Financial Stability Report

June 2015

Issue No. 1

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EXECUTIVE SUMMARY

This is the first issue of the Turks and Caicos Islands Financial Services Commission's (FSC) bi-annual Financial Stability Report. The FSC is an independent statutory body tasked with the regulation and supervision of the financial services sector. It is also responsible for the oversight of company formation and registration.

Like many other financial sector regulators, the FSC recognizes the importance of assessing the financial system's inherent vulnerabilities and the likely impact of macroeconomic factors on the system. To this end, this report provides a range of financial analyses which include aggregated financial stability indicators as well as aggregated balance sheet and income and expenditure trends for the period ending June 2015. It is important to note that this assessment takes cognizance of the system as a whole and does not consider idiosyncratic impacts on individual financial institutions.

This report comes on the heels of an International Monetary Fund (IMF) mission to the Turks and Caicos Islands (TCI) in April 2015. The mission's purpose was to conduct an assessment of the financial sector in the TCI with the aim of identifying key sources of systemic risk and recommend appropriate policies to enhance system resilience to shocks and contagion.

Overall, the TCI economy is stable, reflecting the positive economic outturns in Canada and the U.S. during the review period. As this report reflects, the financial sector also remained stable over the period.

Over the six (6) month review period January to June 2015, total assets grew by 4.8%, mainly driven by growth in placements as loan growth softened. Assets were funded primarily by deposit inflows. The banking sector's total qualifying capital[1] grew by 0.5%, driven by transfers to statutory reserve fund. Notwithstanding capital growth, the sector's capital adequacy ratio declined

[1] Total qualifying capital as defined under Basel I and section 13 of the Banking Ordinance and the Capital Regulations.

marginally, as the growth in capital was overshadowed by a higher growth rate (5.7%) in risk-weighted assets.

The domestic insurance sector also remained buoyant, reflecting balance sheet growth of 12 percent ($5mn), with the 14.6 percent ($2.9mn) growth in investment assets accounting for a substantial portion of that increase. The domestic insurance sector reported overall net income of $1.83mn for the six-month period, 80 percent of which was attributable to general insurance business.

Government National Statistics at report date reveal that the financial sector was estimated to contribute 10.7 percent to the country's Gross Domestic Product (GDP) in 2014. Of this amount, the banking sector was projected to make the largest contribution to GDP – 7.9 percent, and non-bank financial institutions, the remaining 2.8 percent.

At end June 2015, total financial sector assets were estimated at $2.04 billion[2], a 4.4 percent increase over end December 2014 levels. Banks held the lion's share of that total with an estimated 87.2 percent ($1.8 billion), while non-bank financial institutions accounted for the remaining 12.8 percent.

The domestic financial sector is comprised of six (6) commercial banks, ten (10) trust companies forty-three (42) insurance licensees[3], and four (4) Money Service Transmitters.

[2] This amount could be slightly higher since the National Insurance Board's figure is at March 2014.

[3] Licensees include: Insurers, Agents, Brokers, Sub Agents and Principal Representatives.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

Global growth is projected at 3.3 percent in 2015, slightly lower than 2014. Performances are mixed with advanced economies showing signs of a gradual recovery while emerging markets and developing economies are decelerating. Lower than expected economic activity in North America in the second quarter of 2015 resulted in a downward outlook for 2015. The continued implementation of key economic drivers such as easy financial conditions, more neutral fiscal policy in the Euro area, lowers fuel prices, and improving confidence and labor market conditions, are expecting to accelerate economic activity in advanced economies. Factors such as lower commodity prices and tighter external financial conditions, structural bottlenecks, rebalancing in China, and economic distress related to geopolitical factors have contributed to the slower pace of economic activity in emerging markets. Tourism-based countries in the Caribbean generally continue to face weak economic growth when compared to that of commodity-dependent economies in the region.

As depicted in Table 1.1, growth in Canada is expected to decline in 2015 to 1.0 percent from 2.4 percent in 2014. Real GDP in the United States for 2015 is expected to reach its highest level since 2010 at 2.5 percent, and slightly above its 2014 growth of 2.4 percent. China’s economy continues to experience contraction from 10.4 percent in 2010 to 6.8 percent in 2015. The Euro area is recovering slightly from negative growths in 2012 and 2013 to 0.9 percent and 1.4 percent in 2014 and 2015 respectively. The United Kingdom has sustained growth rates at above 2.0 percent in the last four years except in 2012 when in was 1.2 percent. Growth for the U.K. is expected to slow down slightly to 2.5 percent in 2015 from 2.9 percent in 2014 – the highest growth level within the last five years.

The unemployment situation in all the selected developed economies in Table 1.1 is encouraging with declining rates. Japan has maintained the lowest jobless rate among this grouping at 3.5 percent while the Euro area with the highest projection at 11.0 percent in 2015.

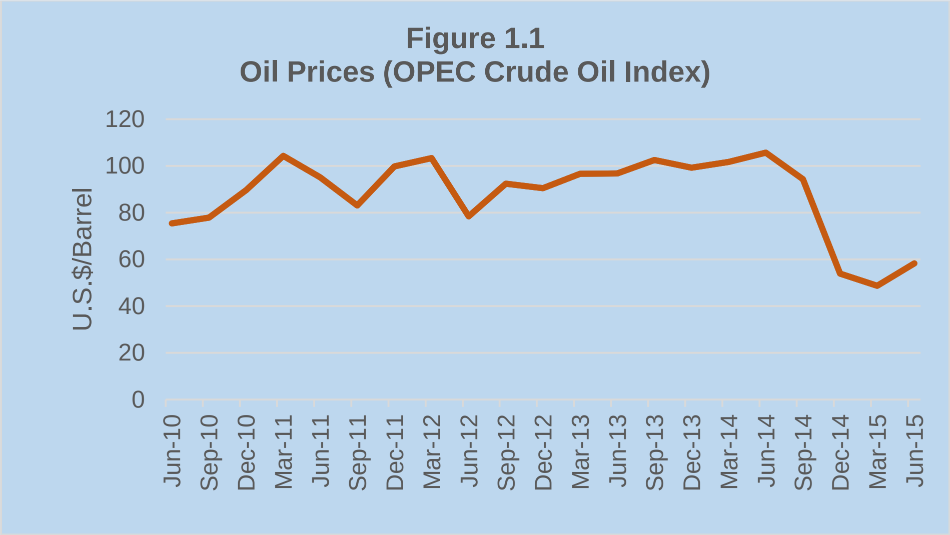
Table 1.1						
Selected Indicators for Developed Economies* (%)						
	2010	2011	2012	2013	2014	2015
GDP Growth Rates						
Canada	3.4	3	1.9	2	2.4	1.0
United States	2.5	1.6	2.2	1.5	2.4	2.5
Japan	4.7	-0.5	1.7	1.6	-0.1	0.6
United Kingdom	1.5	2	1.2	2.2	2.9	2.5
Euro area	2	1.6	-0.8	-0.3	0.9	1.4
China (People's Republic of)	10.4	9.4	7.8	7.7	7.4	6.8
Unemployment Rates						
	2010	2011	2012	2013	2014	2015
Canada	8.0	7.5	7.3	7.1	6.9	6.8
United States	9.6	8.9	8.1	7.4	6.2	5.3
Japan	5.1	4.6	4.3	4.0	3.6	3.5
United Kingdom	7.9	8.1	8.0	7.6	6.2	5.6
Euro area	10.2	10.2	11.4	12.0	11.6	11.0
China (People's Republic of)	5.1	4.6	4.3	4.0	3.6	3.5
Inflation Rates						
	2010	2011	2012	2013	2014	2015
Canada	1.8	2.9	1.5	1.0	1.9	1.0
United States	1.6	3.1	2.1	1.5	1.6	0.1
Japan	-0.7	-0.3	0.0	0.4	2.7	0.7
United Kingdom	3.3	4.5	2.8	2.6	1.5	0.1
Euro area	1.6	2.7	2.2	0.8	-0.2	0.7
China (People's Republic of)	3.3	5.4	2.6	2.6	2.0	1.5

