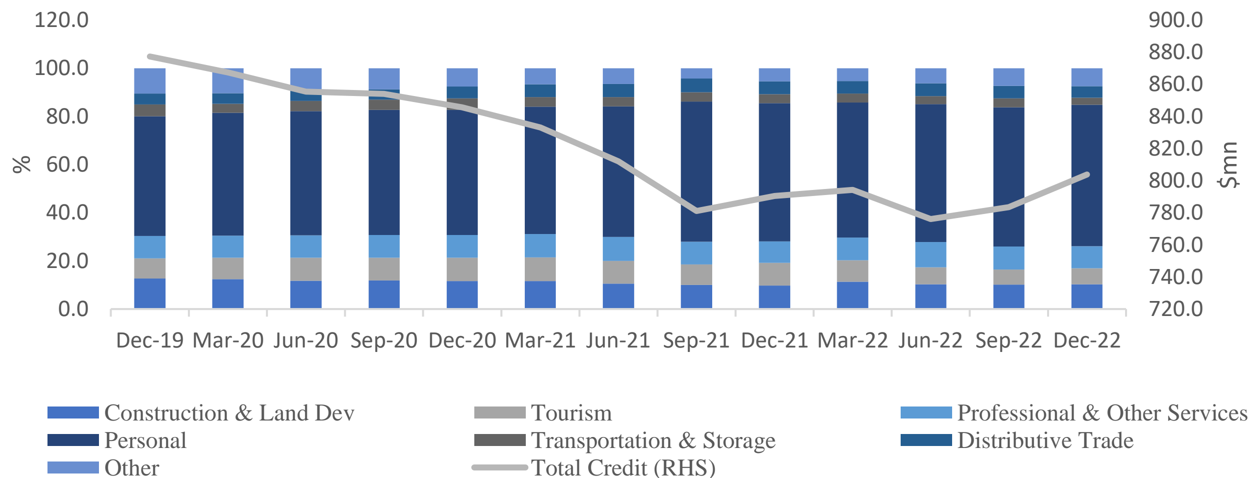
Figure 8: Banking sector asset classification



Source: TCI Financial Services Commission

The distribution of credit remained relatively stable throughout the review period (see figure 9). Private sector credit was concentrated in four main economic sectors, namely, i) construction and land development, ii) tourism, iii) household (personal credit), and iv) professional and other services. The household sector remained the largest recipient of credit, with 58.7 per cent as at year-end 2022.

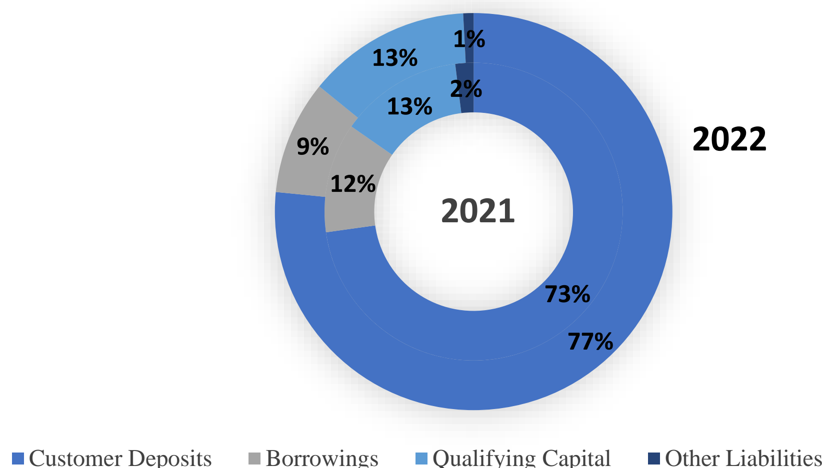
Figure 9: Sectoral distribution of credit



Source: TCI Financial Services Commission

Total liabilities for the banking sector increased during 2022. Banks' funding structure remained relatively unchanged with the primary funding source being deposits (see figure 10). Specifically, banks' total deposits increased by 10.7 per cent to $2,058.4 million and represented 77.0 per cent of total liabilities as at December 2022, relative to 72.8 per cent as at December 2021. Loans to deposit ratio, which is a measure of financial intermediation, declined by 3.5 percentage points to 39.1 per cent during the review period, reflecting a decrease in banks' liquidity risk exposure.

Figure 10: Banking sector funding sources



Source: TCI Financial Services Commission

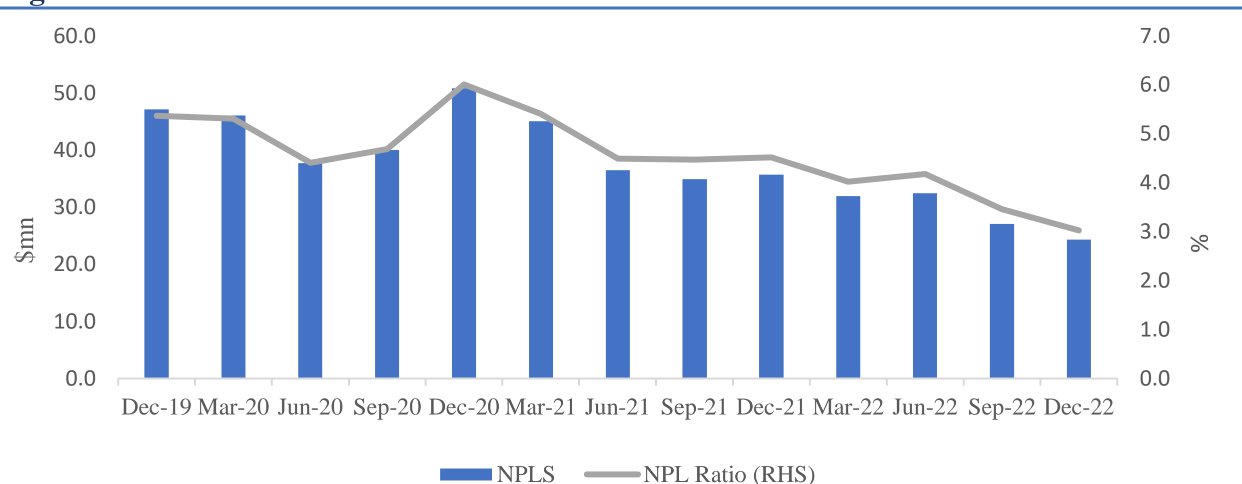
3.2.2 Asset Quality

Banks' asset quality improved during the review period. The ratio of non-performing loans (NPL) to total loans decreased by 1.5 percentage points to 3.0 per cent at year-end 2022. Recoveries from the sale of collateral and expansion in credit facilities explained the decline in this ratio. The stock of NPLs declined by 31.9 per cent to $24.3 million at year-end 2022, in comparison to a decrease of 29.7 per cent recorded at year-end 2021 (see figure 11).

Total provisions set aside by banks declined by 15.6 per cent to $24.3 million as at end-December 2022, predominantly as a result of recoveries. Despite this decline, the NPL coverage ratio, which measures provisions as a share of NPLs, increased to 112.4 per cent at year-end 2022 from 90.7 per cent at year-end 2021, signifying that NPLs were adequately covered by banks' provisions. The outturn reflected stronger reduction in banks' NPL stock relative to decline in provisions. Consistent with the reduction in provisions, banks loan loss provisioning rate, as measured by the ratio of loan loss provisions to total loans, declined as at year-end 2022 to 3.4 per cent, compared

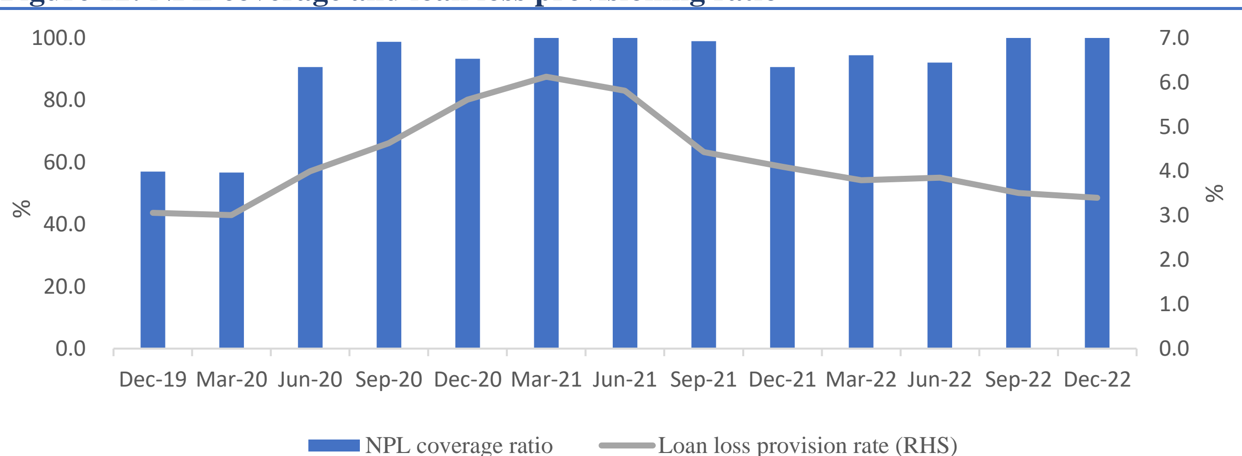
to 5.6 per cent in the prior period (figure 12)[14], indicating that banks did not expect loan quality to deteriorate.

