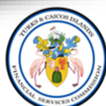
2021

Financial Stability Report



Turks and Caicos Islands
Financial Services Commission

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Turks and Caicos Islands Financial Services Commission

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PREFACE

The Turks and Caicos Islands 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 within the TCI.

This 2021 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). The 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 2021, the international financial sector was dominated by over 7,000 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 TCI also supervises a small number of other captive insurers, as well as corporate service providers, non-profit organisations, and designated non-financial businesses and persons for anti-money laundering (AML) and combating the financing of terrorism (CFT) and proliferation purposes.

This document, unless otherwise stated, references data available as at 31 December 2021.

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
AMLC	Anti-money Laundering Committee
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BSI	Banking Stability Index
CAR	Capital Adequacy Ratio
CARTAC	Caribbean Regional Technical Assistance Centre
CPI	Consumer Price Index
FATF	Financial Action Task Force
FSI	Financial Soundness Index
FVI	Financial Vulnerability Index
GDP	Gross Domestic Product
HHI	Hirschman-Herfindahl Index
IDB	Inter-American Development Bank
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
VA	Virtual Assets
VASP	Virtual Asset Service Provider
WECI	World Economic Climate Index
WEO	World Economic Outlook

1.0 FINANCIAL STABILITY OVERVIEW

Like other economies around the globe, TCI began to recover from the effects of the Covid-19 pandemic in 2021. Local restrictions continue to ease, and the engines of growth regained momentum, aided by the continued roll-out of the vaccination programme. Policy support also began to taper off as financial risks stemming from the pandemic shock declined. The impact of the pandemic on the financial position of the banking sector started to dissipate with the sector recording improved profitability. In the aggregate, the financial system remained strong and resilient, demonstrating its ability to absorb adverse shocks.

1.1 Macroeconomic Environment

Global economic activity continued to improve in 2021 with growth estimated at 5.9 per cent for the year. However, after the first half of 2021, the recovery began to lose impetus due to the emergence of the Omicron and Delta variants of the Covid-19 virus in several parts of the world, imbalances in supply and demand associated with bottlenecks in the global supply chain, and persistent inflationary pressures. For many countries, vaccines remained a binding constraint in economic activity and output remained below pre-pandemic levels. In addition, persistent price pressures have induced several countries to tighten monetary policy by increasing policy rates, which is expected to slow output even further.

The domestic macroeconomic environment was broadly stable during the review period. There was a marked recovery in the domestic market on account of the full reopening of economic sectors made possible by the continued roll-out and uptake of vaccines on the islands. The domestic economy is estimated to have grown in real terms by 13.6 per cent in 2021, following the rebound in tourism, the island's main contributor to GDP. As revenues recovered in tourism, the government's fiscal position strengthened, and public debt continued on its downward trajectory. Additionally, the unemployment rate fell to 9.0 per cent in 2021 from an estimated 11.0 per cent in 2020. Increasing international food and commodity prices resulted in inflationary pressures in the TCI; the Consumer Price Index (CPI) grew to 4.5 per cent in 2021 relative to 2.3 per cent in 2020.

1.2 Financial System Soundness and Resilience

Within the context of the economic recovery, risks to the financial system were relatively subdued. Financial institutions remained adequately capitalised and had high liquidity positions in excess of statutory requirements. The banking sector, the largest domestic financial intermediary, remained stable over the pandemic. Stress tests conducted by the Commission showed that banks continued to be resilient to selected hypothetical adverse shocks to their credit and liquidity portfolios.

Banks' balance sheets remained strong over the review period. There was an expansion in their asset base on account of larger liquid asset holdings. Improved economic activity was reflected in banks' profitability, although still below pre-pandemic levels. Indicators of financial soundness for the banking sector generally pointed to a healthy sector from the standpoint of capital adequacy, liquidity, asset quality and profitability. Systemic risk indicators suggested general improved financial stability for 2021 relative to 2020 with small pockets of vulnerability in the real sector, mainly attributed to higher inflation.

Non-bank financial institutions recorded an increase in total assets, consistent with the continuing recovery in the domestic economy. Investment businesses continued to account for the highest market share within this group and recorded moderate growth in assets during the review period.

The life and general insurance sectors recorded increases in assets for 2021.Though the sector as a whole recorded increased profitability over the previous period, there were mixed results for the two sub-sectors. Nevertheless, financial soundness indicators point to a stable insurance sector with adequate liquidity and capital levels in compliance with regulatory requirements.

On-balance sheet assets for trust companies declined as at December 2021 after a temporary spike in the previous period due mainly to difficulties in transferring funds. Profitability indicators for this sector improved over the review period.

The MSB sector recorded a decline in both assets and net profit for the period. Remittance flows also declined mainly driven by changes in exchange rate policy for one of the main remitting countries.

1.3 Outlook for Financial Stability

Looking ahead, global financial conditions are likely to remain vulnerable to unexpected increases in interest rates and disruptions to the global economic recovery. Conditions could tighten due to uncertainty over the trajectory of interest rates in the United States and the Euro area, should inflation be higher and more persistent than expected. This may cause spill-over effects to the domestic financial system by way of increase in financing costs for local financial institutions. The risk of increasing interest rates could also have implications for local borrowing as the cost of accessing credit could become more expensive, thereby spurring macrofinancial risks to the local economy. In addition, repricing rates for assets could also have adverse effects in the cost of servicing outstanding debts, which could result in weakening banks' asset quality.

In the real sector downside risks to the global and domestic economic outlook remain, given the potential for further Covid-19 setbacks should new variants emerge. In addition, sustained increases in inflation in the US and other trading partners could pose threat to TCI's growth

trajectory through weakened household income causing visitors to cut back on travelling costs. Near-terms risks are likely to emerge in the form of weakened household liquidity due to higher consumer prices and increase cost of doing business on account of elevated input cost. Such shocks, if sustained, could have broad macroeconomic consequences for smaller counties such as the TCI, especially if amplified by a slowdown in the economic recovery of major trading partners.

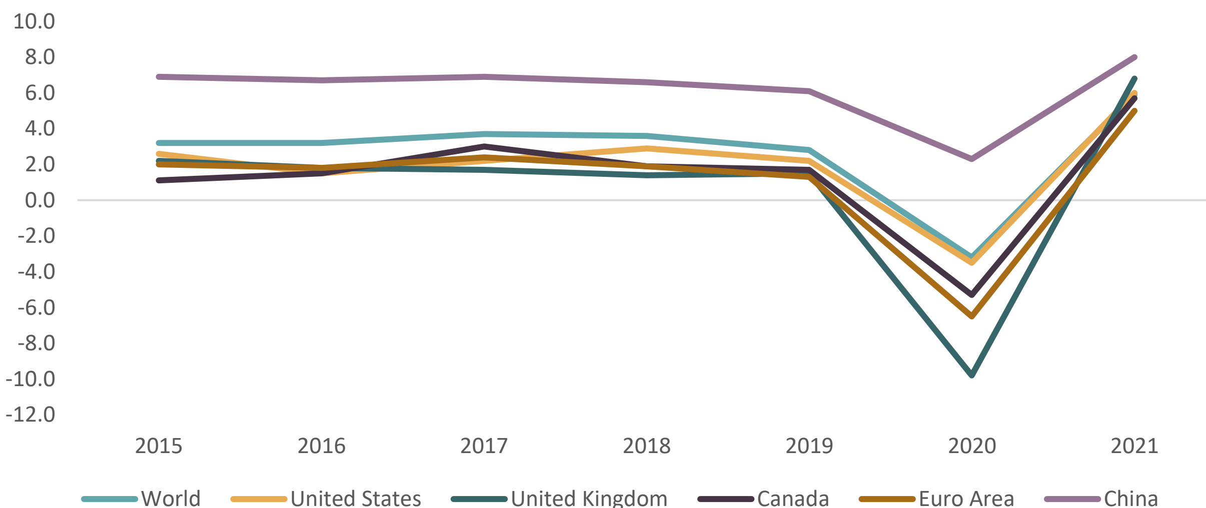
Despite the above, and in view of the resilience and general solid position of financial intermediaries, characterised by capital and liquidity levels above regulatory minima, the broad TCI financial system, and banks in particular, is well-positioned to withstand possible imbalances in the economy.

2.0 MACROFINANCIAL ENVIRONMENT

2.1 Global Macroeconomic Developments

Global economic activity continued to recover in 2021, albeit at a slower rate in the second and third quarters and unevenly across countries. The global economy is estimated to have grown by 5.9 per cent in 2021, after a sharp contraction of 3.1 per cent in 2020, according to the International Monetary Fund (IMF) World Economic Outlook (WEO). The estimate reflected a downward revision of 0.1 percentage point from the previous report in July, due in part to ongoing supply chain disruptions and worsening pandemic occurrences in some countries. There was a rebound in growth in most advanced economies such as the US, UK, Euro area and Canada; China and India had the largest recovery of 8.0 and 9.5 per cent in 2021, respectively (see figure 1 and table 1). The vaccination programme has led to increase optimism and gradual reopening of economies. However, unequal access to vaccines, vaccine hesitancy, and higher levels of infections have caused uneven recovery across several developing and emerging markets in 2021. The risk of new variants will therefore create uncertainties about the future path of the pandemic, and, despite continuing recovery, the risk of derailment remains as long as the pandemic continues (IMF, 2021)[2].