* Estimates starts from 2014

Source: IMF World Economic Database, October 2015

Also depicted in Table 1.1 is the general decrease in consumer prices as portrayed by declining Consumer Price Indexes for all selected developed economies except for the Euro area, moving from -0.2 in 2014 to 0.7 in 2015. Japan experienced the largest one-year decline from 2.7 to 0.7.

Global decline in fuel prices is perhaps the major contributing factor for declining Consumer Price Indices. For instance, according to Figure 1.1, the price per barrel of crude oil fell precipitously from $105.69 in June 2014 to $58.27 in June 2015. The lowest recorded quarterly crude oil price within the last five years was in March 2015 at $48.73 per barrel.



Depicted in Table 1.2 is a weak and declining economic environment for the Caribbean region overall. The Dominican Republic and Antigua and Barbuda are expecting a 1.8 and 2.0 percentage point decline in growth respectively in 2015. In those economies with signs of improvements, the projected growth is miniscule at best -- Jamaica (0.7), Barbados (0.8), The Bahamas (0.2), and Trinidad and Tobago (0.2).

TABLE 1.2

Selected Latin American and Caribbean Countries GDP Growth Rates (%)

	2008	2009	2010	2011	2012	2013	2014	2015 (est)
Antigua and Barbuda	1.5	-10.7	-8.5	-1.9	3.6	1.5	4.2	2.2
The Bahamas	-2.3	-4.2	1.5	0.6	2.2	0.0	1.0	1.2
Barbados	0.4	-4.0	0.3	0.8	0.3	0.0	0.2	1.0
Belize	3.2	0.7	3.3	2.1	3.8	1.5	3.6	2.2
Dominican Republic	3.1	0.9	8.3	2.8	2.6	4.8	7.3	5.5
Guyana	2.0	3.3	4.4	5.4	4.8	5.2	3.8	3.2
Jamaica	-0.8	-3.4	-1.5	1.4	-0.5	0.2	0.4	1.1
Suriname	4.1	3.0	5.1	5.3	3.1	2.8	1.8	1.5
Trinidad and Tobago	3.4	-4.4	-0.1	0.0	1.4	1.7	0.8	1.0
Eastern Caribbean	2.1	-5.3	-3.5	-0.2	0.4	1.7	2.9	2.2

Sources: IMF, World Economic Outlook Database, October 2015 and Eastern Caribbean Central Bank

1.2 The Domestic Environment

The Turks and Caicos real economic sector shows signs of strength based on the limited available data. Real GDP growth was projected at 4.6 percent in 2014 compared to the 2013 estimate of 1.3 percent and -2.5 percent in 2012 (see Table 1.3).

Table 1.3

Turks and Caicos: Macroeconomic Indicators

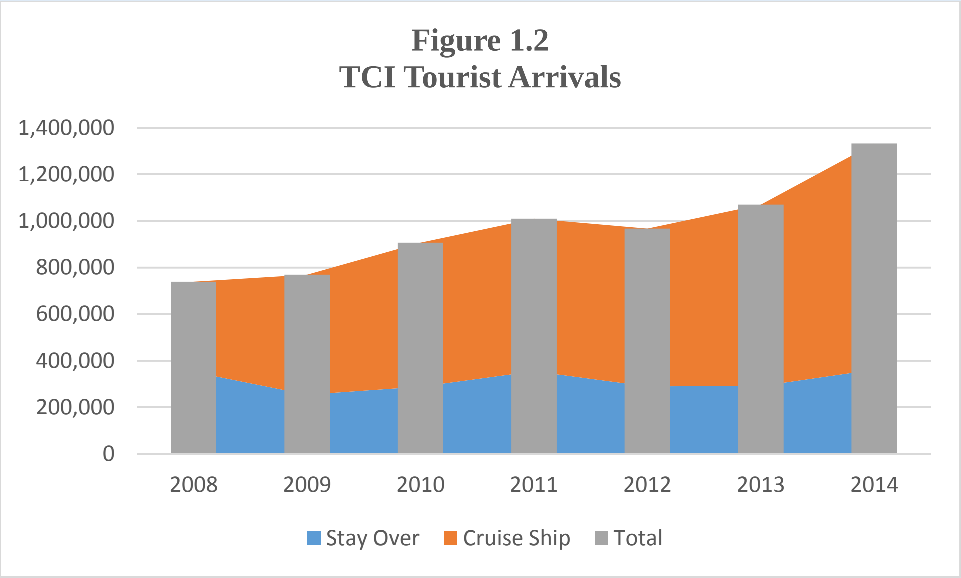
	2010	2011	2012	2013	2014	Jun-15
Nominal GDP Growth (%)	-2.3	6.1	-1.8	2.9	8.2*	n.a.
Real GDP Growth (%)	1.0	4.6	-2.5	1.3	4.6*	n.a.
Inflation Rate	3.2	5.2	3.11	2.5	2.0	n.a.
Unemployment Rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Privtae Sector Credit ('000s)		1060.2	1,048.4	1006.0	1,094.5	944.1
Total Public Debt ('000s)	188,475	214,586	214915	209,491	192,534	190,250
Tourist Arrivals ('000s)	907	1,010	967	1,071	1,332	n.a
Stay-over	288,702	354,223	290,236	291,695	360,653	n.a.
Cruise ship	617,863	655,497	676,647	778,920	971,838	n.a.