Figure 11: Total NPLs and NPL ratio



Source: TCI Financial Services Commission

Figure 12: NPL coverage and loan loss provisioning ratio

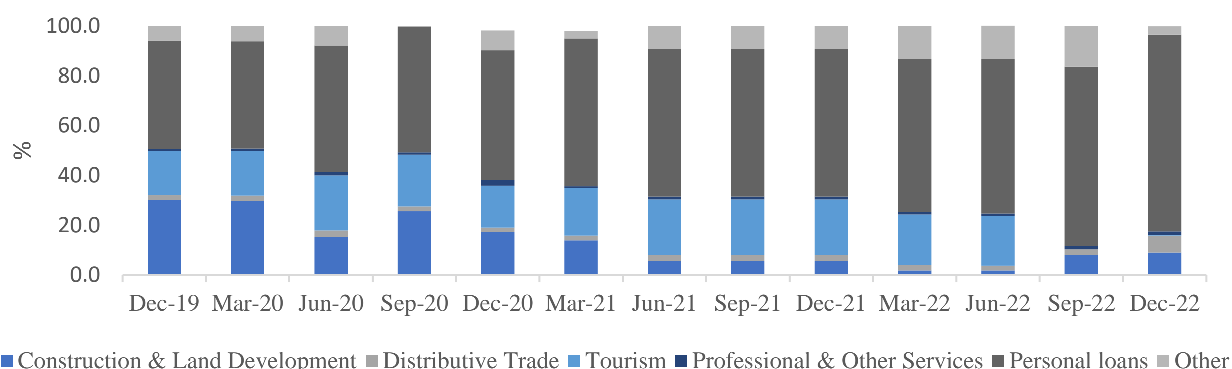


Source: TCI Financial Services Commission

The distribution of NPLs remained relatively steady for the review period with moderate changes for personal and tourism credits. Notably, the share of NPLs for credits to the tourism sector decline by 22.1 percentage points at year-end 2022, from 22.3 per cent in 2021 (see figure 13). Personal credits remained the largest share of sector NPLs.

[14] The loan loss provisioning ratio represents the portion of funds set aside for potential impairments relative to the total outstanding loans held by an institution. This is done based on their judgement as to the likelihood of losses. The higher the ratio, the more conservative the institution is in accounting for potential loan losses.

Figure 13: NPL distribution by sector

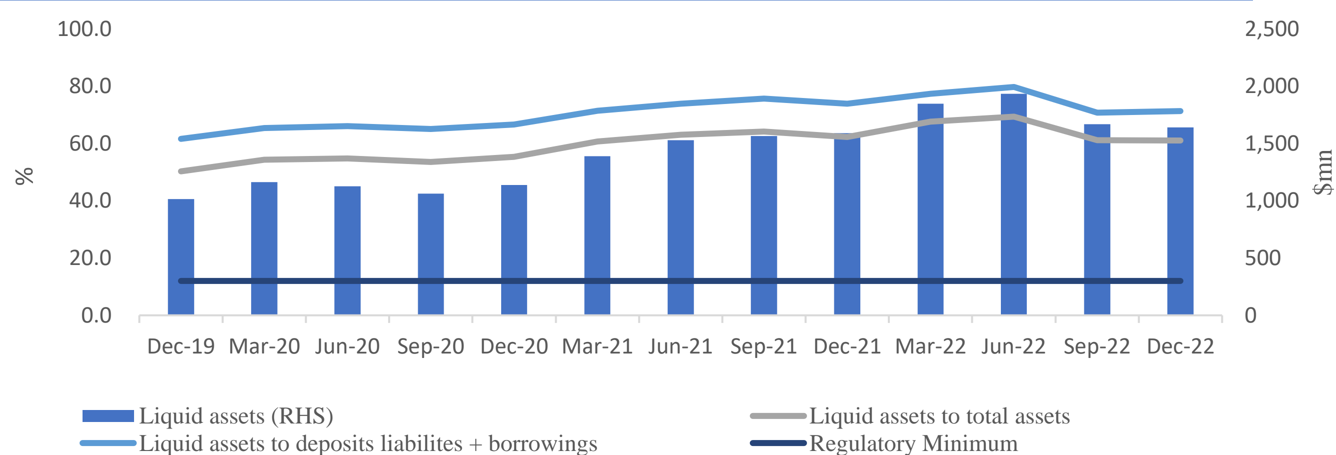


Source: TCI Financial Services Commission

3.2.3 Liquidity and Funding

Banks continued to manage their liquidity risks by maintaining adequate liquidity levels. The aggregate ratio of liquid assets to total liabilities stayed well above the regulatory minimum[15], indicating the resilience of banks to potential short-term outflow of funds. However, the ratio of liquid assets to total assets declined by 1.2 percentage points to 61.0 per cent at year-end 2022 (see figure 14). The reduction was primarily driven by stronger growth in total assets relative to the growth in banks' holdings of liquid assets. The rate of growth in banks' liquid asset holdings declined to 3.1 per cent in 2022, relative to a growth rate of 39.9 per cent during 2021 as funds were diverted to higher interest-bearing assets. Customer deposits continued to account for the dominant share of banks' funding base and remained the main source of credit financing. The marginal contraction in liquidity was not a cause for concern.

Figure 14: Liquidity profile of the banking sector



Source: TCI Financial Services Commission

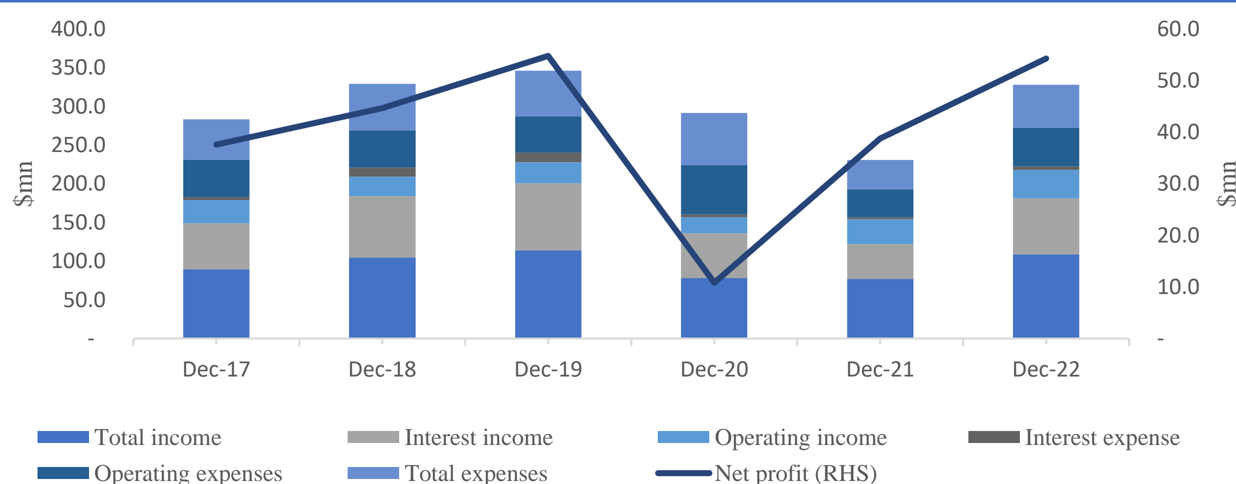
[15] Banks are required by law to maintain a minimum holding of liquid assets at 12 per cent of total deposit liabilities.