Figure 1: 2020 and 2021 global growth projections



Source: IMF World Economic Outlook

[2] See https://www.imf.org/en/Publications/WEO/Issues/2021/10/12/world-economic-outlook-october-2021

Table 1: WEO estimates and projections for GDP growth

		WEO October 2021 Projections		*Change from July 2021 Projections*	
	2020	**2021**	**2022**	**2021**	**2022**
World	-3.1	5.9	4.9	-0.1	0.0
Advanced	-4.5	5.2	4.5	-0.4	0.1
United States	-3.4	6.0	5.2	-1.0	0.3
United Kingdom	-9.8	6.8	5.0	-0.2	0.2
Canada	-5.3	5.7	4.9	-0.6	0.4
Euro Area	-6.3	5.0	4.3	0.4	0.0
Emerging and Developing	-2.1	6.4	5.1	0.1	-0.1
China	2.3	8.0	5.6	-0.1	-0.1
India	-7.3	9.5	8.5	0.0	0.0
Mexico	-8.3	6.2	4.0	-0.1	-0.2
Brazil	-4.1	5.2	1.5	-0.1	-0.4
Latin America & Caribbean	-7.0	6.3	3.0	0.5	-0.2

Source: IMF World Economic Outlook October 2021

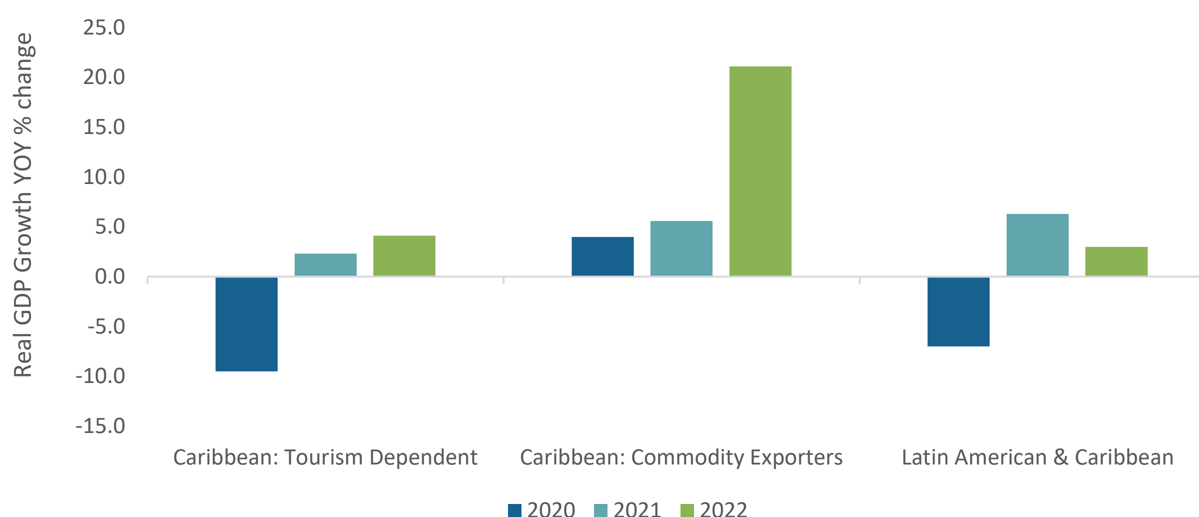
As global economic activity recovered, on-going supply and demand imbalances and higher commodity and energy prices have contributed to higher levels of inflation internationally. According to the IMF, price pressures are anticipated to stay elevated in 2022 in some emerging and developing economies, which may result in tighter monetary policies. In addition, the Inter-American Development Bank (IDB) posits that the Russian-Ukraine conflict could impact commodity prices, which may further impact inflation in 2022 and beyond (IDB 2022)[3].

2.2 Regional Macroeconomic Conditions

In contrast to the 7.0 per cent loss in GDP in 2020, real GDP in the region is projected to grow by 6.3 per cent in 2021, followed by a more moderate growth of 3.0 per cent in 2022, according to the IMF Regional Economic Outlook for Latin American and the Caribbean (LAC)[4]. Unlike advanced economies, economic recovery in the region has been slower especially for tourism-dependent economies. Tourism in the region is projected to grow slowly at 2.3 per cent, remaining at just 60 per cent of pre-pandemic levels in 2021. This is due to renewed outbreaks of the Omicron variant, continued restrictions on movement, and increased cost of travel related to Covid-19 testing and quarantine requirements (IMF regional outlook 2021). For commodity exporters, Guyana's economy is estimated to grow by 5.6 percent in 2021 to double-digit rates in 2022, driven by a large expansion of oil production and higher international oil prices. A more modest performance is expected in Suriname and Trinidad and Tobago (see figures 2a and 2b).

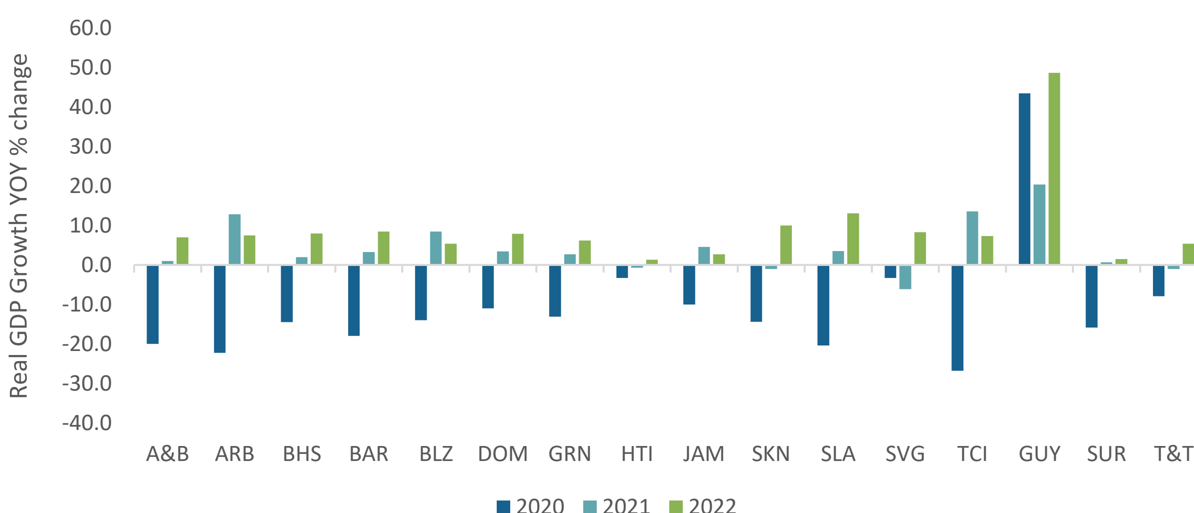
[3] See https://publications.iadb.org/publications/english/document/2022-Latin-American-and-Caribbean-Macroeconomic-Report-From-Recovery-to-Renaissance-Turning-Crisis-into-Opportunity.pdf.
[4] See https://www.imf.org/en/Publications/REO/WH/Issues/2021/10/21/Regional-Economic-Outlook-October-2021-Western-Hemisphere.

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



Source: Financial Services Commission elaboration based on IMF Regional Economic Outlook 2021

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



Source: Financial Services Commission elaboration based on IMF Regional Economic Outlook 2021[5]

Like the global economy, the region also experienced increased inflationary pressures on account of supply disruption and higher fuel and commodity prices. Some central banks have reacted by raising policy interest rates to ensure that inflation expectations are contained. For the external sector, current account deficits are projected to widen for 2021 due to slow recovery of tourism, higher prices of imported goods and declining remittances due to the pandemic (see table 2). The

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

expected rebound in tourism may improve the region's current account position but this may be derailed by prolonged imported inflationary pressures, such as higher fuel and commodity prices.

Table 2: Main economic indicators for selected Caribbean territories

	Percent Inflation End of period			*External Current Account Balance as a % of GDP*		
		Projection			Projection	
	2020	2021	2022	2020	2021	2022
Tourism Dependent	**10.4**	**8.3**	**8.3**	**-5.7**	**-7.4**	**-6.4**
Antigua & Barbuda	2.8	2.0	2.0	-8.0	-10.3	-9.9
Aruba	-3.1	1.7	1.6	-13.1	-7.0	-4.7
The Bahamas	1.2	5.0	3.5	-18.1	-20.9	-15.8
Barbados	1.3	3.2	2.5	-7.3	-12.7	-8.4
Belize	0.4	4.1	2.2	-7.5	-8.2	-8.2
Dominica	-0.7	2.0	2.0	-24.5	-35.5	-24.9
Grenada	-0.8	2.5	0.6	-22.2	-22.8	-20.6
Haiti	25.2	15.0	16.3	3.4	-0.3	0.2
Jamaica	5.2	6.0	6.5	-0.1	-1.6	-3.7
St. Kitts & Nevis	-1.2	-0.8	-0.3	-14.5	-11.3	-7.3
St. Lucia	-0.4	3.8	1.8	-13.2	-13.5	-9.1
St. Vincent & the Grenadines	1.0	2.2	2.0	-16.0	-21.5	-13.4
Turks and Caicos Islands	2.4[6]	4.5[7]	6.0[8]	-15.1	7.1	-
Commodity Exporters	**8.8**	**8.2**	**4.9**	**-1.7**	**5.4**	**15.7**
Guyana	0.9	3.4	2.8	-14.5	-16.8	13.8
Surinam	60.7	48.6	25.2	9.0	3.4	-1.7
Trinidad & Tobago	0.8	1.2	1.4	0.1	13.2	18.8

Source: IMF Regional Economic Outlook 2021 and TCI Department of Statistics

Fiscal deficits in the region declined from 7.5 per cent of GDP in 2020 to 5.8 per cent in 2021 as countries began to unwind fiscal and other policy support. Despite the still high fiscal deficits, average debt-to-GDP ratios declined marginally from 72.6 per cent in 2020 to 71.6 per cent in 2021 due to stronger than expected growth in the region (IDB 2022).

The medium-term outlook for the region is beset with uncertainties as countries continue to grapple with the effects of the pandemic and rising prices in the global environment. Average real GDP growth in the LACs is expected to reach their pre-pandemic levels in 2022; however, downside risks may thwart GDP growth due to tightening financial conditions on account of persistent inflationary pressures, as well adverse climate shocks which may pose additional challenges to the region based on its vulnerability to extreme weather phenomenon.

[6] Represents CPI growth for 2020. Source: TCI statistics Office.
[7] Represents CPI growth for 2021. Source: TCI Statistics Office.
[8] Represents forecast CPI growth for 2022. Source: TCI Statistics Office.