* projected

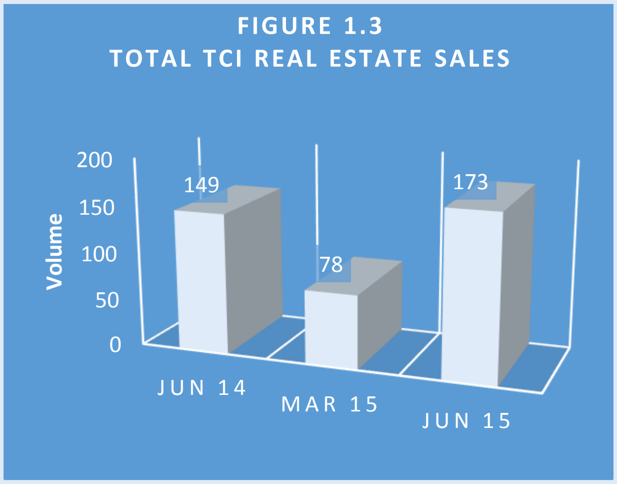
Sources: TCI FSC and TCI authorities.

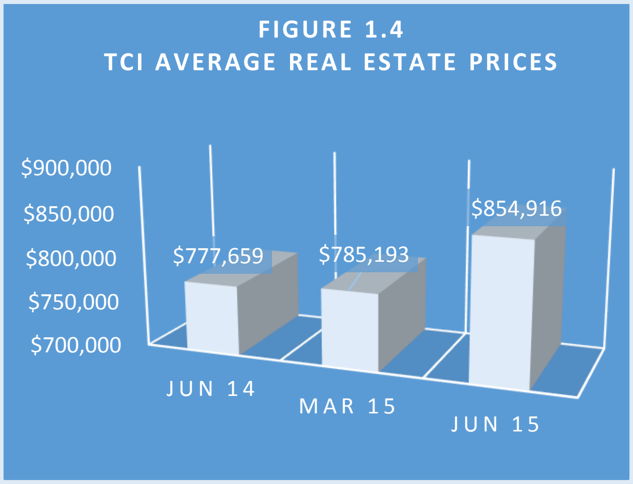
Tourism is the mainstay of the TCI economy. On average, that sector contributes just over 25 percent of the Government's annual recurrent revenue. The Continental North America typically accounts for approximately 90 percent of the tourism source market, with the United States representing roughly 80 percent of that share.

Tourist numbers have increased steadily overall since 2010 but more sharply for cruise ship visitors than for stay-over visitors (see Figure 1.2). Total arrivals surpassed the one million mark for the first time in 2014 of which 73 percent were cruise ship visitors.



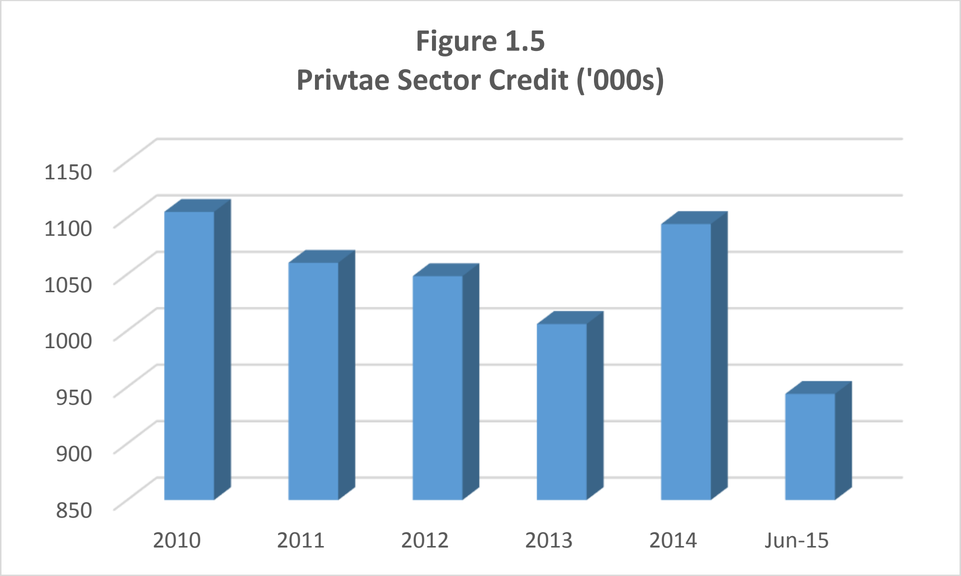
The tourism-related real estate sector[4] continues to show strength in the current period when compared to its performance a year ago and in the previous quarter. In terms of sales volume, there was a 16 percent jump in the current quarter compared to the same time last year and a 122 percent leap from last quarter. The increased demand in that sector has resulted in an upward pressure in the average price in the review period by 10 percent and 9 percent when compared to June 2014 and March 2015 respectively.





[4] The analysis represents 56 percent of the real estate market in the Turks and Caicos Islands as reported by the Turks and Caicos Real Estate Association

Consistent with the robust development in the real estate sector is the increased private sector credit in the financial sector since 2013. As seen in Figure 1.5 and in Table 1.2, private sector credit has steadily remained slightly above one billion dollars at least in the last five years. This increased trend is likely to sustain through 2015 based on mid-year figure of $944 million.



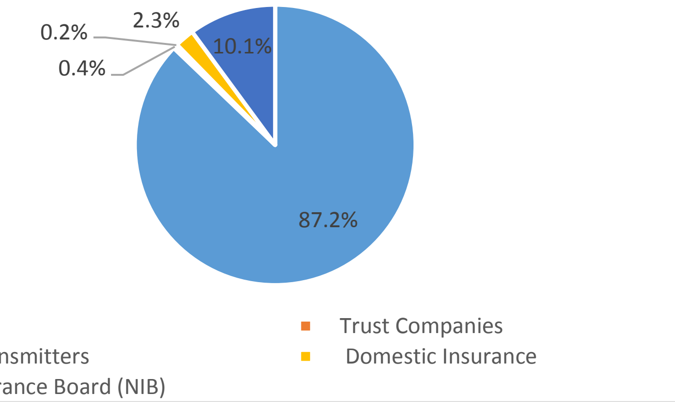
CHAPTER 2: THE FINANCIAL SYSTEM

2.1. Overview

The financial sector is the second largest in the TCI economy – contributing between 10.72% and 12.53% and averaging roughly 11.9% of overall economy, over the last eight (8) years.[5] The sector, though smaller than some of the other British Overseas Territories' (BOTs), is large relative to the size of economy, with domestic players' assets accounting for an estimated 253% of GDP, and the overall financial system (inclusive of offshore financial businesses) valued at close to 450% of GDP. The system has seen rapid growth in numbers in recent years, particularly among offshore businesses, as the TCI continues to establish itself as a popular domicile for niche U.S. manufacturer-owned offshore reinsurance companies called Producer Owned Reinsurance Companies (PORCs).

As at June 2015, the domestic financial sector comprised some sixty-two (62) firms, including banks, trust companies, insurance, money transmitters[6] and the National Insurance Board (NIB). At end June 2015, domestic system assets were estimated at $2.04 billion[7] with banks sharing 87.2% of that total followed by the National Insurance Board with 10.1% (see Figure 2.1).

Figure 2.1
Asset Composition of Financial Sector



[5] The latest available GDP data is a nominal projected figure of $797mn for 2014.
6 Three of the four were active.
7 This figure could be slightly higher since most recent data for the NIB was end March 2015.