3.2.4 Earnings and Profitability

Banks' profitability remained strong over the review period. During 2022, annualised interest income and operating income, particularly fees from services and commissions, increased by 60.9 per cent and 14.1 per cent to $72.4 million and $36.6 million, respectively. Similarly, banks' interest and operating expenses grew by 95.8 per cent and 38.9 per cent to $4.7 million and $50.0 million, respectively. The growth in interest expense was attributed to increases in interest expense paid on deposits, while growth in operational expenses were driven mainly by increases in personnel expenses. A contraction in provisions for loan losses partly offset the increase in annual operating expense. Income written back for provisions previously set aside supported the reduction in provision charges.

Against this background, profit for the sector grew from $38.8 million to $54.3 million in 2022, an increase of 40.0 per cent over the previous year (figure 15).

Figure 15: Banking sector income, expense and profit

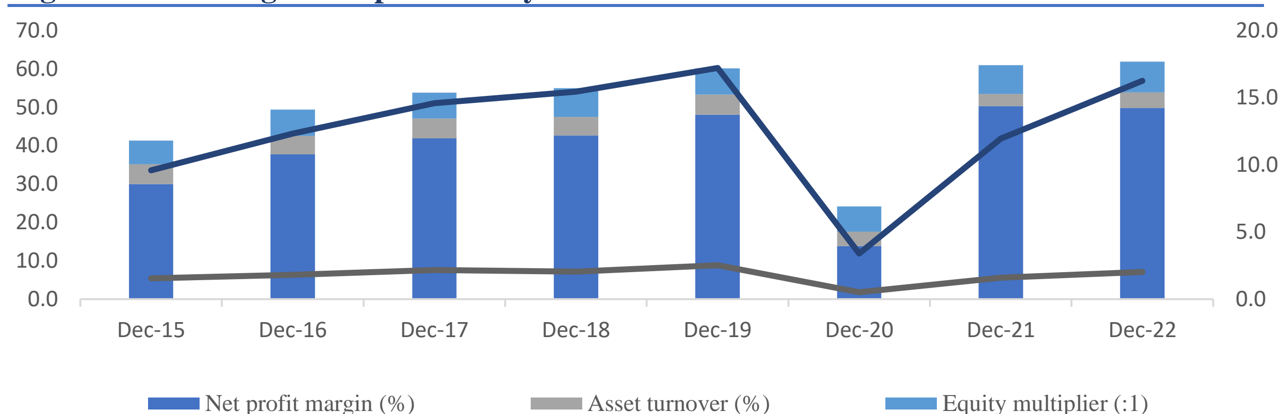


Source: TCI Financial Services Commission

Amid the higher profit outturn, profitability ratios for the banking sector improved in 2022. Specifically, return on equity (ROE) for the sector grew to 16.3 per cent for the period ended December 2022, from 12.0 per cent for the period ended December 2021. A decomposition of the ROE using the DuPont Analysis showed a marginal reduction in net profit margin of 0.5 per cent, attributed to a larger increase in total income relative to increase in net profit. The asset turnover ratio showed growing efficiency of the sectors' income generating assets, while the equity multiplier increased slightly, signalling an increase in the sector's leverage ratio.

Similar to the performance of the sectors' ROE, banks' return on assets (ROA) increased to 2.0 per cent in 2022, from 1.6 per cent in 2021 (see figure 16).

Figure 16: Banking sector profitability ratios

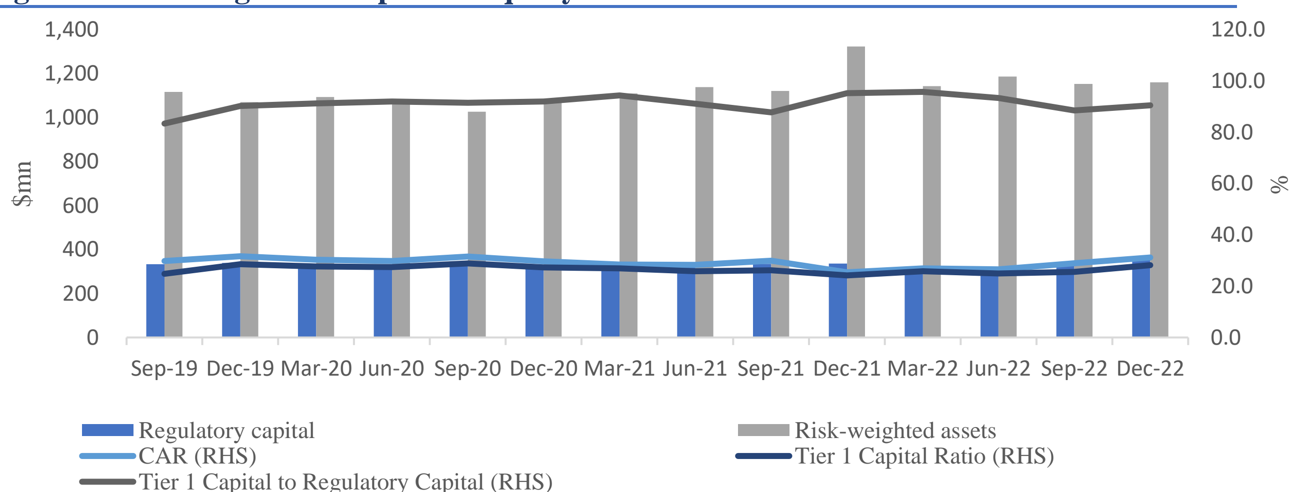


Source: TCI Financial Services Commission

3.2.5 Capital Adequacy

The capital position of the banking sector remained strong, providing banks with buffers against shocks to their balance sheets. The aggregate Capital Adequacy Ratio (CAR)[16] of 31.2 per cent as at December 2022 was well above the regulatory requirement of 11 per cent of risk-weighted assets and reflected an increase of 5.8 percentage points, relative to end-December 2021. Simultaneously, banks' tier 1 capital ratio improved by 4.0 percentage points from 24.2 per cent at year-end 2021. However, the overall quality of the sector's capital, measured as the ratio of tier 1 capital to total regulatory capital, declined by 4.7 percentage points to stand at 90.5 per cent at year-end 2022 (see figure 17).

Figure 17: Banking sector capital adequacy



Source: TCI Financial Services Commission

[16] Capital adequacy ratio is the ratio of regulatory capital to risk-weighted assets.

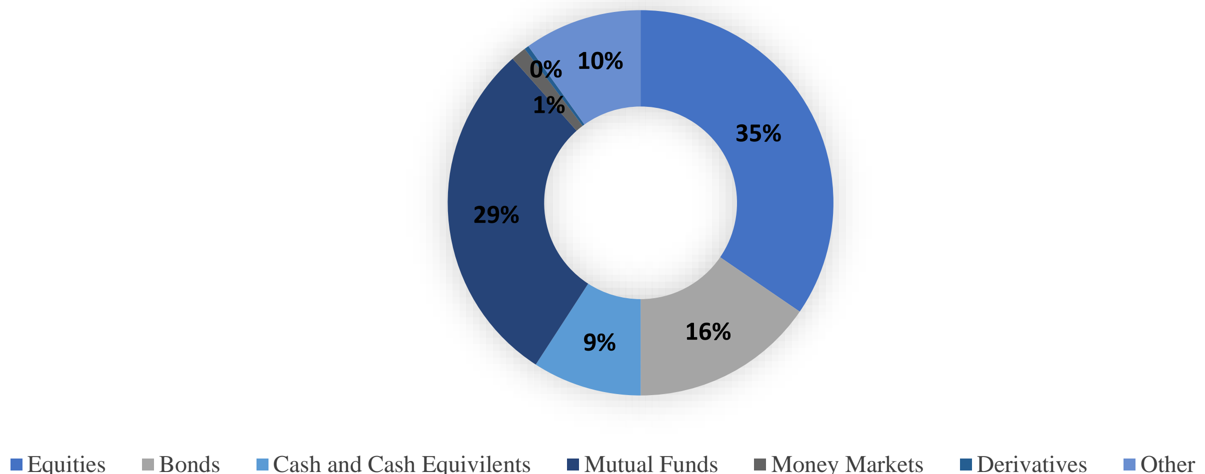
3.3 Non-bank Financial Sector Performance[17]

The asset base of the non-bank financial sector totalled $1,369.9[18] million as at December 2022, a decline of 2.4 per cent when compared to the corresponding period of the previous year. The investment sector continued to account for the largest share of the assets in the non-bank financial sector.