2.3 The Domestic Economy

Domestic macroeconomic conditions were stable during 2021. Real GDP is estimated to have grown by 13.6 per cent for 2021 in contrast to the decline of 26.8 per cent in 2020 on account of the lock down measures which caused a sudden drop in tourist arrivals, the largest contributor of GDP in the TCI. A combination of government actions, early provision of vaccines, and the release of pent-up demand in the market led to a strong recovery in tourism, which in turn has led to a better-than anticipated economic recovery. Due to the continued easing of Covid-19 containment measures, tourism in 2021 is estimated to have recovered to almost 80% of pre-pandemic levels. In this context, the unemployment rate fell by two percentage points to 9.0 per cent in 2021. Conversely, annual inflation, measured by the percentage change in the Consumer Price Index (CPI), increased in 2021 primarily driven by imported inflation, including higher cost of energy and food prices in the global economy. CPI growth went up to 4.5 per cent in 2021 compared to 2.3 per cent in 2020. The lack of a central bank or monetary authority with responsibility for price stability in the TCI constraints the implementation of monetary policy tools to help curtail the rise in inflation (see table 3 below for key statistics).

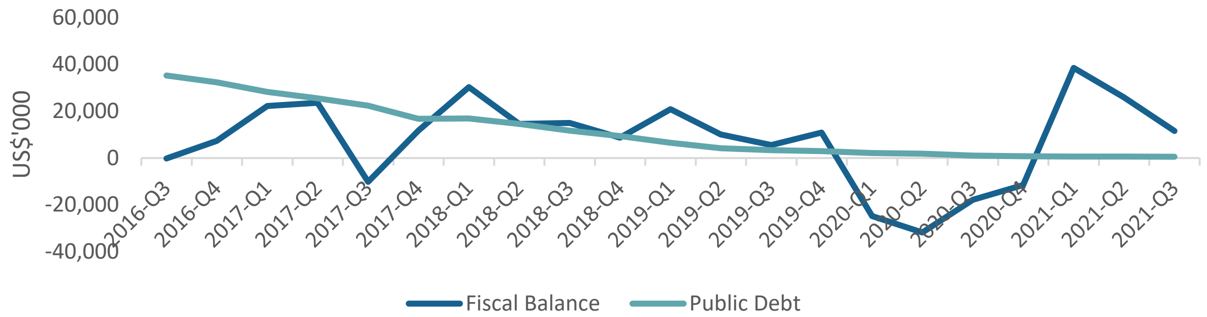
Table 3: Domestic macroeconomic indicators

	Actuals				*Projections*		
Indicators	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Nominal GDP (bil. $)	1.02	1.11	1.2	0.92	1.09	1.24	1.37
Real GDP growth (%)	-2.5	5.6	5.3	-26.8	13.6	7.3	7.1
Unemployment rate (%)	6.0	7.0	7.0	11.0	9.0	8.0	7.0
Trade balance/GDP (%)	-40.7	-41.7	-39.2	-36.2	-42.7	-42.7	-42.7
CPI growth (%)	2.1	2.1	2.2	2.3	4.5	6.0	3.5

Source: TCI Department of Statistics

Given the rebound in the economy, the TCI government had a positive fiscal balance of $11.6 million for the period ending December 2021, in contrast to a $17.8 million deficit in the previous period. The outturn was largely driven by strong revenues from hotel and restaurant tax, import tariffs and stamp duties. The government's public debt continued to decline totalling $0.57 million as at December 2021, a reduction of 49.1 per cent when compared to the same period in the prior year (see figure 3). Due to the better-than-anticipated fiscal outturn in 2021, the TCI government retired its undrawn bank facility by the end of 2021.

Figure 3: TCIG fiscal balance and public debt performance (2016 – 2021)



Source: TCI Government Treasury Office

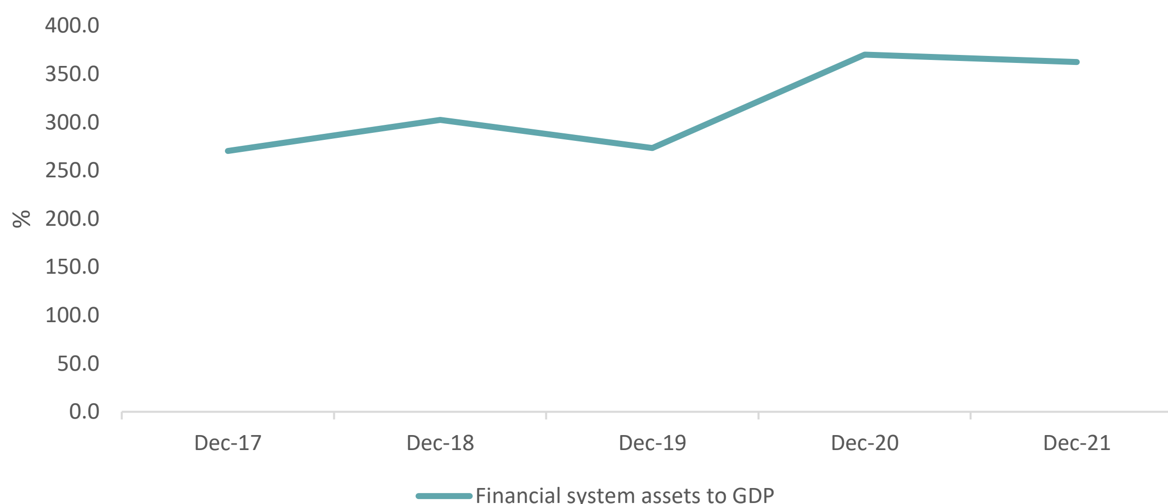
The TCI economy is projected to continue on its growth trajectory for 2022. Continued rebound in tourist arrivals will likely support a projected 7.3 per cent increase in GDP in 2022. In addition, the real estate and construction sectors, which showed strength in 2021 as several tourism related projects were completed (such as the Ritz Carlton, which opened in June 2021), is anticipated to spur growth in the economy. Despite the expected continued recovery, there remains downside risks as the path of the pandemic continues to be a source of vulnerability. The emergence of new variants could result in adverse consequences for the economy. In addition, persistent increase in inflation due to the ongoing global challenges could weaken aggregate demand and constrain anticipated growth.

3.0 FINANCIAL SYSTEM DEVELOPMENT

3.1 Overview

Financial intermediation, measured as the share of total financial system assets[9] to GDP, declined slightly by 7.6 percentage points to 362.6 per cent at year-end 2021 (see figure 4). The outturn largely reflected stronger growth in GDP relative to financial assets growth.

Figure 4: Financial intermediation in the TCI

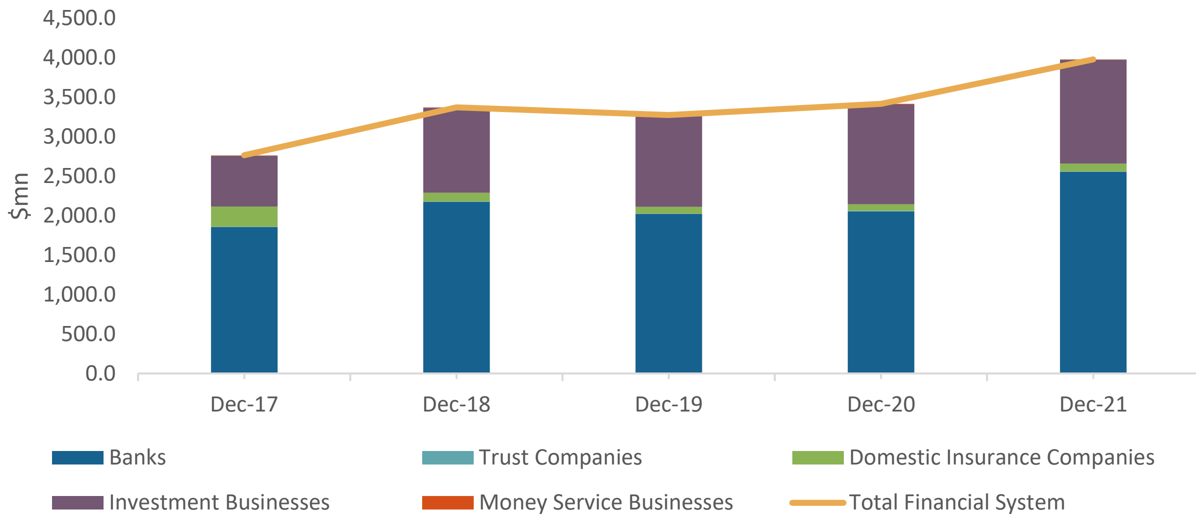


Source: TCI Financial Services Commission

The domestic financial sector continued to be dominated by the banking and investment sectors, which collectively accounts for over 90 per cent of total domestic financial system assets[10]. Total financial assets grew by 16.5 per cent to $3,977.1 million as at December 2021, driven predominantly by expansions in asset bases of the banking, investment[11] and domestic insurance sectors. Conversely, total assets declined in the trust and money service businesses sectors at year-end 2021 (see figure 5).

[9] Total financial system assets comprise of assets at the following institutions: banks, trust companies, domestic insurers, investment businesses, mutual fund operators and money service businesses.
[10] At the end of December 2021, the TCI financial system comprised 6 banks, 18 domestic insurance companies, 7 investment dealers, 4 mutual fund administrators, 7 trust companies, and 4 money service businesses.
[11] The investment sector is comprised of investment advisers and dealers, fund managers and mutual fund administrators.

