July 2021

TURKS AND CAICOS ISLANDS
FINANCIAL SERVICES COMMISSION

2020 FINANCIAL STABILITY REPORT HIGHLIGHTS

In this issue:

- Macroeconomic Environment
- Financial System Development
- Financial Sector Performance
- Risk & Vulnerabilities
- Key Policy Initiatives

Preface

The Commission periodically conducts assessments on the resilience and strength of the TCI financial system. The financial stability report examines key developments in TCI's macroeconomic and financial landscape and the resulting challenges posed to the stability of the financial system. The report also includes updates on the performance of the banking and non-banking sectors, highlights on regulatory developments, and offers perspectives on the near-term macro-financial outlook for the TCI.

The report aims to:

- **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;**
- **review trends of specific risk indicators and the outcome of stress test exercises; and**
- **highlight emerging risks to system stability and their likely implications**

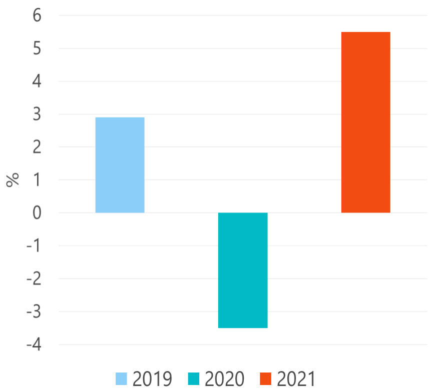
In Summary:

- Global financial stability concerns increased during 2020 on account of the global outbreak of the novel coronavirus (COVID-19) pandemic which caused a destabilizing effect on the economic and financial positions of various economies around the world.
- The pandemic severely impacted the already challenged Caribbean region as lock down measures affected industries where physical distancing was impractical, such as the tourism industry, the main economic driver for several islands within the region.
- Domestically, the pandemic led to a sharp decline in economic activity resulting in an estimated 22.8% decline in Gross Domestic Product (GDP), 144.8% contraction in the external current account balance and 57.1% point increase in the unemployment rate.
- There was also heightened risk in the financial sector. Nonetheless, bolstered by mitigating measures instituted by policy makers to alleviate the impact of the pandemic, prudent actions from the licensees and the favourable conditions that existed pre-covid period, the financial sector continued to be well capitalised and liquid.
- In particular, the banking system, the largest domestic financial intermediary on the islands, remained sound and broadly robust to macro-prudential stress tests, maintaining capital adequacy ratios well above the minimum required by law.
- The non-bank sector experienced growth in assets except for the domestic insurance sub-sector. Risks within these sectors remain within acceptable levels.
- The medium to long term outlook for domestic performance is dependent on how quickly the economy rebounds which, in turn, is dependent on the economic recovery of TCI's main trading partners.
- As the pandemic progresses, policy actions should ensure that effective support for vulnerable segments of the economy is not prematurely withdrawn but remains until economic recovery is firmly underway.

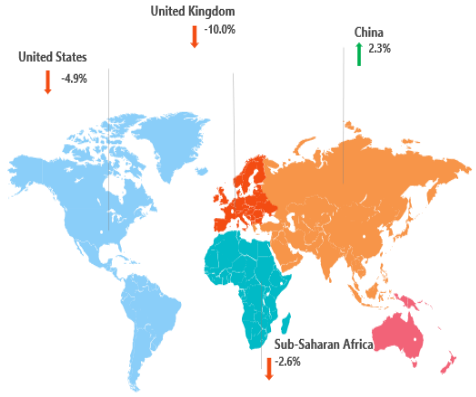
1.0 MACROECONOMIC ENVIRONMENT

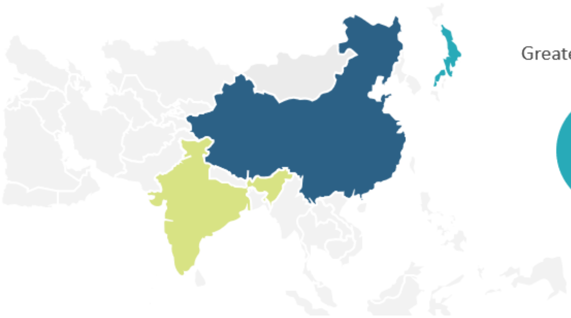
1.1 The Global Experience

- Global growth is estimated to have contracted by 3.5% in 2020, down from the 2.9% growth trajectory in 2019. Rebound of 5.5% is projected for 2021.



- The International Monetary Fund (IMF) projected output in 2020 for select countries.





Greater than expected performance in these economies

Japan

China

India

1.2 The Regional Context

Estimated GDP contraction of 8.1% in 2020.

Pandemic resulted in lower levels of remittances, greater current account deficits and higher levels of unemployment.

Tourism-dependent countries such as St. Lucia and Aruba were hit the hardest when cruise-lines and stay-over arrivals came to a halt as borders were closed.

Commodity exporters such as Trinidad and Suriname experienced large declines in the exports of merchandise goods; however, this was mitigated by strong performance in the Guyanese economy.