3.3.1 Investment Business Sector

Clients' investment assets managed by investment businesses reduced by 3.2 per cent to $1,255.4 million as at December 2022, relative to $1,297.0 recorded as at December 2021[19]. At year-end 2022, three banks accounted for over 45 per cent of the consolidated investment business portfolio. Equities accounted for the largest share of investment products followed by mutual funds (see figure 18).

Figure 18: Investment products breakdown by type



Source: TCI Financial Services Commission

3.3.2 Domestic Insurance Sector

FSIs for the insurance sector were strong over the review period (see table 5a and 5b). Solvency and liquidity remained at acceptable levels and well above minimum requirements; however, profitability indicators were mixed for the two subsectors.

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[17] The non-bank financial sector includes the domestic insurance companies, investment businesses, trust companies and money service businesses.
[18] A large portion of this represents assets under management.
[19] At the time of reporting, one institution did not submit their report.

Table 5a: Financial soundness indicators – Life insurance sector

Ratio	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Solvency Ratio - Standard minimum 8%					
Total Equity / Total Liabilities	444.7	411.3	455.5	403.2	381.8
Return on Equity					
Net Income / Total Equity	8.0	6.2	5.1	0.5	5.9
Liquidity - Standard minimum 60%					
Liquid Assets / Total Liabilities	429.1	420.9	490.9	470.9	390.4

Source: TCI Financial Services Commission

Table 5b: Financial soundness indicators – General insurance sector

Ratio	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Solvency Ratio - Standard minimum 25%					
Total Equity / Total Liabilities	45.6	43.4	34.3	33.6	34.4
Return on Equity					
Net Income / Total Equity	10.7	24.4	25.0	26.0	-1.0
Combined Ratio - Standard maximum 100%					
Total Underwriting Expenses / Net Earned Premiums	79.7	64.4	72.0	68.3	104.0
Liquidity - Standard minimum 95%					
Liquid Assets / Total Liabilities	138.9	131.1	121.9	127.0	125.3

Source: TCI Financial Services Commission

There was an increase in the consolidated assets of insurance companies during 2022. Specifically, the sector's assets increased by 6.6 per cent to $104.4 million as at year-end 2022. General insurance companies accounted for 86.6 per cent of the insurance sector's total assets, relative to 85.9 per cent at year-end 2021. The life and general insurance sub-sectors both recorded increases in their asset bases for the year ending 2022. Specifically, assets in the life and general insurance sub-sectors increased by 1.2 per cent and 7.5 per cent, respectively to $14.0 million and $90.4 million at year-end 2022.

The growth in assets for life insurance companies was reflected in an increase in amounts due from related parties while for general insurance, growth in asset base was reflected in an increase in reinsurer's share of insurance liabilities, on account of increase in claims provision due to the passage of Hurricane Fiona in September 2022.

The combined profitability for the insurance sector declined over the review period but there were mixed results for the two sub-sectors. The combined profit for the sector decreased by 92.7 per cent, from $5.6 million in 2021 to $0.4 million in 2022. The life insurance sector recorded positive profit of $0.7 million for 2022, compared to $0.1 million for 2021. The outturn was largely driven by an increase in total income of 24.0 per cent, on account of declines in claims and insurance reserves. Simultaneously, total expenses for this sub-sector fell by 36.1 per cent, due largely to a

reduction in policy holder benefits payout. Conversely, the general insurance sub-sector recorded a loss of -$0.2 million in 2022, compared to the $5.5 million profit recorded in 2021. The performance was driven mainly by underwriting loss of 113.3 per cent reported by the sector, which stemmed from a 110.0 per cent increase in claims expense associated with Hurricane Fiona.

3.3.3 Trust Sector

As at December 2022, the trust sector on-balance sheet assets declined by 15.5 per cent to $3.7 million when compared to the previous year. This was largely reflected in reductions in loans, cash balances and other assets. Total consolidated income for the sector increased by 17.9 per cent to $15.0 million during the period, compared to $13.0 million for 2021. *Income from Services,* the largest income generator for trust companies, increased by 19.6 per cent, from $12.3 million in 2021 to $14.7 million in 2022. Total consolidated expenses fell by 8.0 per cent to $7.8 million in 2022, relative to $8.5 million the previous year. The reduction was mostly reflected in declines in expenses related to services which fell by 29.9 per cent, but the effect was cushioned by an increase in operating expenses which grew by 6.5 per cent. Consequently, profit for the sector for 2022 increased by 72.3 per cent to $7.0 million, compared to $4.1 million recorded in 2021.

3.3.4 Money Service Business (MSB) Sector

The MSB sector recorded asset growth of 40.9 per cent to $6.4 million at year-end 2022, relative to $4.5 million recorded at year-end 2021. This was mainly reflected in an increase in cash holdings of 43.5 per cent for the period. Total revenue and total expenses increased by 7.4 per cent and 1.7 per cent to $2.8 million and $2.6 million, respectively, spurring a 130.2 per cent increase in profit to $0.3 million in 2022, compared to $0.1 million in 2021.

Total value of funds transmitted for 2022 increased by 13.9 per cent to $132.7 million, following a decline of 2.1 per cent the previous year. Outbound funds accounted for 92.1 per cent of total transmitted funds. The value of outbound funds increased by 17.1 per cent to $122.2 million in 2022, relative to $104.3 million in 2021. This was mainly reflected in increased outbound activity to the Dominican Republic, Jamaica and the United States. The Dominican Republic continued to be the largest recipient of outbound funds, accounting for 34.9 per cent of total outbound activity. Outbound activity to Haiti, the second largest recipient, declined further in 2022 by 3.1 per cent, amid the introduction of a new foreign exchange policy which became effective in October 2020[20], resulting in a 40.9 per cent reduction in remittances to Haiti in 2021. Remittance inflows reduced by 13.4 per cent to $10.5 million in 2022, compared to $12.2 million transmitted in 2021. The United States of America continued to account for the largest portion of inflows to the TCI, with 66.5 per cent of total inflows in 2022.

[20] In an effort to stabilize the exchange rate, Haiti's central bank, Banque de la Republique d 'Haiti (BRH), made it mandatory for remittance transfers to be paid in Haitian gourde currency at the official exchange rate except for direct foreign currency transfers to account holders.

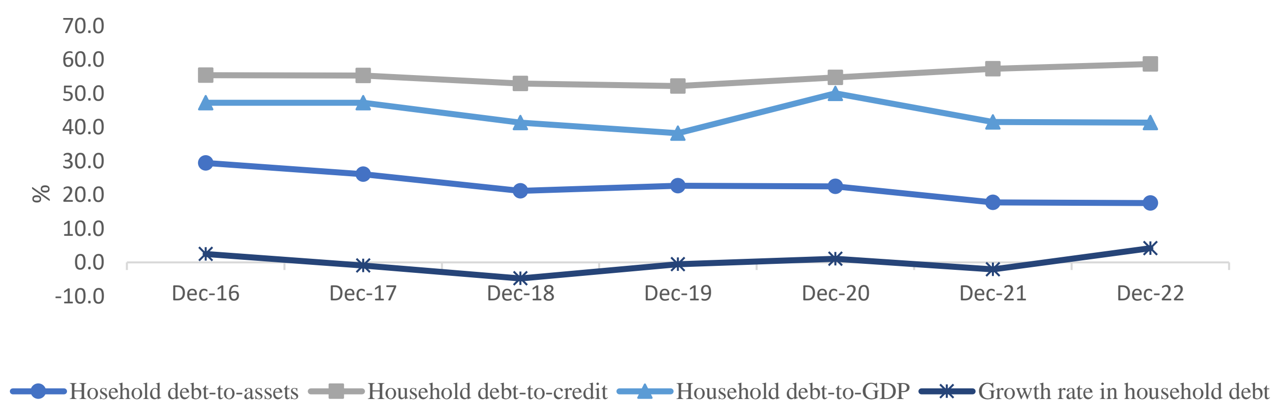
4.0 BANKING SYSTEM SECTORAL EXPOSURES

4.1 Household Sector

Household debt, represented as personal credit[21], remained the largest credit exposure for banks during the review period. The share of credit to this sector increased to 58.7 per cent at year-end 2022, from 57.3 per cent at year-end 2021. Debt held by households expanded at an annual rate of 4.2 per cent at end-2022 relative to a decline of 2.1 per cent at end-2021. The rebound in growth in household debt was driven by an increase in mortgage credit (acquisition of property) which grew by 5.8 per cent over the review period. Conversely, household debt as a percentage of total assets declined marginally by 0.2 percentage points to 17.6 per cent as at December 2022.