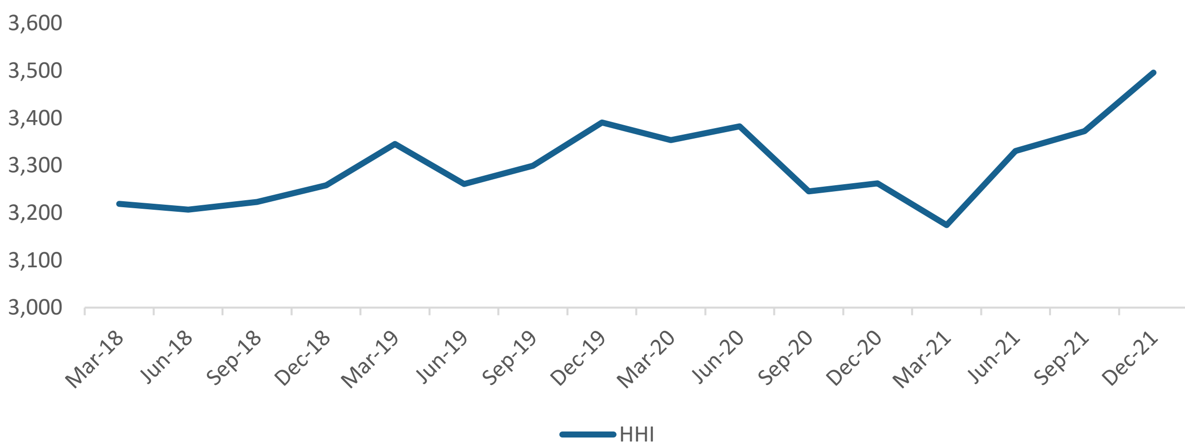
Figure 5: Financial institutions' assets



Source: TCI Financial Services Commission

Banking assets concentration, measured by the Hirschman-Herfindahl Index (HHI)[12], increased by 7.2 per cent to 3,496 as at December 2021, relative to December 2020 (figure 6). The outturn signals a slight increase in asset concentration risk in the sector. Banking sector assets remained heavily concentrated in the three Canadian-owned banks, accounting for an average quarterly market share of 98.0 per cent for the last three years, which warrants continued monitoring for developments in these institutions.

Figure 6: Banking sector concentration as measured by the HHI



Source: TCI Financial Services Commission

[12] 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.

The financial soundness indicators point to a relatively stable banking sector with high capital buffers and a sound liquidity position. There were marked improvements in the sector's profitability and asset quality as at December 2021, relative to the previous year's outturn (see table 4 below).

Table 4: Banking sector's annual financial soundness indicators

Ratios	*Dec-17*	*Dec-18*	*Dec-19*	*Dec-20*	*Dec-21*
Capital Adequacy					
Regulatory Capital / Risk-weighted Assets	25.2	27.6	31.9	29.6	25.4
Regulatory Tier I Capital / Risk-weighted Assets	26.8	29.0	28.7	27.3	24.2
Total Capital / Net Assets	14.4	14.6	16.8	15.6	13.2
Asset Quality					
NPLs / Gross Loans	7.7	5.4	5.4	6.0	4.5
NPLs net of provisions for loan losses / Total Capital	8.9	6.9	6.0	1.1	1.0
Provision for loans losses / Gross Loans	5.0	2.9	3.1	5.6	4.1
NPLs net of provision for loan losses / Paid-up capital	25.4	23.3	21.1	3.5	3.4
Earning and Profitability					
Return on Assets (Net profit / Average net assets)	2.2	2.1	2.5	0.5	1.6
Return on Equity (Net profits / Average total capital)	14.6	15.4	17.2	3.4	12.0
Net interest income / Gross income	64.8	64.6	67.1	65.9	52.1
Non-interest expenses / Gross income	67.6	64.1	49.4	107.9	45.1
Liquidity					
Liquid assets / Total assets	46.9	53.9	50.3	55.4	62.2
Liquid assets / Short-term liabilities	54.8	82.9	60.5	65.4	72.6
Gross Loans / Customers Deposits	68.0	66.7	63.0	59.2	42.5
Liquid assets / Total deposits + borrowings	55.6	63.9	61.6	66.6	73.8

Source: TCI Financial Services Commission

3.2 Banking Sector Performance

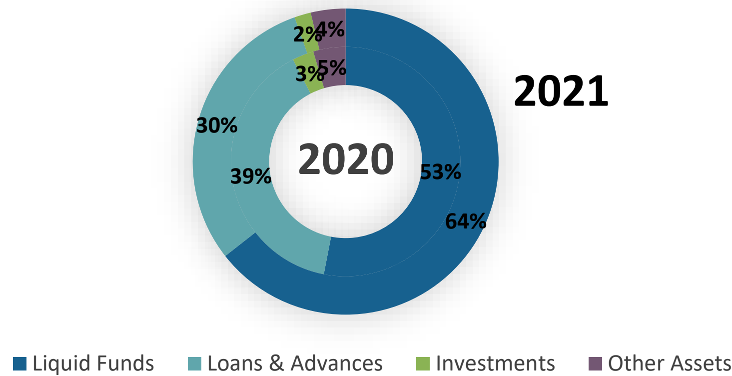
3.2.1 Balance Sheet

Total assets in the banking sector grew by 24.5 per cent to $2,555.4 million during 2021, relative to the 1.6 per cent growth recorded in the prior year. The growth in banking sector assets was primarily in holding of liquid assets, which grew by 39.9 per cent to $1,589.5 million.

The composition of banks' assets remained relatively unchanged at year-end 2021, when compared to year-end 2020. *Liquid Funds* and *Loans & Advances* continued to account for the largest share of banks' assets, representing 66.0 and 30.9 per cent, respectively (see figure 7). Banks held less investments in 2021; holdings declined by 29.7 per cent to $45.8 million, reflecting banks' risk aversion due to the potential impact of the pandemic. The portfolio of *Loans and Advances* declined by 6.5 per cent in 2021, relative to a 3.6 per cent decline in the previous year. A sectoral breakdown of banks' credit portfolio revealed that the reduction was largely in loans to the *Transportation & Storage* sector by 20.3 per cent, and the *Construction & Land Development*

sector by 15.7 per cent. In addition, there was a reduction in credit exposures to the *Tourism* and *Professional & Other Services* industries by 3.4 per cent and 4.7 per cent, respectively. The reduction in loan balances is attributed to resumption in regular loan repayments as banks wound up their Covid-19 customer relief programs.

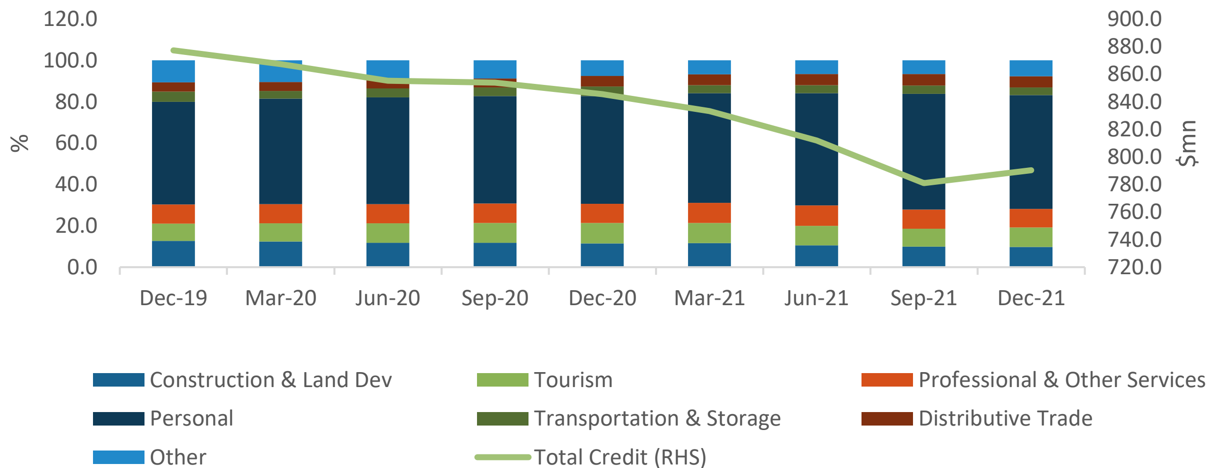
Figure 7: Banking sector asset classification



Source: TCI Financial Services Commission

The distribution of credit remained relatively stable throughout the review period (see figure 8). Private sector credit was concentrated in four main economic sectors, namely personal, construction and land development, tourism, and professional and other services. The household sector (personal loans) remained the largest recipient of credit, with 55.1 per cent as at year end 2021.

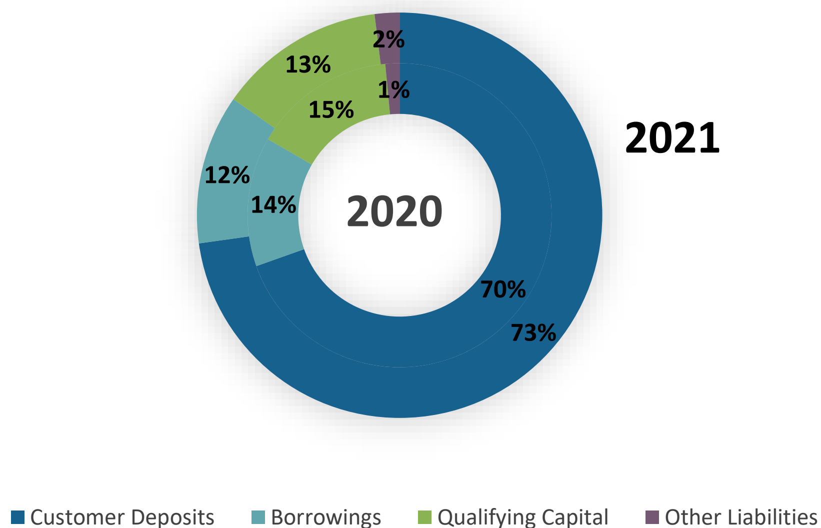
Figure 8: Sectoral distribution of credit



Source: TCI Financial Services Commission

Total liabilities in the banking sector also increased during the review period. Banks' funding structure remained relatively unchanged with the primary funding source being deposits (see figure 9). Specifically, banks' total deposits increased by 30.2 per cent to $1,860.0 million and represented 72.8 per cent of total liabilities as at December 2021, relative to 69.6 per cent as at December 2020. Furthermore, there was a decline in financial intermediation as the loans to deposit ratio fell by 16.7 percentage points to 42.5 per cent during the review period.