2.2 Domestic Banks

Despite the departure of two (2) banks from the system, in 2010 and 2012, the domestic banking landscape continues to expand. The domestic sector, with its six (6) bank complement, is highly concentrated, with three (3) Canadian retail commercial banks controlling over 77% of market assets. Of the remaining players, all of which are also foreign-owned, two (2) specialize in providing wealth management services and the other is heavily engaged in wholesale banking.[8]

Following assessment in 2012, four (4) of the six (6) domestic banks were designated as Domestic Systemically Important Banks (D-SIBs), critical not only to the financial sector but to the overall economy, owing to their role in providing payment services, key public sector infrastructure support, and funding of recurrent expenditures for certain critical economic sectors.

Domestic banking operations have been primarily funded from deposits which are primarily employed towards loan origination and to a lesser extent, placements with financial institutions outside of the TCI, many of which support liquidity upstreaming to group affiliates.

2.3. Non-Bank Financial Institutions

2.3.1. Insurance Companies

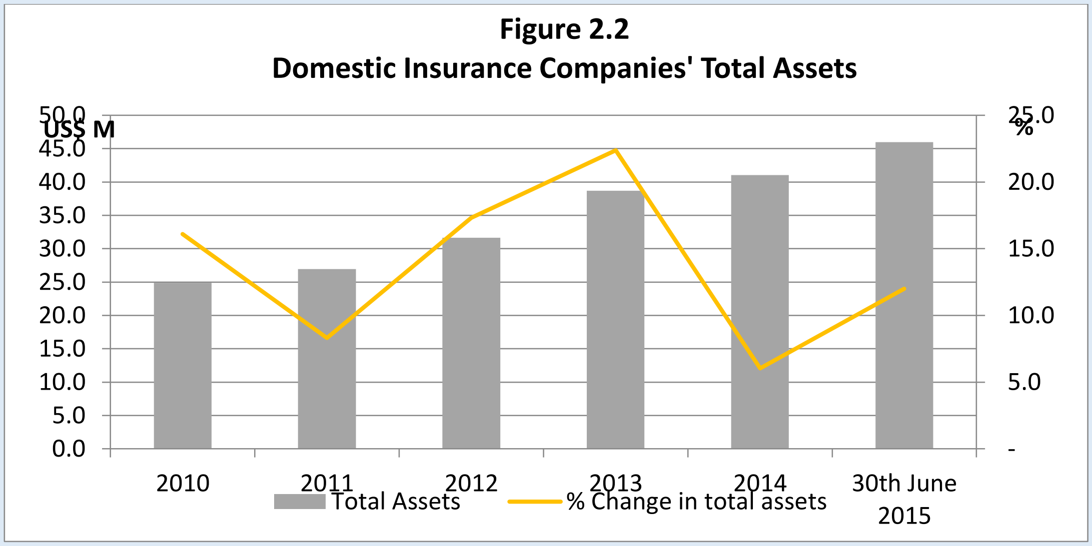
All Insurance Companies and Insurance Intermediaries licensed to operate in and from within the TCI are governed by the Insurance Ordinance (the Ordinance) and are regulated and supervised by the Financial Services Commission ("the Commission"). Secondary legislations governing the industry are the Financial Services Commission Ordinance and the Proceeds of Crime Ordinance. As at 30 June 2015, there were forty-two (42) domestic insurers and insurance intermediaries providing service to the residents of TCI, including personal, commercial and long-term insurance. Table 2.1 below shows the number of licensed domestic insurance entities in the TCI, 2010–2015

[8] There is one bank with an overseas (off-shore) license but is not considered systemically important as the bank does not transact business with residents of the Island, hence the risk to the local economy is minimal.

Table 2.1: Domestic Insurance Entities

	As at 31 December					30 June
	2010	2011	2012	2013	2014	2015
Domestic insurers	**41**	**43**	**45**	**48**	**45**	**42**
Domestic insurance companies	19	19	20	21	18	18
Life	*6*	*6*	*6*	*7*	*6*	*5*
Non-life	*12*	*12*	*12*	*12*	*10*	*11*
Composite insurers	*1*	*1*	*2*	*2*	*2*	*2*
Brokers	9	9	10	12	13	13
Agents	11	11	12	12	11	5
Sub-agents	2	4	3	3	3	6

Based on unaudited quarterly information submitted to the Commission, the value of the domestic insurance sector assets as at 30 June 2015 amounted to \$46.0mn, which reflects a 12 percent increase compared to 31 December 2014[9]. The total assets of the insurance sector have increased significantly over the 5-year period (2010-2015) as seen in Figure 2.2 below.



[9] The provisional figure for the Company that was placed in liquidation in early 2015 was excluded from total sector assets as at 31st December 2014.

During the 5 year period, the most significant increases in total assets of 17.3 percent and 22.4 percent were recorded for 2012 and 2013 respectively. This was a direct result of new entrants being granted insurance licences to operate in the market coupled with insurers being instructed to increase their assets held in the TCI.

2.3.2. Trust Companies

Corporate trust business carried out in and from the TCI is regulated pursuant to the Trust Ordinance (2014 Revision) and the Trustees Licensing Ordinance and the Trustees Licensing Regulations (2014 Revision) which provide for restricted and unrestricted licenses to be granted.

All persons and companies, who receive remuneration for their services as a trustee and who have been appointed expressly or under a power of appointment act as trustees, executors or both, are deemed to be professional trustees and are required to hold the appropriate license.

From the period December 2011 to December 2014, eight (8) trust companies ceased operations in the TCI: five (5) by voluntary liquidation, two (2) by Court ordered liquidation and one (1) by enforcement action.

As at June 30, 2015, ten (10) trust companies were licensed to conduct unrestricted professional trust business. The sector's total consolidated assets amounted to US$15.6 million, reflecting a 2.2 percent decline when compared with December 31, 2014.

Following the departure of one trust company in December 2014, the total assets under the stewardship of TCI Trustees declined to US$783 million as at June 30, 2015 from US$837 million recorded at the end of December 2014.

2.3.3. Money Transmitters

In the TCI, Money Services Businesses (MSBs) cater primarily to the expatriate populace and must be licensed by the FSC. The number of these licenses in effect decreased to four (4) as at June 30, 2015, from five (5) in December 2014. Total aggregate assets amounted to $2.1 million as at June 30, 2015, which reflects a 29 percent increase when compared with December 31, 2014.

Remittance outflow from these entities for the period January – June 2015 amounted to US$43 million, a 7.5 percent increase when compared with the US$40 million for the same period in 2014.

Haiti was the largest recipient of remittances from the TCI for the period January to June 30, 2015, with 31 percent of the total remittance outflow from the TCI.

Remittance inflow to TCI through the MSBs totaled US$3.2 million, of which 46 percent was from the United States of America in the review period.