The debt servicing capacity of households, as measured by the ratio of household debt to GDP, improved in 2022. Specifically, the ratio decreased by 0.2 percentage points to 41.4 per cent in 2022, relative to 41.6 per cent recorded in 2021. The improvement reflected a faster pace of growth in nominal GDP relative to the increase in household debt (see figure 19).

Figure 19: Household sector exposure and indebtedness

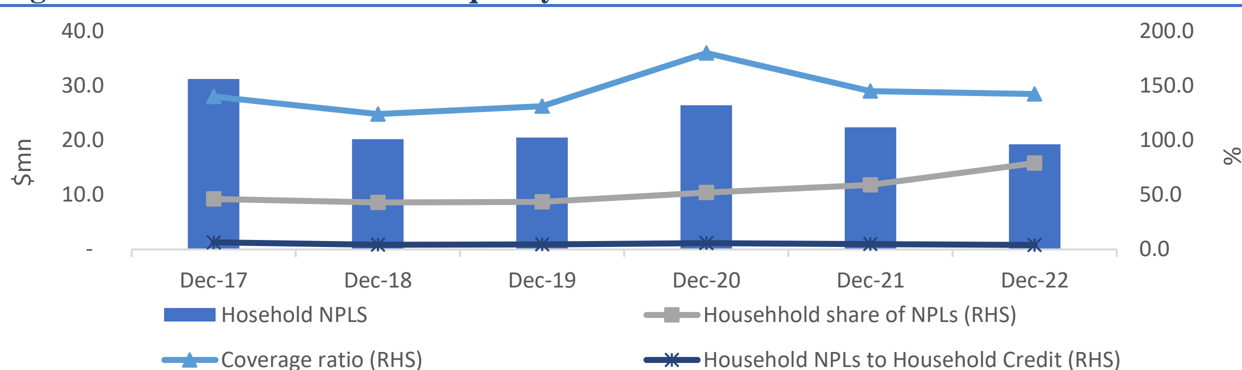


Source: TCI Financial Services Commission

At 79.0 per cent, households continue to hold the highest share of banks' NPLs as at year end-2022. The quality of households' credit portfolio improved over the review period. Specifically, the total value of household NPLs declined by 14.0 per cent, from $22.4 million at year end 2021, to $19.2 million at year end-2022, resulting in a decline in the NPL ratio for households[22] to 4.1 per cent, from 4.9 per cent in 2021. In addition, banks continued to maintain adequate coverage of NPLs for the household sector, as the ratio of provisions to non-performing household credit exceeded 100.0 per cent for the review period (see figure 20).

[21] Total household debt is proxied by the sum of residential mortgage loans, consumer loans (which includes loans for motor vehicles and other durables) and personal credit card receivables.
[22] This is the defined at the value of household NPLS to total household credit.

Figure 20: Household sector loan quality



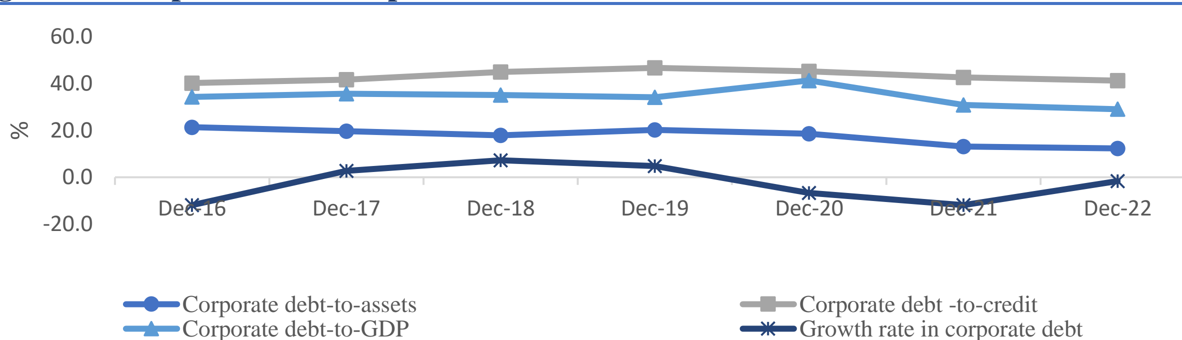
Source: TCI Financial Services Commission

4.2 Corporate Sector

Banks' exposure to the corporate sector, as measured by corporate sector debt[23] to total banking assets, declined by 0.9 percentage points, to 12.3 per cent at year-end 2022. In addition, corporate sector debt contracted at an annual rate of 1.6 per cent during 2022, compared to a decline of 11.9 per cent the previous year (see figure 21). Notably, corporate sector debt held by *Manufacturing*, *Tourism* and *Transport* had the largest reduction of 32.9 per cent, 28.6 per cent and 22.1 per cent, respectively. On the other hand, lending to *Public Utilities* and *Agriculture* grew notably by 49.9 per cent and 27.8 per cent, respectively.

The corporate sector debt to credit ratio declined by 1.4 percentage points to 41.2 per cent in 2022, reflecting a growth in total credit, relative to the decline in lending to corporates. In addition, the debt servicing capacity of the sector, represented by the ratio of corporate debt to GDP, improved, reflected in a decline of 1.8 per centage points, from 30.9 per cent in 2021 to 29.0 per cent in 2022. The outrun reflected a faster pace of growth in nominal GDP (see figure 21).

Figure 21: Corporate sector exposure and indebtedness

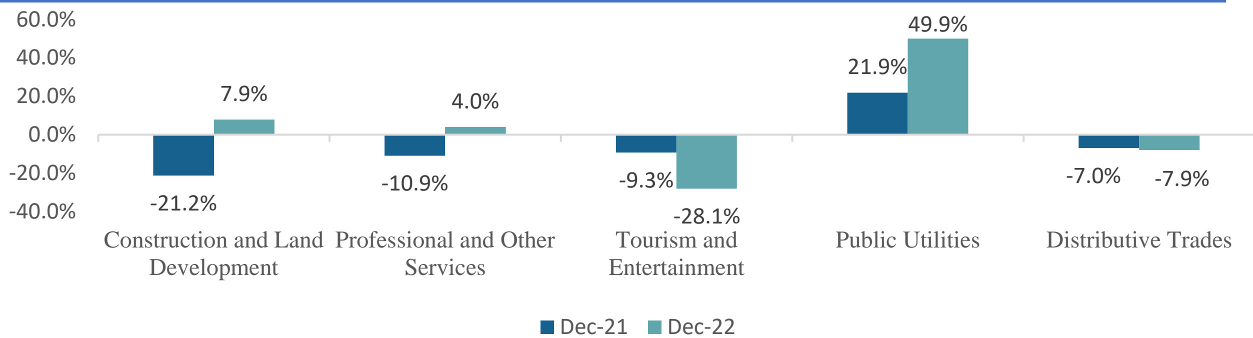


Source: TCI Financial Services Commission

[23] Corporate sector debt includes loans to commercial businesses (which includes agriculture, fishers, mining and quarrying, manufacturing, public utilities, construction, distributive trades, tourism, entertainment, transport, professional services and commercial credit card receivables).

Construction and Land Development continued to hold the highest share of credit to the corporate sector, accounting for 25.1 per cent of total corporate credit as at December 2022. Consistent with the increase in economic activity within this sector, credit to *Construction and Land Development* increased by 7.9 per cent at year end 2022, relative to the decline of 21.2 recorded in 2021. Lending to the top five corporate subsectors[24] grew with the exception of *Tourism and Entertainment* and *Distributive Trades* (see figure 22).