Figure 9: Banking sector funding sources

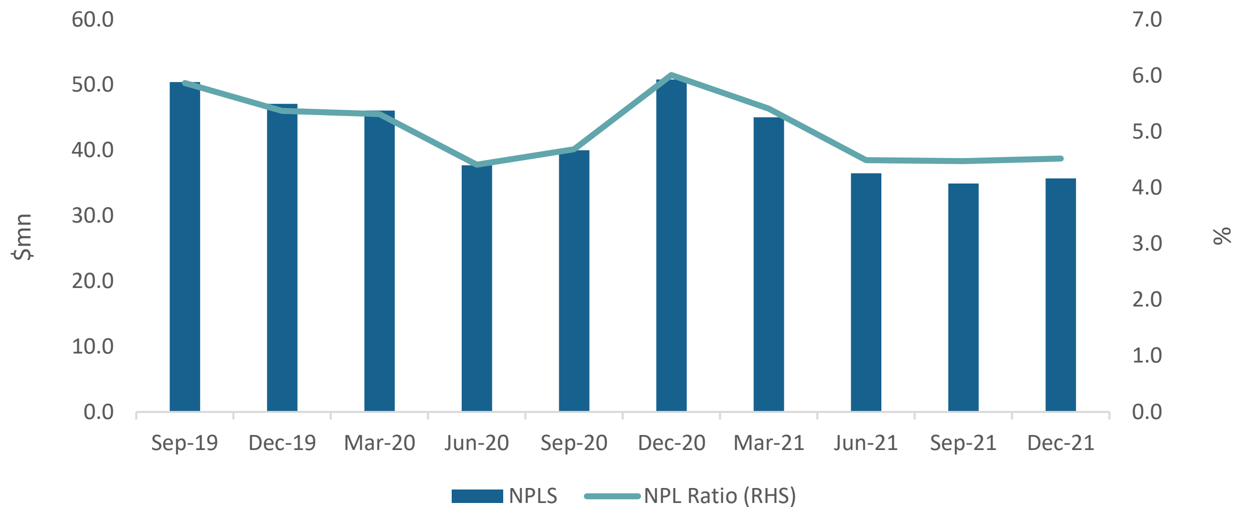


Source: TCI Financial Services Commission

3.2.2 Asset Quality

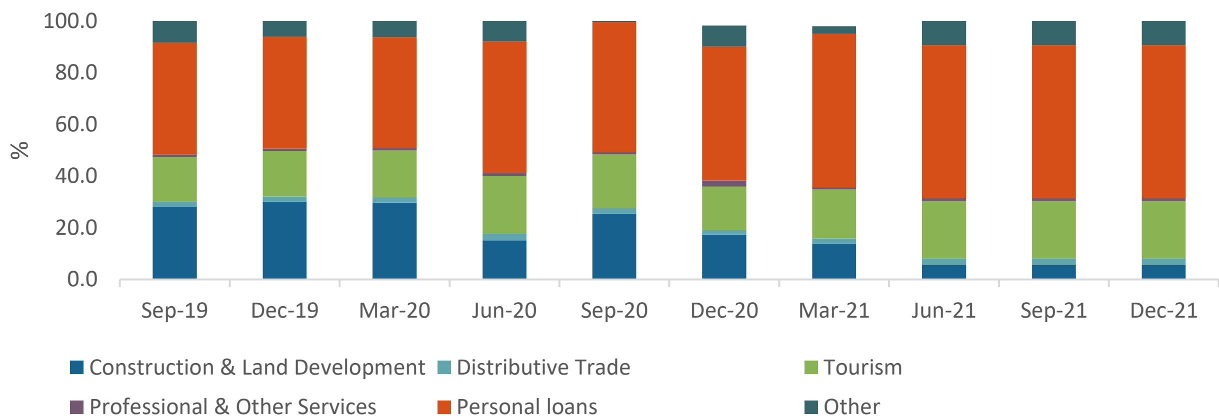
Banks' asset quality showed a marked improvement as at December 2021, relative to the previous year's outturn. Specifically, the non-performing loans (NPL) ratio decreased by 1.5 percentage points to 4.5 per cent at year end 2021. There was a decline in the stock of NPLs by 29.7 per cent to $35.7 million at year-end 2021, in comparison to the increase of 7.8 per cent to $50.8 million recorded as at December 2020 (see figure 10). The distribution of NPLs remained relatively constant throughout the period, with personal loans holding the largest share (figure 11). A declining trend was observed for the construction and land development's share of NPLs over the last five quarters. The year-end outturn showed higher rate of contraction from 17.3 per cent in 2020 to 5.6 per cent in 2021.

Figure 10: Total NPLs and NPL ratio



Source: TCI Financial Services Commission

Figure 11: NPL distribution by sector

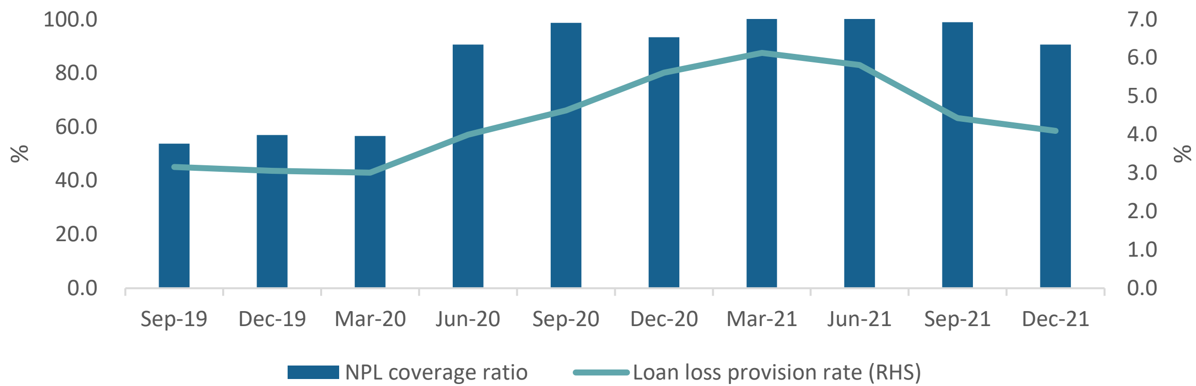


Source: TCI Financial Services Commission

The NPL coverage ratio, which measures provisions as a share of NPLs, declined to 90.7 per cent as at December 2021, signifying that approximately 90 per cent of NPLs were covered by banks' provisions. The outturn represented a 2.7 percentage point reduction when compared to December 2020. The reduction in the ratio was driven mainly by banks reducing provisions that were previousy booked in anticpation of potential loan losses on account of the pandemic. The loan loss provisioning rate[13] also declined as at year-end 2021 to 4.1 per cent, compared to 5.6 per cent in the prior period (figure 12).

[13] The loan loss provision rate is calculated as the ratio of total loan loss provisions to total loans.

Figure 12: NPL coverage and loan loss provisioning ratio

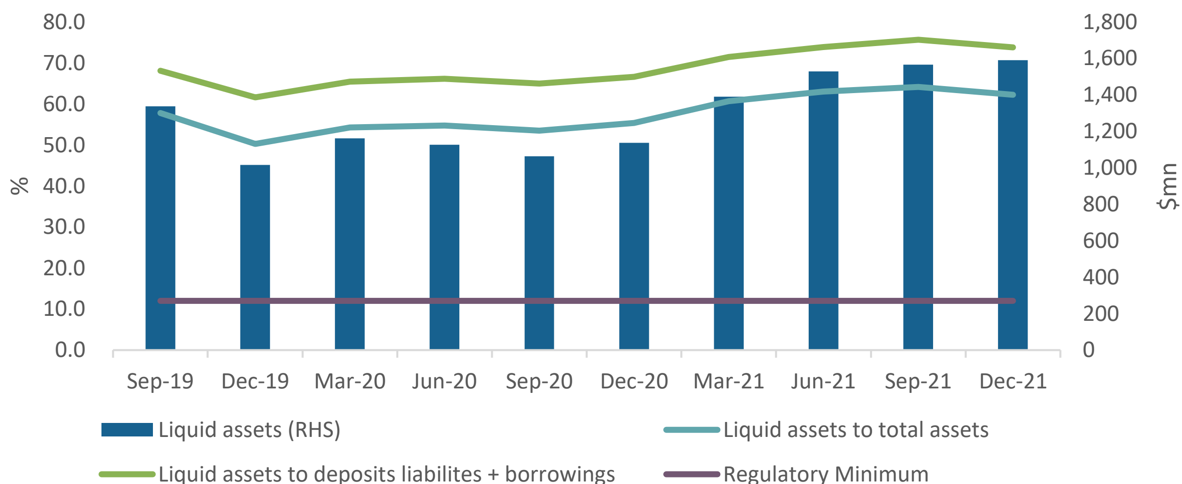


Source: TCI Financial Services Commission

3.2.3 Liquidity and Funding

Banks continued to maintain adequate liquidity levels in compliance with regulatory requirements[14]. The ratio of liquid assets to total assets increased from 55.4 to 62.2 per cent during 2021 (see figure 13). Customer deposits continued to account for the dominant share of banks' funding base and remained the main source of credit financing. The ratio of liquid assets to deposit liabilities and borrowings remained high at 73.8 per cent at year-end 2021, relative to 66.6 per cent at year-end 2020.