2.3.4. National Insurance Board (NIB)

The National Insurance Board is the largest non-bank financial institution in the Turks and Caicos Islands. This institution has demonstrated steady asset growth since its inception in 1992. Its asset base increased from $144.4 million in 2010 to $183.9 million in 2013. Total assets stood at $205.5 million as at March 2014 – an 11.7 percent jump from one year prior.

CHAPTER 3: THE BANKING SECTOR

3.1. Overview

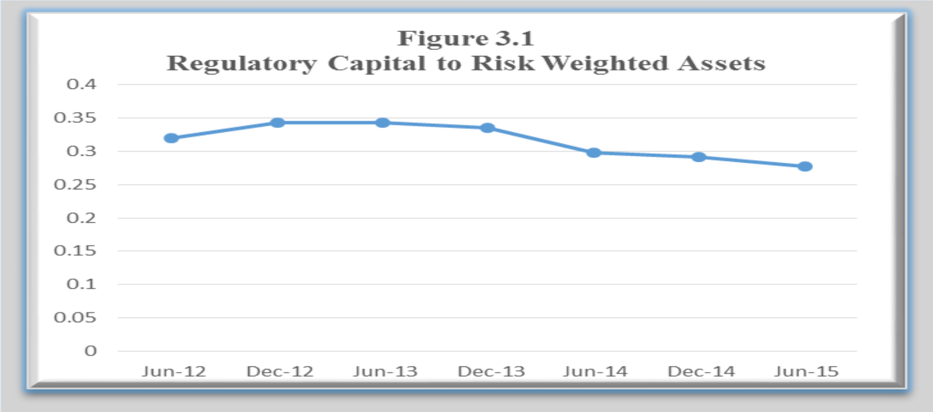
The banking sector in the Turks and Caicos Islands (TCI) consists of seven (7) banks, of which six (6) holds both national and overseas banking licenses and the other holding only an overseas banking license. The assets of the overseas (offshore) banking sector totaled $58.3M at the end of June 2015 when compared to the $63.5M reported at the end of December 2014. In contrast, the assets of the national (domestic) banking sector totaled $1,777.7M at the end of June 2015 relative to the $1,696.8M at the end of December 2014. The focus of this report is on the onshore banks (domestic banking sector), as the offshore bank (with an overseas banking license) is prohibited from doing business with residents of the TCI, hence the risk to the local economy is minimal.

3.2. Onshore/Domestic Banking Sector

All banks in the local banking sector are foreign owned with diverse operational structures. Two (2) of the six (6) banks are stand-alone banking entities, two (2) are subsidiaries of overseas banking groups and the other two (2) are branches of subsidiary banks in the Bahamas. The sector is highly concentrated, with the two (2) largest banks controlling more than seventy percent (70%) of the sector's total assets. Domestic banks are primarily funded by deposits and invest mainly in residential mortgages and placements with financial institutions outside of the TCI.

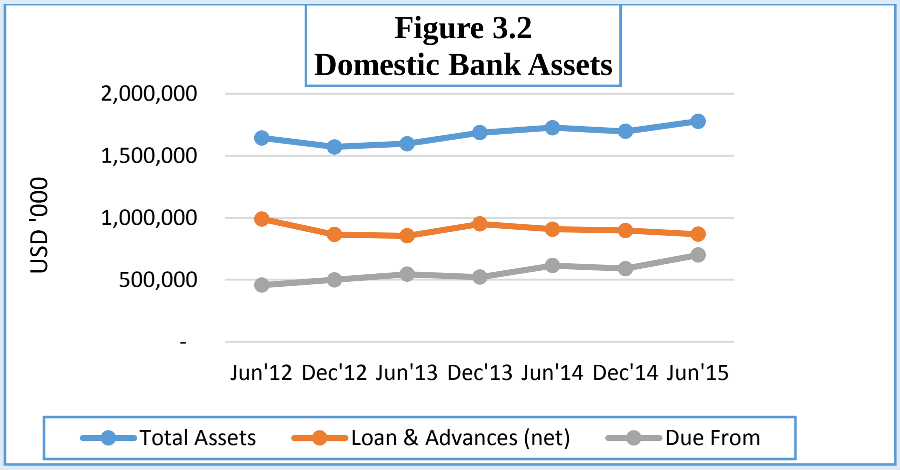
3.3. Capital Adequacy

The aggregate risk-weighted Capital Adequacy Ratio (CAR) was computed at 27.7% at the end of June 2015, compared with the 29.1% at the end-December 2014. Notwithstanding the downward movement, domestic banks remained adequately capitalized, as these ratios were well above the statutory minimum (11%) and international standard. (Refer to figure 3.1 for the historical trend of the capital adequacy ratio.)



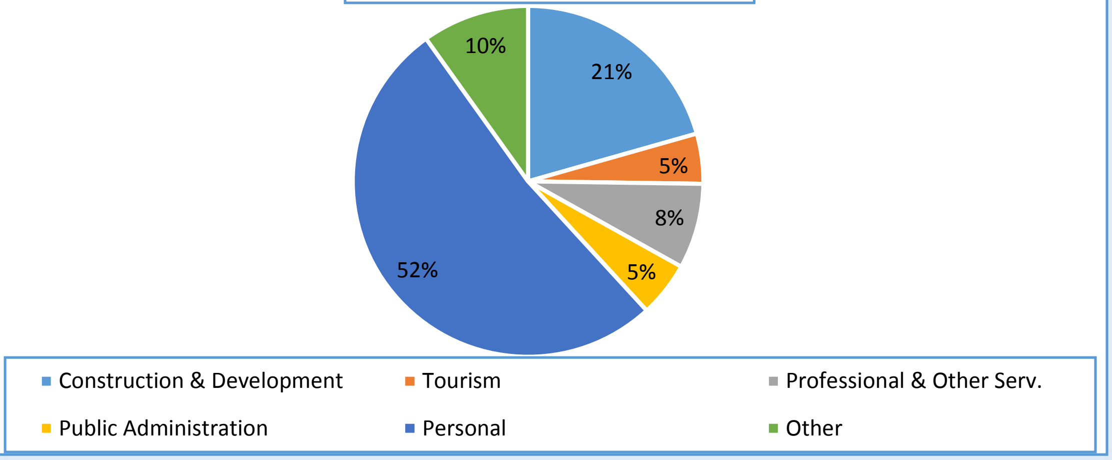
3.4. Growth of Assets

Total domestic assets (net) in the banking system increased by $80.7 M or 4.8% to $1.8B in June 2015 relative to December 2014. Growth in total assets emanated mainly from an $110.6M or 18.8% incease in balances due from financial institutions which was tempered by a $29.9M or 3.3% decline in net loans and advances - the largest asset category (refer to Table 3.1). Net loans and advances declined over the period as a result of a general decelaration in loan origination as well as increased provisioning. In the context of lower funding requirements for loan financing, banks have increased placements at other financial institutions (Figure 3.2). As at June 2015, the majority of credit exposure in the banking system continued to be concentrated in the Personal Loans category (52%) which comprised residential mortgage loans, credit cards and other personal loans (Figure 3.3).