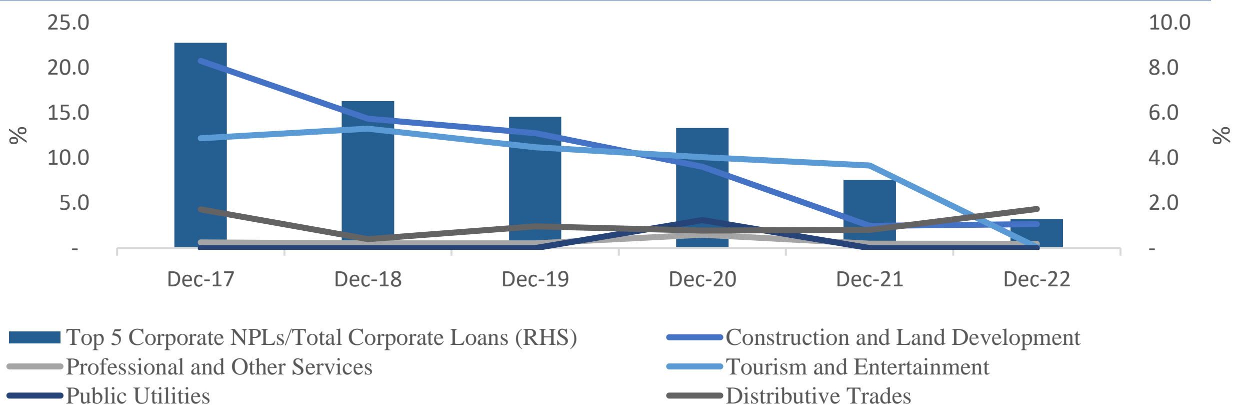
Figure 22: Growth in banks' lending to the top five corporate sub-sectors



Source: TCI Financial Services Commission

The quality of banks' corporate sector loans, as measured by the ratio of the top five corporates' NPLs to total corporate sector loans, improved over the review period. Specifically, the ratio fell to 1.3 per cent at year-end 2022, from 3.0 per cent at year-end 2021. The ratio for most sub-sectors, with the exception of *Construction and Land Development* and *Distributive Trades*, declined for the year. The *Tourism and Entertainment* sub-sector recorded the largest improvement of 9.1 per centage points, from 9.2 per cent at year end 2021 to 0.1 per cent at year-end 2022. *Distributive Trades* recorded the largest deterioration in loan quality, increasing from 2.0 per cent in 2021 to 4.3 per cent in 2022. (see figure 23).

Figure 23: Ratio of corporate sector NPLs to total corporate loans for top 5 sub-sectors



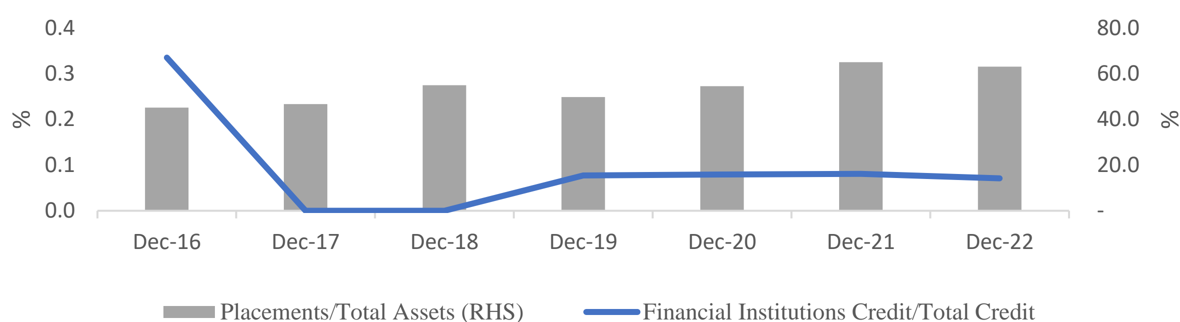
Source: TCI Financial Services Commission

[24] The top five subsectors represent the highest share of total credit within the corporate sector.

4.3 Financial Institutions

Banks' exposure to other financial institutions, both locally and abroad, remained relatively unchanged for the period under review. At year-end 2022, credit granted to other financial institutions was 0.1 per cent of total bank credit exposures. In addition, the ratio of placements to total assets remained significant for 2022. Banks' asset placements as a percentage of total assets reduced by 2.0 per cent to 63.1 per cent at year-end 2022 (see figure 24). This was mainly driven by intragroup exposures. The three largest banks, accounted for approximately 94.1 per cent of claims on financial institutions, 87.7 per cent of which were with parent banks abroad.

Figure 24: Indicators of exposure to financial institutions

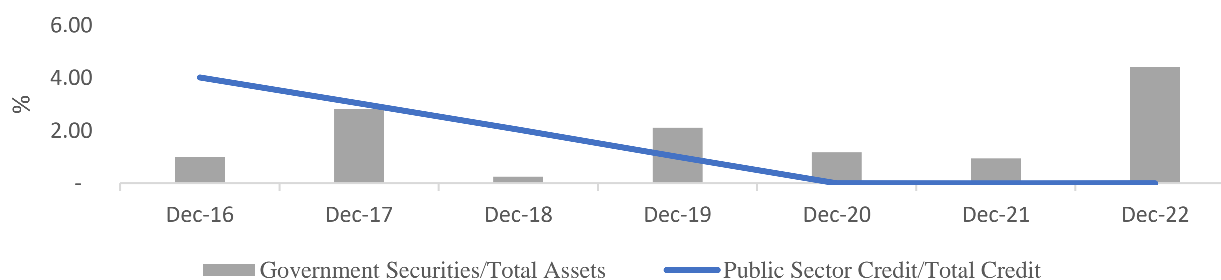


Source: TCI Financial Services Commission

4.4 Public Sector

The TCI banking system continued to have little credit exposure to the public sector during the review period. As at 31 December 2022, public sector's share of total credit was maintained at almost 0 per cent, similar to the two previous year's outturn. On the other hand, the ratio of investments in government securities to total assets increased by 3.5 percentage points to 4.4 per cent at year-end 2022 (see figure 25). The performance was consistent with banks' increased holdings of investment products, given the high interest rate environment.

Figure 25: Indicators of public sector exposure



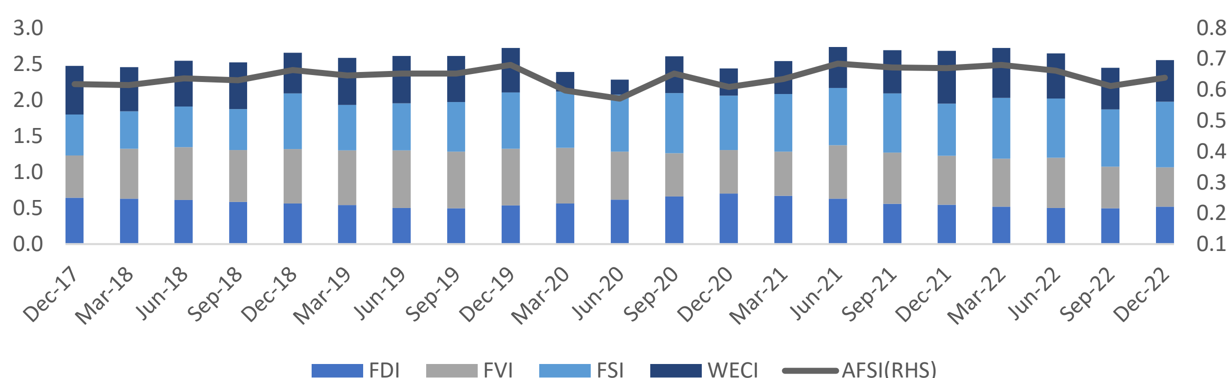
Source: TCI Financial Services Commission

5.0 SYSTEMIC RISK IN THE BANKING SECTOR

5.1 Macrofinancial Risks

Indices of financial stress in the TCI, as measured by the quarterly Aggregate Financial Stability Index (AFSI) and the Macrofinancial Index (MaFI), deteriorated in 2022. Specifically, the AFSI[25] declined to an average of 0.6 for 2022, from 0.7 for 2021, indicating a decline in financial stability (see figure 26). The performance of the AFSI is attributed mainly to deterioration in the financial vulnerability and the world economic climate sub-indices. The increase in domestic inflation and the resultant widening in trade deficit, coupled with the declines in growth rates for the world and the US economy, contributed to the elevated financial stability risks measured by these two sub-indices. However, the deterioration in the financial vulnerability and world economic climate indices were partially offset by increase in the financial soundness sub-index, on account of improvements in banks' asset quality and capital position. The financial development sub-index remained relatively unchanged for the review period.

Figure 26: AFSI and sub-indices



Source: TCI Financial Services Commission

Correspondingly, the MaFi[26] also deteriorated, reflected in an increase in the index to 18 points as at December 2022, from 16 points recorded as at December 2021[27] (see figure 27). The worsening in the index is explained by reduction in government's fiscal balance and higher inflation.