Figure 13: Liquidity profile of the banking sector



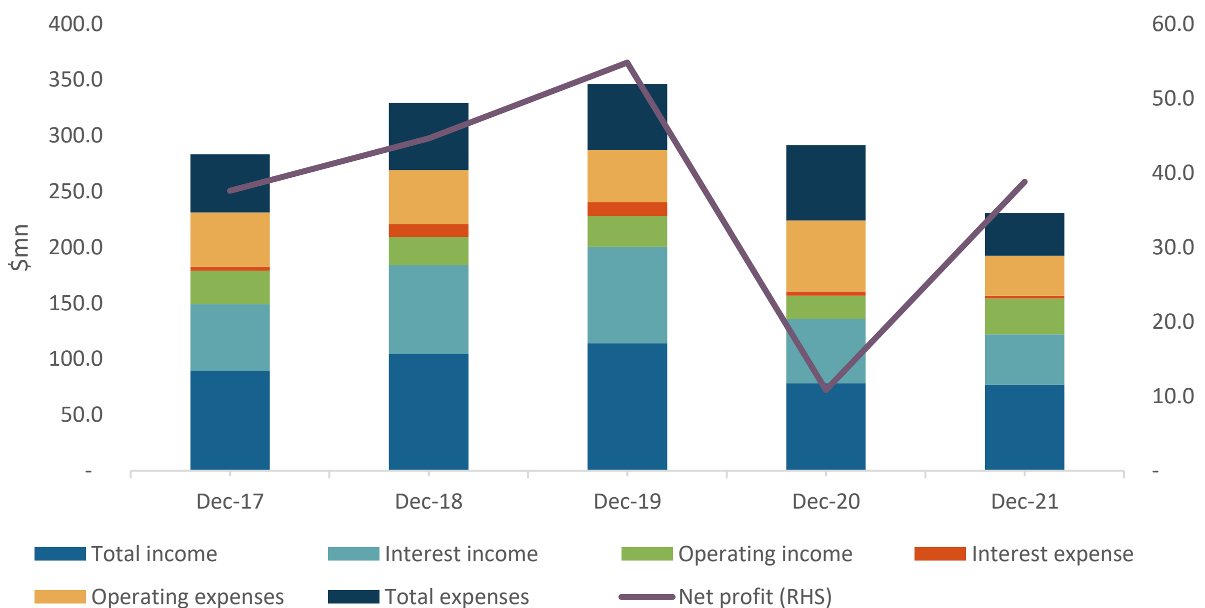
Source: TCI Financial Services Commission

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

3.2.4 Earnings and Profitability

As the economy continued to recover from the effects of the pandemic, banks' profitability for the review period rebounded, albeit still below pre-pandemic levels. From an earnings standpoint, total income for the sector declined slightly from $78.2 million to $77.1 million, representing a 1.7 per cent reduction. The performance was driven by a 22.0 per cent decline in interest income, the larger share of the sector's earnings, but was tempered by an increase in operating income of 54.8 per cent. Further, banks' total expenses fell significantly from $67.4 million to 38.3 million, an impact of 43.2 per cent over the review period. The reduction in expenses was mainly due to income written back for provisions previously booked as a precaution against loan losses during the pandemic. Owing to the larger reduction in total expenses, net profits outcome for the sector grew from $10.8 million to $38.8 million, a rebound of 258.1 per cent over the previous year (figure 14).

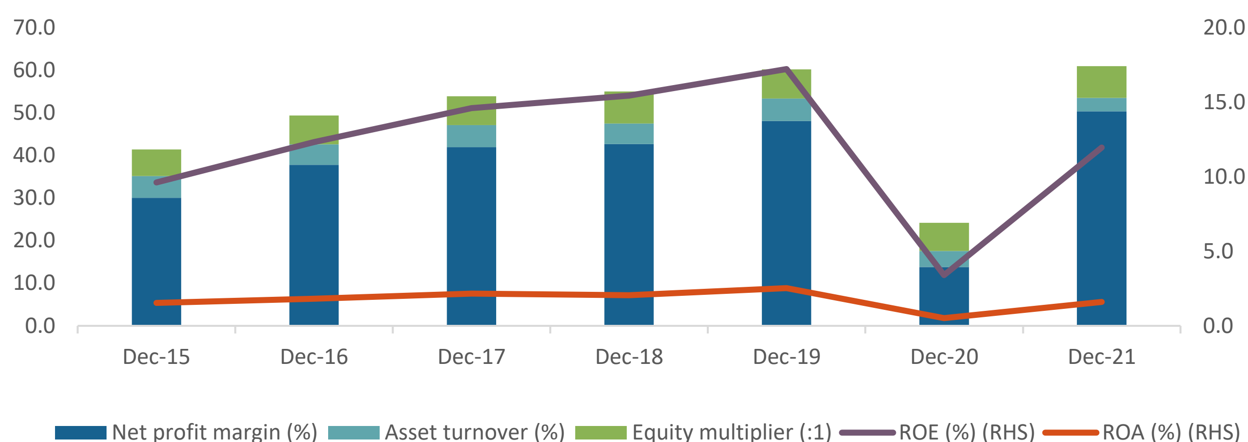
Figure 14: Banking sector's income, expense and profit



Source: TCI Financial Services Commission

Against the background of improved profit outturn, return on equity (ROE) for the sector grew by 8.6 percentage points to 12.0 per cent for the review period, compared to 3.4 per cent for the previous period. A decomposition of the ROE showed that the increase was influenced primarily by a sizeable increase in net profit, small changes in asset turnover, and the equity multiplier. Concurrent with this performance was an increase in the sector's return on assets (ROA) to 1.6 per cent, up from 0.5 per cent in 2020 (see figure 15).

Figure 15: Banking sector profitability performance

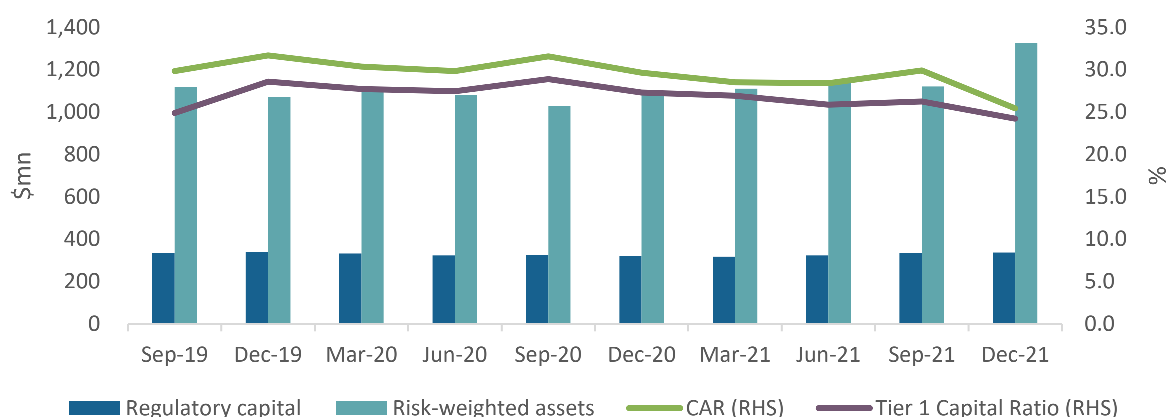


Source: TCI Financial Services Commission

3.2.5 Capital Adequacy

Banks maintained strong capital positions over the review period; the sector's Capital Adequacy Ratio (CAR)[15] remained well above the regulatory requirement of 11 per cent of risk-weighted assets. At year-end 2021, the sector's CAR was 25.4 per cent, relative to 29.6 per cent at year end 2020. The ratio of Tier 1 capital to risk-weighted assets decreased by 3.1 percentage points to 24.2 per cent at year end 2021. The decline in the ratio was due to stronger growth in risk-weighted assets relative to Tier 1 capital (table 16). Notwithstanding the decline in banks' CAR, the sector remained well positioned to absorb potential losses.

Figure 16: Banking sector capital adequacy



Source: TCI Financial Services Commission

[15] CAR represents capital adequacy ratio which is ratio of regulatory capital to risk-weighted assets.

3.3 Non-bank Financial Sector Performance[16]

The asset base of the non-bank financial sector totalled $1,421.7 million as at December 2021, a growth of 4.5 per cent when compared to the corresponding period of the previous year. Expansion was reflected in the domestic insurance and investment business sub-sectors but tempered by declines in assets in the trust and money service business sectors. The investment sector accounted for the largest share of the asset increase in the non-bank financial sector.

3.3.1 Investment Business Sector

Total assets reported by the sector as at December 2021 was $1,315 million, representing a 4.1 per cent increase relative to December 2020. This growth was the result of 28 new accounts totalling $32.0 million being added during 2021, tempered by a contraction in one licensee's portfolio due to operational changes that resulted in the relocation of some investment accounts.

At year-end 2021, the investment business sector comprised three banks, a foreign registered company, and three domestic financial groups. Some entities held multiple licenses as dealers and mutual fund operators. The three banks accounted for 49 per cent of the consolidated investment business portfolio. Notably, 62 per cent of banks' total portfolio was owned by non-resident investors.

3.3.2 Domestic Insurance Sector

Financial soundness indicators for the insurance sector reflected a positive and stable position (see table 5a and 5b) for the year ending December 2021. Solvency and liquidity remained at acceptable levels and well above minimum requirements. Profitability indicators, such as the return on equity and the combined ratio, pointed to weakened profitability for the life insurance sub-sector over the review period, due mainly to higher claims playout.

Table 5a: Financial soundness indicators – Life insurance sector

Ratio	*Dec-17*	*Dec-18*	*Dec-19*	*Dec-20*	*Dec-21*
Solvency Ratio - Standard minimum 8%					
Total Equity / Total Liabilities- Standard minimum 60%	488.2	444.7	411.3	455.5	403.2
Return on Equity					
Net Income / Total Equity	6.4	8.0	6.2	5.1	0.5
Liquidity - Standard minimum 60%					
Liquid Assets / Total Liabilities	408.9	429.1	420.9	490.9	470.9

Source: TCI Financial Services Commission

[16] The non-bank financial sector includes the domestic insurance companies, investment businesses, trust companies and money service businesses.