Total investments declined by $100.7M or 77.2% in light of a reclassification of investment securities (Table 3.1). These reclassified investments were previously reported in 'other assets' and were primarily responsible for the more than threefold increase in the category during the period.

Figure 3.3
Loans & Advances by Sector



Total domestic assets as at June 2015 included Loans & Advances (48.8%), followed by Due From financial institutions (39.3%), other assets (8.5%), investments (1.7%), cash (0.9%) and fixed assets (0.7%). The composition of total domestic assets in the banking system throughout June 2012 – June 2015 is presented in Table 3.1.

Table 3.1

Summary of Total Domestic Assets of the Banking System (June 2012 - June 2015)

US$'000	Jun'12	Dec'12	Jun'13	Dec'13	Jun'14	Dec'14	Jun'15	Jun'15/Dec'14
Cash	15,782	18,831	14,689	36,744	17,716	20,947	18,283	-12.7%
Loan & Advances (net)	989,385	864,127	853,838	949,267	907,069	897,159	867,256	-3.3%
Investments	124,372	128,076	119,290	122,681	128,184	130,446	29,701	-77.2%
Due From	456,216	498,595	543,649	520,613	613,444	588,517	699,099	18.8%
Financial Institution in the TCI	*4,147*	*1,822*	*5,014*	*1,916*	*7,581*	*6,005*	*12,362*	105.9%
Financial Institutions outside the TCI	*452,069*	*496,773*	*538,635*	*518,697*	*605,863*	*582,512*	*686,737*	17.9%
Other Assets	39,832	44,948	51,752	42,886	46,179	46,343	149,556	222.7%
Fixed Assets	17,888	16,880	14,609	14,187	13,990	13,545	13,780	1.7%
Total Assets	1,643,475	1,571,457	1,597,827	1,686,378	1,726,582	1,696,957	1,777,675	4.8%

3.5 Asset Quality

Asset quality, as measured by the ratio of non-performing loans (NPLs) to total loans, improved marginally to 17.3% at the end of June 2015 relative to 18.3% in December 2014 (Figure 3.4). This improvement was attributed to the larger decline in NPLs relative to total loans. NPLs declined by 7.6% to $163.6M as banks continued to implement various measures to reduce their credit risk exposure. The lower NPLs primarily resulted from reduction in arrears in the Personal and Construction & Development sectors.

The sectoral distribution of NPLs, however, remained relatively unchanged, with the Construction & Development sector accounting for the lion's share of total NPLs (47%), followed by Personal (34%) and Tourism (7%). (Refer to Figure 3.5).

Encouragingly, the ratio of provisioning to NPLs increased to 46.9% in June 2015 from 41.0% in December 2014, which was a result of a decline in NPLs coupled with the 5.5% percent increase in provisioning.

Figure 3.4
Ratio of NPL to Total Loans

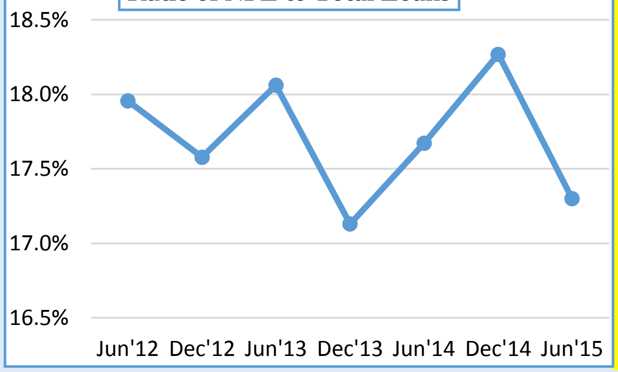
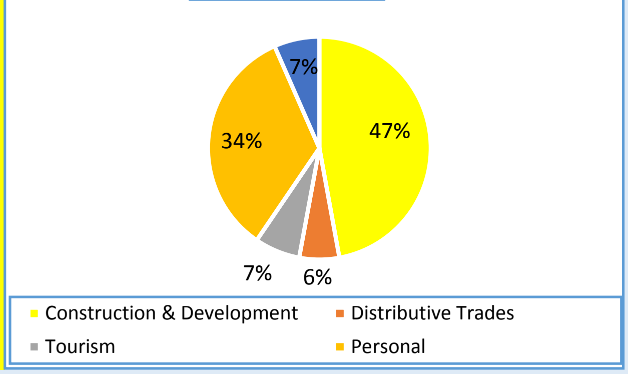
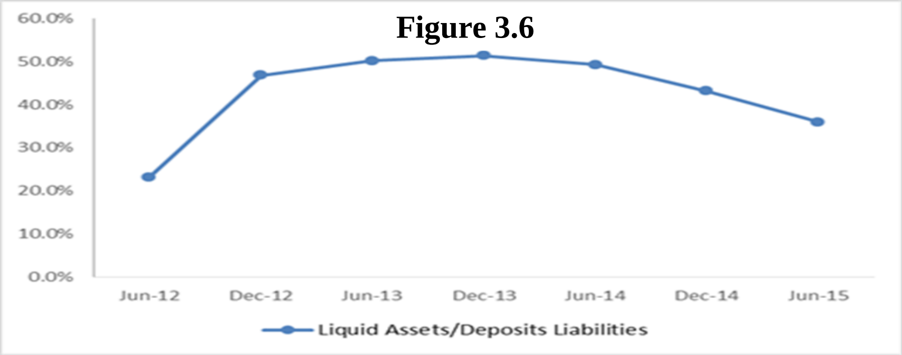


Figure 3.5
NPLs by Sector



3.6. Liquidity

Liquidity in the banking system, as measured by the ratio of liquid assets to total deposits liabilities, continued on a downward trajectory. (Refer to Figure 3.6 below). The ratio was recorded at 36.0% in June 2015, well above the 12.0% statutory minimum requirement, but below 43.2% in December 2014, as a result of an in increase in deposit liabilities.

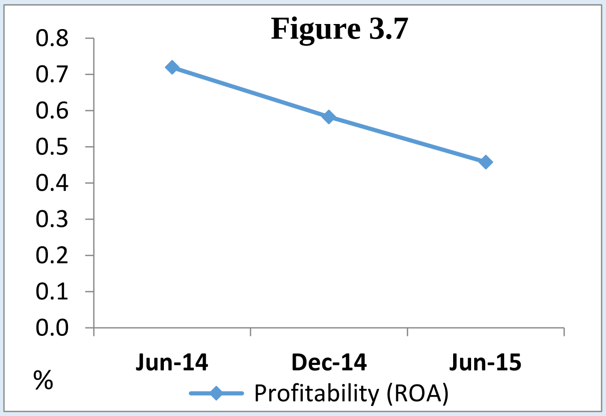


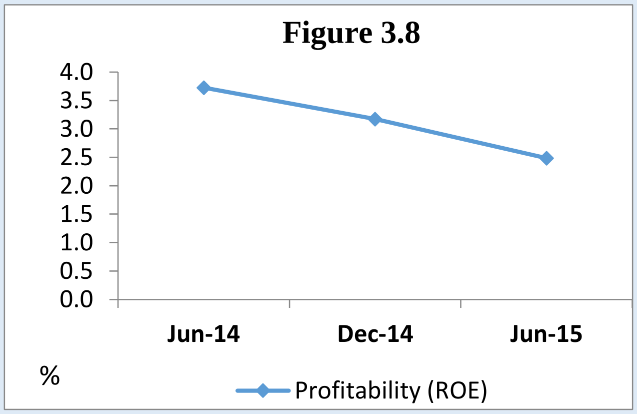
The outlook for the system liquidity remains positive, especially with the recent strengthening of the prudential liquidity requirements, the beginning effects of which should become evident in the second quarter of 2015.