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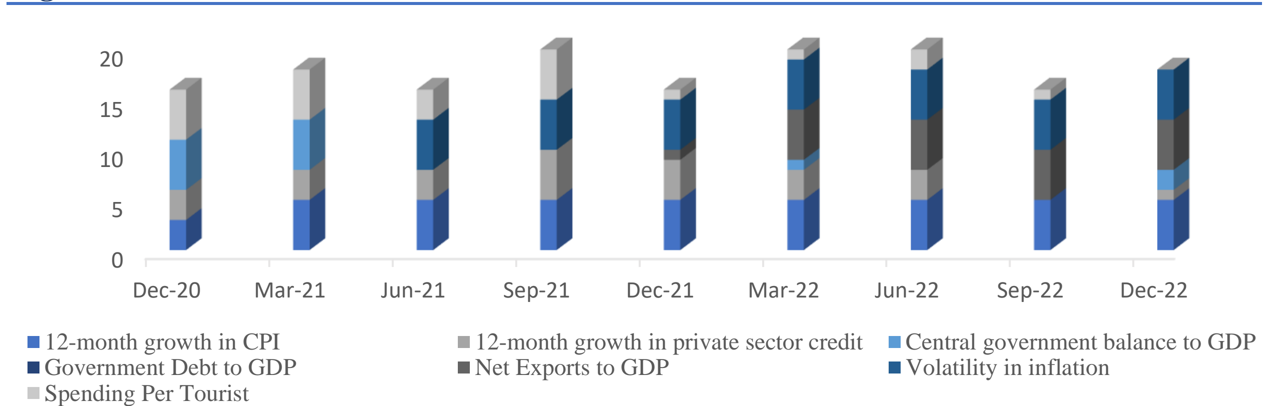
[25] The AFSI is a composite index generated as a weighted average of normalised macroeconomic data and financial statement variables to form an aggregate measure of financial stability. The index is grouped into four sub-indexes namely, financial development index (FDI), financial vulnerability index (FVI), financial soundness index (FSI) and the world economic climate index (WECI). An increase in value of the AFSI shows an improvement in financial stability and a decrease indicates deterioration.

[26] The MaFi is an early warning signal-based indicator of systemic risk that computes scores based on the number of standard deviations of each indicator from their base period mean value. Computation of the overall value of the index, requires aggregation of the signal scores (scores range from 0-5 with 5 representing the most severe signal) across all indicators. In the period leading up to instability, the signals will increase in terms of both the number of variables signalling and the severity of the signals. Increases in the value of the index reflect a deterioration in financial stability.

[27] Reflect revised figures.

However, the impact of these were partially offset by increased tourist arrivals, resulting in higher income from tourism.

Figure 27: Macrofinancial index

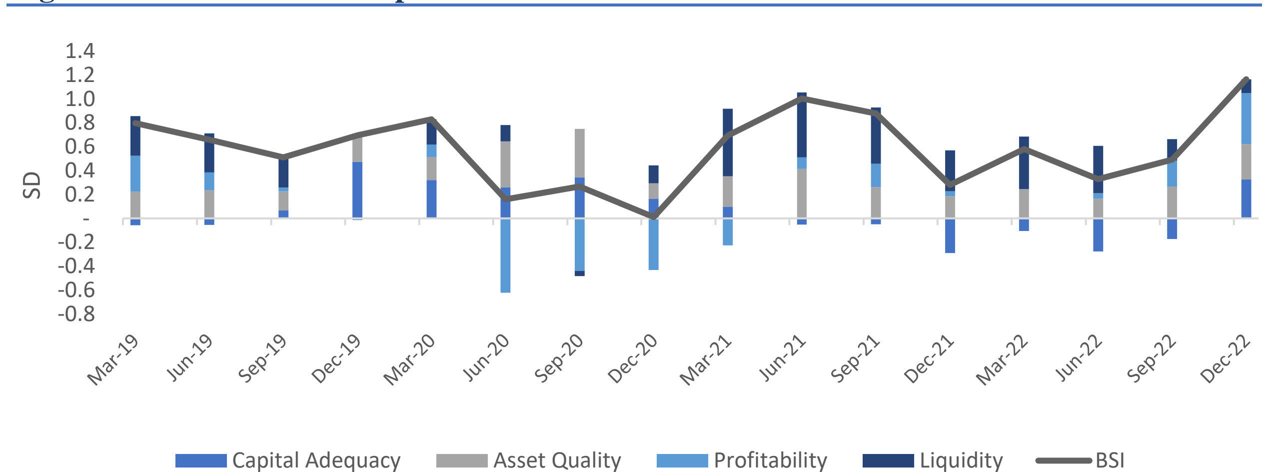


Source: TCI Financial Services Commission

5.2 Risks to Bank Stability

Bank soundness, as measured by the Banking Stability Indicator (BSI)[28], improved for the review period. The indicator was at 1.16 at year-end 2022, up from 0.28 at year-end 2021. The positive performance was driven by improvements in asset quality, capital adequacy and profitability, relative to the previous period. However, the outturn was also impacted by deterioration in the liquidity indicator (see figure 28).

Figure 28: BSI and sub-components



Source: TCI Financial Services Commission

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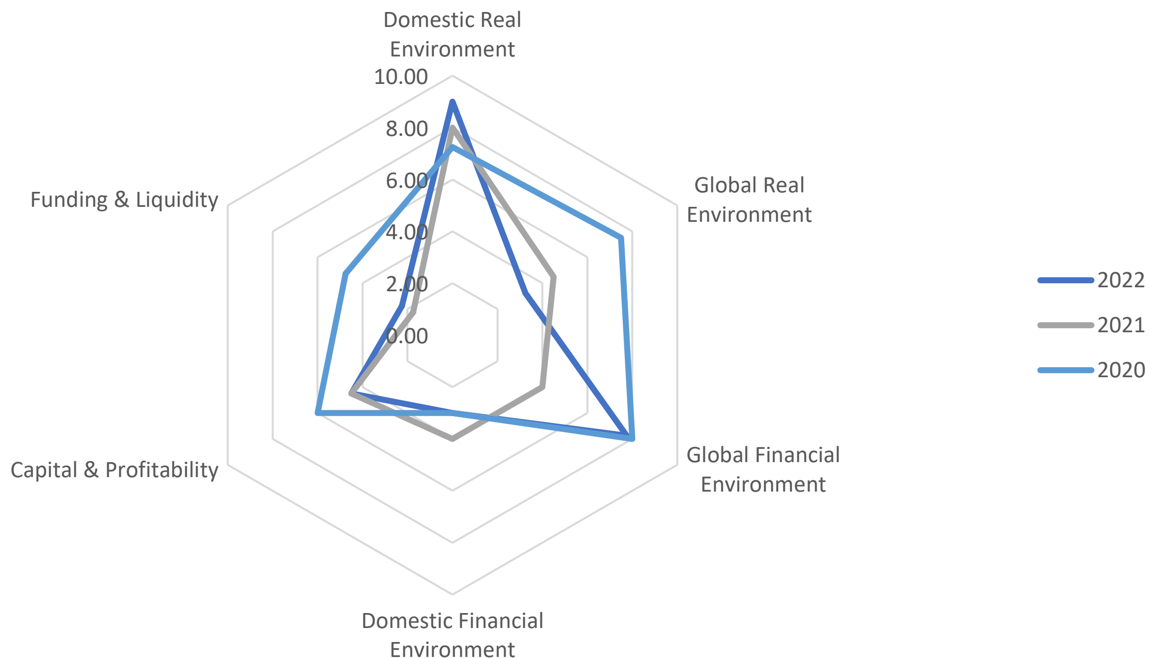
[28] The BSI is computed as the weighted sum of selected, normalised indicators that reflect the IMF's core financial soundness indicators of capital adequacy, profitability, asset quality and balance sheet liquidity. A higher value represents an improvement in financial stability and a decrease symbolises a deterioration.

5.3 Risks in the real and financial sectors

The risk exposure cobweb also confirmed higher risks to financial stability for 2022 (see figure 29). Consistent with the BSI, the cobweb diagram[29] highlighted that for 2022, banks' profitability and capital positions generally improved but showed higher risks in funding and liquidity. Furthermore, the results showed that for 2022 banks were more exposed to risks in the global environment, both in the real and financial sectors. On the domestic side, risks were higher in the real economy for 2022, relative to 2021 due to deteriorating macroeconomic conditions. However, exposure to the financial environment were slightly lowered due to improved performance in the financial sector in 2022, relative to 2021.