Table 5b: Financial soundness indicators – General insurance sector

Ratio	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21
Solvency Ratio - Standard minimum 25%					
Total Equity / Total Liabilities	9.8	45.6	43.4	34.3	33.6
Return on Equity					
Net Income / Total Equity	-50.2	10.7	24.4	25.0	26.0
Combined Ratio - Standard maximum 100%					
Total Underwriting Expenses / Net Earned Premiums	210.9	79.7	64.4	72.0	68.3
Liquidity - Standard minimum 95%					
Liquid Assets / Total Liabilities	106.7	138.9	131.1	121.9	127.0

Source: TCI Financial Services Commission

As at December 2021, insurance sector assets amounted to $97.9 million, an increase of 15.1 per cent over the previous period. General insurance companies accounted for 85.9 per cent of the insurance sector's total assets, relative to 85.3 per cent at year-end 2020. The life and general insurance sub-sectors recorded increases in asset base for the year ending 2021; 10.1 per cent and 16.0 per cent to $13.8 million and $84.1 million, respectively. The growth in assets for life insurance companies was reflected largely in a 19.9 per cent increase in *Cash, Loans and Investment* holdings. For general insurance, the growth in asset base was reflected mainly in a 46.7 per cent increase in *Accounts Receivable* category.

Profitability for the insurance sector increased over the review period but there were mixed results for the two sub-sectors. The combined net income for the sector increased by 8.3 per cent from $5.1 million in 2020 to $5.6 million in 2021. The general insurance sub-sector had positive gains as net income increased by 19.3 per cent to $5.5 million over the review period, driven mainly by an increase in net operating income. Conversely, net income for life insurers declined by 89.3 per cent to $0.06 million in 2021 on account of higher policyholder benefit payments, which increased over nearly 200 per cent relative to the previous period These payments were mostly driven by increase policy surrenders and higher death claims with respect to one insurer.

3.3.3 Trust Sector

The trust sector's on-balance sheet assets as at December 2021 declined by 29.9 per cent to $4.3 million when compared to the previous year. The outturn represents a stabilisation in the level of on-balance sheet assets after the temporary spike in 2020 due to difficulties in transferring clients' funds during the pandemic. Income from services remained the largest income generator for trust companies. Total consolidated income increased by 65.4 per cent to $11.5 million during the period, compared to $6.9 million for 2020. The outturn was driven by a 75.8 per cent increase in *Income from Services*. Total consolidated expenses fell marginally by 0.3 per cent over the period

to $5.3 million. Accordingly, the combined net income for the sector rebounded by 284.2 per cent to $6.2 million, compared to the 2020 year-end outcome of $1.6 million.

3.3.4 Money Service Business (MSB) Sector

Total assets in the MSB sector declined by 16.9 per cent to $4.5 million over the review period. In addition, total revenue contracted by 15.2 per cent to $2.6 million in 2021, spurring a decline in profits of 57.0 per cent to $0.1 million, compared to $0.3 million in 2020.

Total funds transmitted for 2021 amounted to $114.6 million, a decline of 2.1 per cent when compared to the previous year. Outbound funds accounted for 91.0 per cent of total transmitted funds. Outbound and inbound flow of funds reduced by 1.8 per cent to $104.3 million and by 5.1 per cent to $10.3 million, respectively. The outcome was driven mainly by reductions in remittance activity for Haiti as outbound and inbound flows from the country decreased by 40.9 and 29.0 per cent, respectively at year end- 2021. The fall-off in Haiti's remittance activities is attributed to the impact of the country's new foreign exchange policy which became effective in October 2020[17].

Haiti and the Dominican Republic continued to be the main recipients of outbound remittances, collectively accounting for 47.5 per cent ($54.4 million) of total outflows, relative to 53.5 per cent ($62.7 million) remitted the previous period. Remittance inflows from the United States of America, which continued to contribute the largest portion of inflows to the TCI[18], reduced by 2.5 per cent to $6.5 million, relative to $6.7 million remitted in 2020.

[17] 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.
[18] Remittance inflows from the US accounted for 63.0 per cent of total inflows for 2021 and 61.4 per cent in 2020

4.0 FINANCIAL SYSTEM VULNERABILITIES

Within the broad framework of macroprudential analysis, the Commission uses a set of early warning indicators to actively monitor the build-up of systemic risk within the banking sector. Systemic risk monitoring involves the early detection of risks to financial stability and potential sources of vulnerability in the financial system that can lead to imbalances within the economy. The indices are constructed based on financial market indicators, and macroeconomic and financial data.

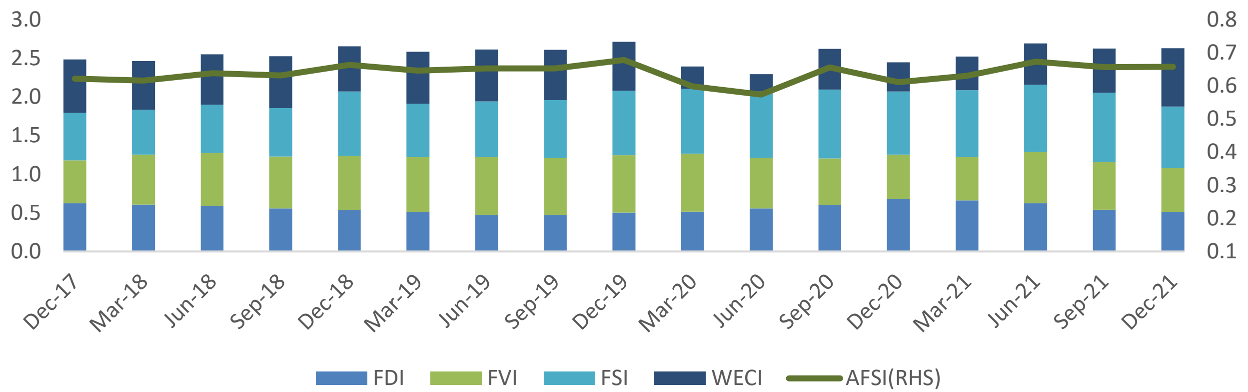
This chapter assesses the key channels of risk and vulnerabilities in the domestic macrofinancial system using four composite indices of financial stability. The results show that notwithstanding the uncertainty created by the pandemic, financial stability risks were generally lower in 2021 when compared to the previous 2020 period.

4.1 Macrofinancial Risks

Domestic macrofinancial risks, as measured by composite indices of financial stress, in particular the Aggregate Financial Stability Index (AFSI) and the Macrofinancial index (MaFi), improved in 2021. The AFSI[19] increased to an average of 0.7 for 2021, from 0.6 for 2020, indicating improved financial stability (see figure 17). The performance of the AFSI is attributed to strong performance in the financial soundness and the world economic climate sub-indices. The performance of the financial soundness sub-index mainly reflected strong liquidity positions and improvements in asset quality, measured by the NPL ratio. The rebound in global growth and the improvement in the US economy contributed to the performance of the world economic climate sub-index. However, these improvements were partially offset by increase in the financial vulnerability sub-index on account of inflationary pressures associated with the continuing impact of the pandemic on international commodity and shipping prices. In addition, the financial development sub-index declined slightly due to reduction in credit to the economy.

[19] 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.

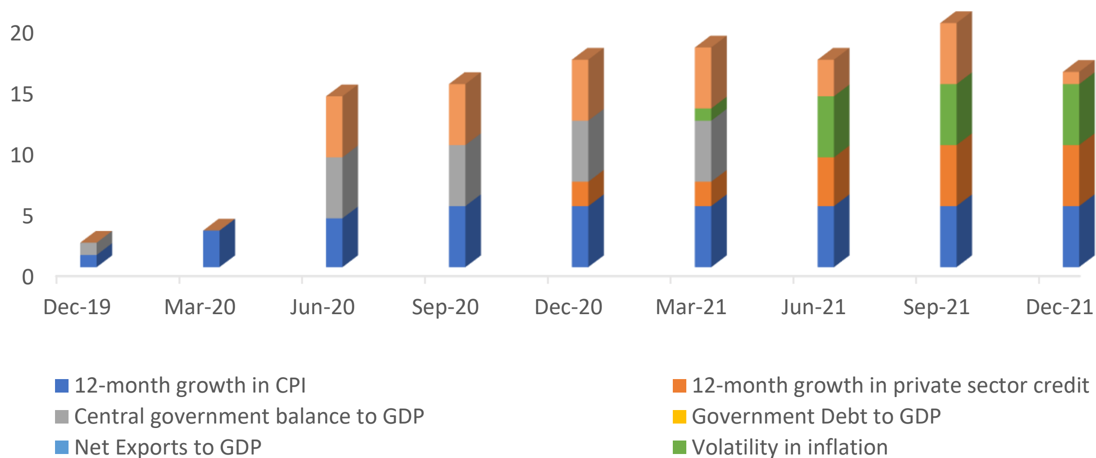
Figure 17: AFSI and sub-indices



Source: TCI Financial Services Commission

The MaFi[20] improved slightly as the index fell to 21 points as at December 2021, relative to 22 points recorded as at December 2020 (see figure 18). The reduction in the index reflected an improvement in the spending per tourist indicator on account of the higher volume of tourist arrival and income from tourism, as well as improvement in the government's fiscal balance. However, the impact of these were partially offset by higher inflation level.

Figure 18: Macrofinancial index



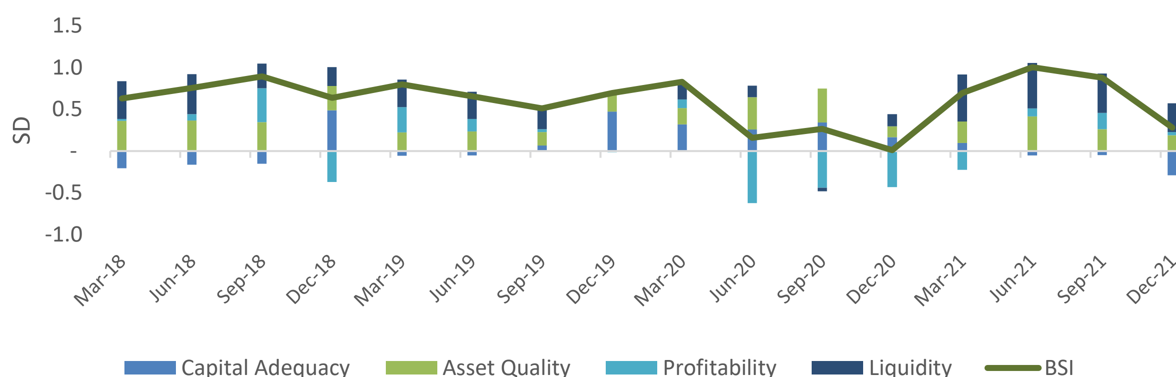
Source: TCI Financial Services Commission

[20] 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.