3.7 Profitability

Profitability in the banking system declined by $2.0M or 20.3% to $8.0M for the six (6) months ended June 2015, when compared with the six (6) months ended December 2014. This reduction in profits was attributed to lower total income of 6.5% ($2.7M), tempered by a 2.2% ($0.7M) decline in total expenses. Interest income had an 11.2% ($3.1M) decline, which was the main contributing factor to the fall in profits during the period under review.

Consistent with the reduction in profitability, Return on average Assets (ROA) declined marginally to 0.5% in June 2015 from 0.6% in December 2014. Return on average Equity (ROE) was recorded at 2.5%, which reflected a 70 basis points decline from 3.2% in December 2014. (Refer to Figure 3.7 and 3.8 for historical trend in the ROA and ROE, respectively.)





3.8. Loan Rates

As shown in Table 3.2, loan interest rates in the banking system ranged from 0.17% to 18% with residential mortgages at the lower end of the range and consumer loans at the higher end.

Table 3.2

Banking System Loan Rates (%)

	Jun-12		Dec-12		Jun-13		Dec-13		Jun-14		Dec-14		Jun-15	
	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max
Lending Rates														
- Prime/base rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	0.24	7.50	0.19	7.50
- Residential mortgages*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.17	14.25
- Commercial mortgages*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	2.42	12.00
- Consumer loans*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1.00	18.00
- Other loans	2.30	26.99	2.30	26.99	2.30	26.99	2.30	26.99	1.00	21.00	1.00	21.00	1.88	12.50
- Weighted average rate (on all loans)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1.51	11.01

Source: TCI Financial Services Commission - Banking Department

Note: * Data collection on loan categories and weighted average loan rate was introduced in quarter ended March 2015.

3.9. Deposits Rates

Interest rates on demand and savings deposits in the domestic banking system showed a decline relative to the rates at end-December 2014. Rates on time (fixed) deposits with longer term maturity (six - twelve months) fell by 25 basis points while rates on time deposits with original maturity of six (6) months or less, increased by 15 basis points to 2.5%. (Refer to Table 3.3)

Table 3.3

Banking System Deposit Rates (%)

	Jun-12		Dec-12		Jun-13		Dec-13		Jun-14		Dec-14		Jun-15	
	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max
Demand Deposits	0.00	1.00	0.00	1.00	0.00	1.00	0.00	1.00	0.00	1.00	0.00	1.00	0.00	0.50
Savings Deposits	0.05	0.50	0.05	0.50	0.05	0.50	0.05	0.50	0.05	0.50	0.05	2.35	0.05	0.40
Special Deposit Rates (if any)	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Time Deposits														
- Up to 3 months	0.02	4.75	0.02	4.75	0.02	4.75	0.02	4.75	0.02	4.75	0.02	2.35	0.02	2.50
- Over 3 months to 6 months	0.04	4.75	0.04	4.75	0.04	4.75	0.04	4.75	0.04	4.75	0.04	2.35	0.04	2.50
- Over 6 months to 12 months	0.05	6.50	0.05	6.50	0.05	6.50	0.05	6.50	0.05	6.50	0.05	3.00	0.08	2.75
- Over 12 months	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.12	3.00

Source: TCI Financial Services Commission - Banking Department

3.9 Stress Testing Analysis

Following the global financial crisis, regulators have sought to develop and enhance their capacity to undertake robust forward-looking approaches to risk management, particularly through the use of stress testing[10] as an analytical tool to determine the potential effects of simulated shocks at varying severities on the financial stability of an institution or system. It is employed complementary to other regulatory approaches to determine appropriate prudential benchmarks and develop suitable resolution mechanisms to treat with potential severe occurrences.

The FSC has recently incorporated the use of stress testing as a predictive tool into its supervisory programme, with initial focus on credit risk and its potential impact on bank capital. Liquidity risk will be incorporated in the short to medium term future.

Credit Risk

Credit risk is the risk that a borrower or counterparty will fail to meet its obligation as it becomes due. Stress testing of credit risk involved analyzing how the downward migration of credit, particularly non-performing loans (NPLs), is likely to result in provisioning shortfalls as well as impact overall compliance with the statutory requirement for maintenance of 11% CAR.

The results[11] of stress test conducted on the following scenarios were:

- *Increase in NPLs*
  NPLs were stressed *for increases* of 100%, 200% and 300%, with 100% provisioning required for the resulting post-shock increase in NPLs. At the 100% and 200% shock levels, the banking sector recorded post-shock CAR of 19.3% and 11.8% respectively, down from 27.7% but above the 11% statutory limit. Applying a shock of 300% would however see reduction of the sector's CAR to 2.8% and would require capital injection of $70.8M for restoration to the statutory limit.
  (*Refer to Figure 3.9) for pre- and post-shock CARs relating to 'Increase in NPLs' scenarios.*)

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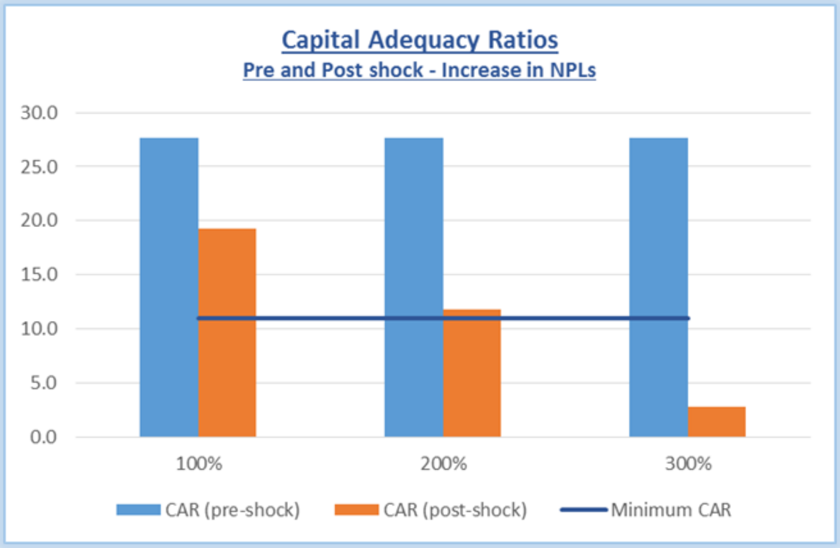
[10] Basel Committee on Banking Supervision Principles for Sound Stress Testing Practices and Supervision 2009.
[11] Results are provisional. The FSC is still refining its stress testing methodology and data parameters of the model.