Figure 29: Cobweb map of risk exposures



Source: TCI Financial Services Commission

[29] The cobweb diagram depicts domestic economic and financial risk exposures across six risk categories: (i) domestic real environment, (ii) domestic financial environment, (iii) global real environment, (iv) global financial environment, (v) capital & profitability and (vi) funding & liquidity. Movements away from the centre of the diagram represent an increase in the risk to financial stability, while movements towards the centre of the diagram represent a reduction in financial stability risks.

6.0 BANKING SECTOR RESILIENCE

Macroprudential stress tests were applied to banks' credit and liquidity portfolios to assess their resilience to hypothetical shocks. These tests measured banks' loss exposure using assumptions of abnormal but plausible shocks to both credit and liquidity positions. The stress test scenarios showed that the banking sector was broadly resilient to the contemplated credit shocks, while some banks displayed weaknesses in the liquidity risk factors[30].

Credit Test

Stress tests carried out to assess vulnerabilities to solvency risks stemming from shocks to banks' credit portfolio, pointed to a general resilience of the financial system over the review period. The credit test outcomes as at end-December 2022 showed a general improvement in post-shock CAR under the range of test scenarios, exceeding the prudential minimum CAR[31] of 11 per cent (table 6). The results were due mainly to higher levels of regulatory capital as at end-December 2022, relative to the previous year. Except for one bank who failed the credit concentration test, the assessment found no substantial capital erosion as a consequence of hypothetical increases in NPLs. The Commission will continue its close monitoring of banks' concentration risk by imposing appropriate large exposure limits, reporting requirements and other measures that may be deemed appropriate. In response to shocks to sectoral exposures, the banking sector remained generally resilient to increases in NPLs within the three main economic sectors namely, tourism, construction & development, and households (personal credit).

Liquidity Test

The liquidity stress test examined, under two scenarios, the number of days banks could withstand a seven-day simultaneous run-on demand and time deposits before liquid assets were depleted and contingent lines or other external sources of liquidity would be required. The first scenario assumed, a daily run rate of 20 per cent on demand and 5 per cent on time and savings deposits. The results pointed to elevated liquidity risks as two banks were not able to withstand the seven-day bank run. The second scenario examined the effect of a 20 per cent daily withdrawal rate on large depositors' accounts for up to seven days. Results indicated that all banks were able to withstand the seven-day bank run for their largest deposit accounts (see table 6). The Commission will maintain its prudent approach in monitoring banks' liquidity contingency plans to ensure that banks are tackling vulnerabilities through appropriate measures.

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[30] Assumptions/shocks for each test are summarised in Appendix B.

[31] The test considered tier 1 capital only.

Table 6: Banking sector credit and liquidity stress test results

		Dec-19	Dec-20	Dec-21	Dec-22
Credit Test					
Baseline/Pre-shock CAR %		**28.6**	**27.3**	**24.2**	**28.2**
Shock 1a: Generalized increase in NPL	Post-shock CAR %	26.7	23.9	22.3	26.5
Shock 1b: Correction for under-provisioning	Post-shock CAR %	26.2	25.4	23.0	27.4
Shock 1c: Migration across NPL categories	Post-shock CAR %	25.5	24.5	22.4	26.9
Shock 1d: Credit concentration	Post-shock CAR %	17.1	17.0	16.0	16.8
Sectoral Shocks					
Shock 1e: Sectoral Shocks (Mortgages)	Post-shock CAR %	27.3	25.6	23.0	27.3
Shock 1f: Sectoral Shocks (Tourism)	Post-shock CAR %		26.8	23.8	28.1
Shock 1g: Sectoral Shocks (Construction)	Post-shock CAR %		26.7	23.8	28.0
Shock 1h: Sectoral Shocks (Personal)	Post-shock CAR %		26.1	23.3	27.6
Liquidity Test					
Bank run on demand & time deposit accounts	No. of banks with liquidity drainage before 7 days	2	1	0	2
Bank run on large depositors' accounts	No. of banks with liquidity drainage before 7 days		1	0	0

Source: TCI Financial Services Commission

7.0 KEY POLICY RESPONSES

The Commission will be undertaking several policy initiatives to strengthen the resilience of the financial system and to ensure its stability. Some of the key initiatives are explained below.

7.1 Broadening the Stress Testing Framework

The Commission will be partnering with the Caribbean Regional Technical Assistance Centre (CARTAC) to continue the revision of its top-down stress testing framework to include multifactor shocks and macroeconomic scenarios. These additions are expected to provide greater insights into the risks and vulnerabilities of banks, and to inform key decisions in policy making.

7.2 Improving Financial Stability Surveillance

The Commission will partner with CARTAC in another mission to improve its financial stability surveillance. The mission will assess the Commission's progress in implementing several recommendations made during the previous 2022 mission and propose other areas for improving the work of the financial stability team.

The Commission in partnership with the International Monetary Fund (IMF) will also continue its work on the development of a residential property price index (RPPI) for the TCI to monitor changes in the aggregate price for comparable residential dwellings. Residential real estate prices will be used as a key indicator for assessing the dynamics of the economy, as well as to measure risk exposures for lenders and investors in the real estate market.

7.3 Enhancing Supervisory Framework

The Commission will continue the work on transitioning to a risk-based supervisory (RBS) framework across the spectrum of supervised entities and to further develop its risk-based approach (RBA) to anti-money laundering (AML) supervision. Additionally, the Commission will undertake a revision of its operational risk guideline to consolidate the operational risk requirements across the various sectors it supervises. Other policy work will include the development of guidance for credit union supervision and enhancing the supervisory framework for investment businesses.

During 2022, the Commission made progress in the work to implement International Financial Reporting Standard (IFRS) 17, which will have implications for the insurance sector. The Commission will continue its work on the implementation of IFRS 17 with regional workshops and technical assistance provided by CARTAC and the Caribbean Association of Insurance Regulators (CAIR) to ensure that the region's insurance industry is in line with international standards.

APPENDIX

Appendix A – List of country abbreviations

Caribbean: Tourism Dependent

Antigua & Barbuda	A&B
Aruba	ARB
The Bahamas	BHS
Barbados	BAR
Belize	BLZ
Dominican Republic	DOM
Grenada	GRN
Haiti	HTI
Jamaica	JAM
St. Kitts & Nevis	SKN
St. Lucia	SLA
St. Vincent & the Grenadines	SVG
Turks & Caicos Islands	TCI

Caribbean: Commodity Exporter

Guyana	GUY
Suriname	SUR
Trinidad & Tobago	T&T

Appendix B – Stress test assumptions

The credit component of the stress test carried the following assumptions:

Risk Type	Scenario	Assumptions and shocks
General Credit Risk	1a- Worsening of NPLs	- Each category of NPLs increases by 100%. - Each bank's new NPLs provided for at its current rate of provisioning.
	1b- Correct for under provisioning	- NPLs in arrears for longer than 1 year fully provided for and written off.
	1c- Worsening of NPLs	- All loans in each NPL category migrate 'down' to the next worst category and the prudential provisioning rates applied. - Loss category is fully written off.
Concentration Risk	1d - Default of largest loan to group	- There is default of the largest borrowers (group) from each institution, with a provisioning rate of 100%
Sector Credit Risk	1e – Mortgage portfolio shock	- Sector wide deterioration of mortgage loans leads to 100% increase in mortgage NPLs with 100% provisioning.

	1f – Portfolio shock to loans given to Tourism sector	- Deterioration of Tourism loans leads to 100% increase in NPLs with 100% provisioning.
	1g – Portfolio shock to loans given to Construction sector	- Deterioration of Construction loans leads to 100% increase in NPLs with 100% provisioning.
	1h – Portfolio shock to Personal loans	- Deterioration of Personal loans leads to 100% increase in NPLs with 100% provisioning.

The following assumption were used in the liquidity test:

(i) Daily attrition rate of 20% and 5% in demand and time deposit runs, respectively.

(ii) 50% of (remaining) liquid assets would be available on any given day to offset deposit withdrawals.

(iii) Ill-liquid assets are not available to offset deposit withdrawals.

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Financial Stability Report 2022

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