4.2 Bank Stability Indicator

Bank soundness, as measured by the Banking Stability Indicator (BSI)[21], improved for the review period. The positive performance was attributed to improvements in asset quality, liquidity and profitability relative to the previous period. However, the outturn was also impacted by lower levels of capital adequacy (see figure 19).

Figure 19: BSI and sub-components



Source: TCI Financial Services Commission

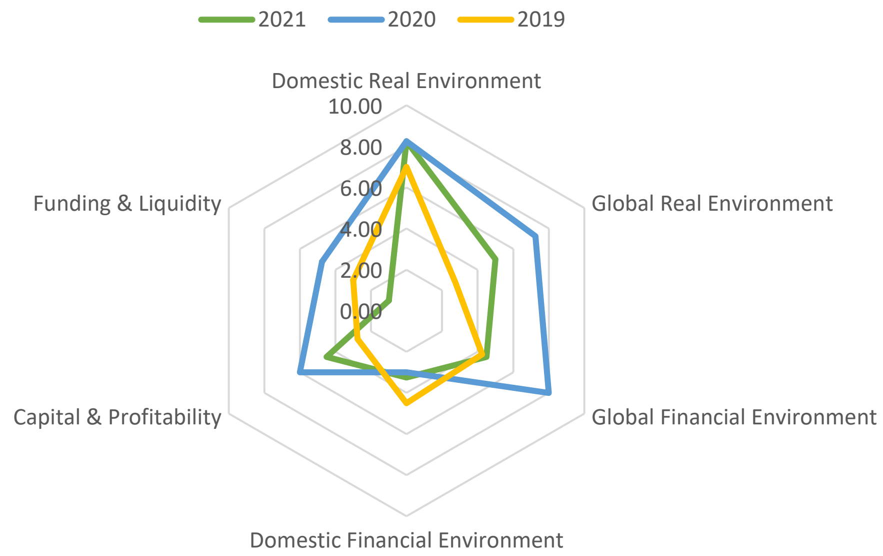
4.3 Financial Risk Exposure

Risks to financial stability were lower in 2021 relative to 2020 as shown in the risk exposure cobweb (see figure 20). Consistent with the BSI, the cobweb diagram[22] highlighted that for 2021, banks' funding, liquidity and profitability generally improved. Also, banks' risk exposure to the global real and financial environment were lower relative to 2020, due to stronger global growth and financial market performance. On the domestic side, risks were slightly elevated in 2021 in comparison to 2020 due to higher domestic inflation and lower credit growth relative to the growth in domestic GDP.

[21] 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.

[22] 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.

Figure 20: Cobweb map of risk exposures



Source: TCI Financial Services Commission

5.0 BANKING SECTOR RESILIENCE

Macroprudential stress tests were applied to banks' credit and liquidity portfolios to assess their resilience to hypothetical shocks. These tests measured the 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 shocks to credit and liquidity risk factors[23].

Credit Test

Banks' aggregate capital was lower as at December 2021 relative to the prior period. Nevertheless, the test outcomes revealed that the banking sector was well capitalised and resilient to a range of scenarios, while exceeding the prudential minimum CAR[24] of 11 per cent (table 6). Of note, the test found no substantial capital erosion as a consequence of hypothetical growth in the NPLs by sectors and associated provisioning. In response to hypothetical shocks to sectoral exposures, the banking sector remained generally resilient as at December 2021 to increases in NPLs to the major sectors of credit exposure namely, tourism, construction & development and personal.

Liquidity Test

The liquidity stress test examined, under two scenarios, the number of days banks could withstand a 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 assumes, a daily run rate of 20 per cent on demand and 5 per cent on time and savings deposits. The results indicate that as at December 2021, the banking sector can generally withstand a simultaneous run-on demand, time and savings deposits over the seven-day period. The second scenario examines the effect of a 20 per cent daily withdrawal rate on large depositors' accounts. Results indicate that all banks were able to withstand the seven-day bank run (see table 6).

Table 6: Banking sector credit and liquidity risk stress test results

		Dec-19	Dec-20	Dec-21
Credit Test				
Baseline/Pre-shock CAR		**28.6**	**27.3**	**24.2**
Shock 1a: Generalized increase in NPL	Post-shock CAR %	26.7	23.9	22.3
Shock 1b: Correction for underprovisioning	Post-shock CAR %	26.2	25.4	23.0

[23] Assumptions/shocks for each test are summarised in Appendix B.
[24] The test considered tier 1 capital only.

Shock 1c: Migration across NPL Categories	Post-shock CAR %	25.5	24.5	22.4
Shock 1d: Credit Concentration	Post-shock CAR %	17.1	17.0	16.0
Sectoral Shocks				
Shock 1e: Sectoral Shocks (Mortgages)	Post-shock CAR %	27.3	25.6	23.0
Shock 1f: Sectoral Shocks (Tourism)	Post-shock CAR %		26.8	23.8
Shock 1g: Sectoral Shocks (Construction)	Post-shock CAR %		26.7	23.8
Shock 1h: Sectoral Shocks (Personal)	Post-shock CAR %		26.1	23.3
Liquidity Test				
Bank run on demand & time deposit accounts	No. of banks with liquidity drainage before 7 days	2	1	0
Bank run on large depositors' accounts	No. of banks with liquidity drainage before 7 days		1	0

Source: TCI Financial Services Commission

6.0 KEY POLICY INITIATIVES

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.

6.1 Broadening the Stress Testing Framework

The Commission will be revising its top-down stress testing framework to include multifactor shocks and macro scenarios. These additions are being included with a view to provide greater insights into the risks and vulnerabilities of banks, and to inform key decisions in supervisory actions and policy making.

6.2 Improving Financial Stability Surveillance

The Commission is currently working at refining its systemic risk monitoring framework to better consolidate the composite indicators. Additionally, systemic monitoring will be broadened to include analysis on sectoral exposures. This will examine vulnerabilities of the financial system due to potential developments in the household and private sectors.

Consistent with assessing sectoral developments, the Commission has also embarked on a project to develop a residential property price index (RPPI) for the TCI to monitor changes in the aggregate price for comparable residential dwellings. RPPIs can be used as a financial soundness indicator, as sharp falls in real estate prices have a detrimental impact on the health and soundness of the financial sector and on the financial situation of households, by affecting credit ratings, the value of collateral, and the debt-to-equity ratio. As such, the Commission will use real estate prices as a key indicator for assessing the dynamics of the economy as well as to measure risk exposures for lenders and investors.

6.3 Enhancing Supervisory Framework

The Commission continues to press ahead with the implementation of its risk-based supervisory (RBS) framework across banks, trust companies, insurers, investment businesses, and to further develop its risk-based approach (RBA) to anti-money laundering (AML) supervision.

During 2021, the Commission issued the Guidelines for Prudential Supervision of Investment Businesses and the Annual Questionnaire for Prudential Supervision of Investment Businesses, which were aimed at improving data collection and reporting to effectively undertake risk-based supervision for entities within this sector. Further updates will be made to the questionnaire to include reporting requirements on capital flows.

The Commission continues to undertake initiatives aimed at strengthening the supervisory framework for its licenses. During the year, work was undertaken to assess the progress and level of preparedness of insurers transitioning to the new IFRS 17 standard. This will continue into the next calendar year. Additionally, the Commission continues to assess the level of compliance of insurers with AML/CFT/PFT regulation and standards. For the banks, the Commission will continue to work on and fully implement its new prudential standard for credit risk classification and provisioning, that is based on the adoption of the new IFRS 9 forward looking expected credit loss model. These initiatives are aimed at the continued alignment of the Commission's regulatory and supervisory framework with international standards to enhance TCI's regulatory landscape.

6.4 Addressing Developments in the Financial Sector Landscape

Over the review period, the Commission initiated policy-related research on the emerging forms of digital assets, which included crypto and virtual assets as well as Central Bank Digital Currencies (CBDC). The research was conducted in two phases: phase one explored the digital asset ecosystem, examining the unique characteristics and uses of crypto assets and CBDCs, while phase two assessed the risks and vulnerabilities emanating from crypto assets usage and the regulatory implications for adoption, in view of the recommendations from international standard-setting bodies. Each phase culminated in a Board-approved research paper that will be used to guide the Commission's policy direction on the potential regulatory treatment of crypto assets.

Over the next period, the Commission will be submitting a report to the Anti-money Laundering Committee detailing the findings of the research and proposing a regulatory approach for the regulation and supervision of virtual assets (VAs) and virtual assets service providers (VASPs). The aim of the document is to assist the government in deciding on a policy position for the treatment of VAs and VASPs amid growing interests among stakeholders in the industry. It is expected that in the near future, the country will revise or enact new legislation to comply with the Financial Action Task Force (FATF) recommendation 15, that requires the regulation of VAs and VASPs for AML/CFT purposes.

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.

Turks and Caicos Islands Financial Services Commission

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PO Box 140 Caribbean Place
Leeward Highway
Providenciales
Turks and Caicos Islands
Telephone: (649) 946-5314

PO Box 79 Building C, Waterloo Plaza
Waterloo Road
Grand Turk
Turks and Caicos Islands
Telephone: (649) 946-2369
Email: fsc@tcifsc.tc
Website: www.tcifsc.tc