1.3 The Domestic Economy

01 GDP Growth (%)

GDP is projected to have contracted by 22.8% in 2020 following a growth of 7.6% in 2019. The economy is expected to grow by 2% in 2021

02 Inflation %

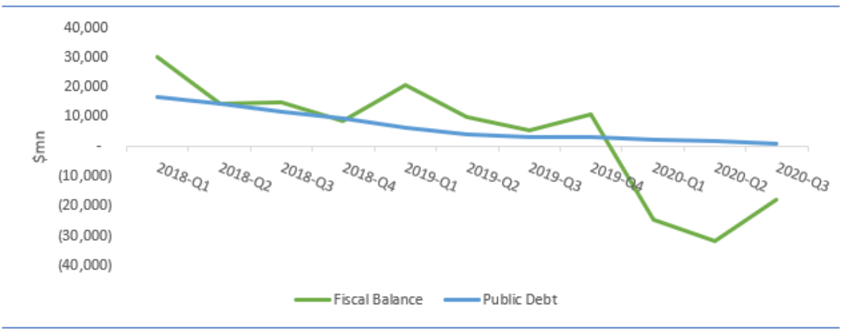
The projection for inflation in 2020 was 2.4%, up from the 2.2% estimated for 2019. This is expected to fall to 2.3% in 2021.

03 Balance of Trade ($mn)

Net exports decline to -345.8 from -482.3 in 2019. The projection for 2021 is -434.6

04 Unemployment (%)

Unemployment rate is projected to increase to 11% in 2020 from 7% estimated in 2019. The rate is expected to remain higher in than pre-covid levels 2021 at 9% .



2.0 Financial System Development

Total Financial System Assets

$3,417 USD Million in 2020

↑4.6%

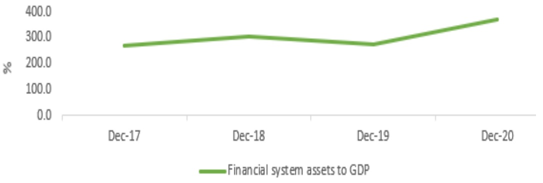
Sector Growth

- ↑1.6% Banks
- ↑37.2% Trust Companies
- ↑10.3% Investment Businesses

Sector Declines

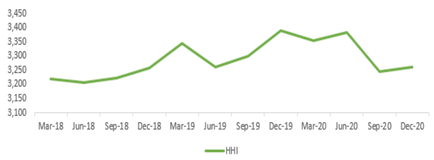
- ↓-3.0% Domestic Insurance
- ↓-12.9% Money Service Businesses

Financial Intermediation



- Measured as a share of financial system assets to GDP
- 370.2% at the end of 2020

Banking Sector Concentration



- Sector concentration, as measured by the Hirschman-Herfindahl Index (HHI), decreased by 3.8% signaling lower levels of asset concentration in the banking sector.

3.0 Financial Sector Performance

01 Banking Sector

Capital levels remained high with a composite capital adequacy ration of 2.6%. Slight deterioration in asset quality as non-performing loans grew to 6% of total credit. Strong funding and liquidity positions but weakened profitability over the period.

02 Domestic Insurance Sector

Moderate decline in asset base over the period. Strong solvency and liquidity positions over the period. General decline in earnings. Net income fell by 12% and 20% for life insurance and general insurance, respectively.

03 Investment Businesses

Favourable asset growth of 10.3% over the period. Three entities accounted for 54% of investment business portfolio. The Commission has issued guidance for prudential reporting which will close some of the reporting gaps identified in the sector.

04 Trust Sector

Total on-balance sheet assets increased due to difficulties in transferring clients' funds during the pandemic. Combined profits for the sector declined by 39% over the period.

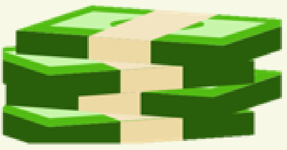
05 MSB Sector

Reduction in asset base and profit level were observed over the period. Total funds outflow reduced over the period due to reduced traffic and tightened economic conditions. Total inflows increased which may have been driven by income from governments' stimulus packages abroad.

3.1 Banking Sector Resilience

Credit Test

Though bank capital was lower as at December 2020 relative to 2019, banks were mostly resilient to a range of shocks, exceeding the regulatory minimum Capital Adequacy Ratio of 11%.



Liquidity Test

Liquidity test revealed that the sector could generally withstand a simultaneous run of demand and time deposits, except for one bank which exhausted it liquid assets before the 7-day mark.

4.0 Risks and Vulnerabilities

- Sharp contraction in the domestic economic environment
- Deterioration in financial sector profitability and asset quality.
- Erosion of government's fiscal buffers to facilitate pandemic relief
- Tightened global financial conditions and slow down in trade

5.0 Key Policy Initiatives

Research and Policy Development

1. Research on new forms of digital assets to include crypto assets and Central Bank Digital Currencies
2. Crypto Asset and Fintech Policy

Enhancing Regulatory and Supervisory Framework

1. Strengthen financial stability function to improve analysis and assessment of systemic risk through partnership with CARTAC.
2. Continue the implementation of risk-based supervision across banks, insurance companies and investment businesses.
3. Risk-based approach for AML/CFT supervision

Strengthen Industry Guidelines

1. Enhancement to the guidelines for Credit Classification and Provisioning Standards.
2. New prudential guidelines for investment businesses.
3. New guidance for due diligence and reporting suspicious activities

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