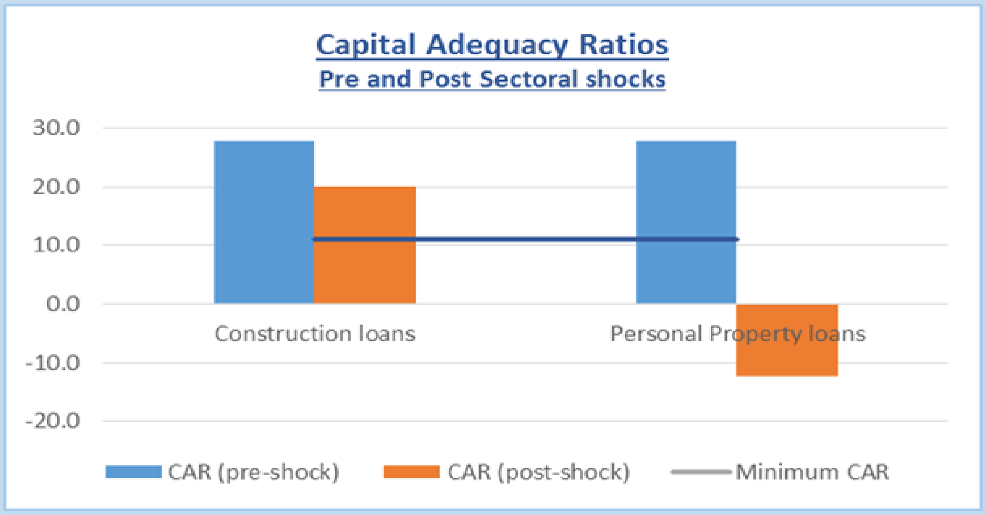
Figure 3.9



- *Sectoral shocks to NPLs*

  This stress scenario assumed a 100% migration of Construction & Development and Personal Property loans to NPLs, with 100% provisioning required for each category. Shock to the construction sector resulted in deterioration of that sector's CAR to 20.1%, down from 27.7%. A similar shock to Personal Property loans would result in complete erosion of capital, and the sector's CAR falling to -12.4%, with approximately $175.0mn capital injection required to meet the 11% statutory limit. Refer to Figure 3.10 for CAR – pre-and post-sectoral shocks.

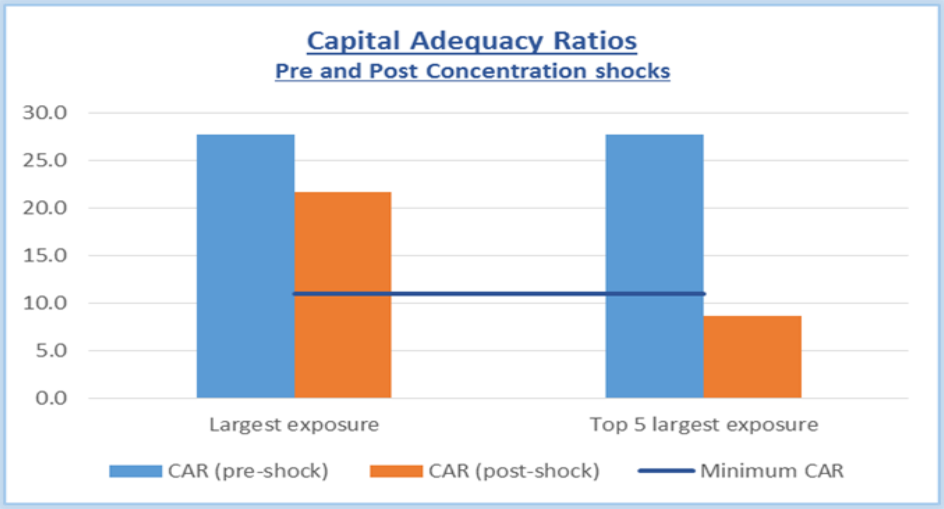
Figure 3.10



- *Credit concentration shocks to NPLs*

Large exposure shocks highlight the high levels of concentration risk within sector. Assuming default by each individual bank's largest credit exposure to a single person or group of related persons, the sector's CAR would re-compute at 21.7%, down from 27.7%. Given default by the top five (5) of each bank's exposure to *a* single person or group of related persons, the sector's CAR would re-compute at 8.6%, requiring additional capital injection of $21.9mn to satisfy the 11% statutory limit. Refer to Figure 3.11 for CAR - pre and post sectoral shocks.

Figure 3.11



Liquidity Risks

Liquidity risk is the likelihood that a bank will be unable to access funding on a timely basis and at a reasonable cost. The potential for liquidity implications in the TCI is compounded by the lack of a lender of last resort to provide short-term lending or a deposit insurance mechanism to augment financial system confidence and provide financial assistance. The FSC will be incorporating liquidity risks in its stress-testing program to determine the number of days a bank may be able to endure adverse liquidity event before depleting its stock of liquid assets.

CHAPTER 4: THE INSURANCE SECTOR

4.1 Overview

The number of licensees conducting domestic insurance business decrease by 3 compared to 31 December 2014. Based on an application presented to the Supreme Court of the TCI by the Commission, one life insurer was placed in liquidation during January 2015. This resulted in the cancellation of the licences of one life insurer and its' six insurance agents. However, licences were issued for one non-life insurer and three insurance sub-agents during the period under review. The domestic sector comprised eighteen domestic insurers: five life insurers providing cover for ordinary life, group life and sickness and health; eleven non-life insurers providing cover for property, motor vehicle, marine aviation and transport, liability and personal accident; and two composite insurers providing cover for ordinary life, group life, creditor life and creditor health insurance. A composite insurer is licensed to underwrite both life and non-life insurance. The sector continues to be dominated by a few insurers: one life insurer and five non-life insurers. Overall, the domestic insurance sector experienced positive growth with higher levels of assets and net income recorded despite the reduction in the number of licensees.

As at June 2015, there were a total of 6,373 international insurance licensees. This sector includes specialist Captive Insurers, Producer Owned Reinsurance Companies ("PORCs") and Insurance Managers.

4.2 Life Insurance

Quarterly information received showed a 1.3 percent growth in the total assets of the domestic sector despite the fact that one insurer was placed in liquidation. Life insurance business accounted for only 17.3 percent of the total assets for the sector. The two largest line items reported on the Balance Sheet were Cash and Bank Balances and Retained Earnings. As at 30 June 2015, Cash and Deposit increased by 15 percent compared to 31 December 2014 as insurers put measures in place to ensure that they were in compliance with Section 8 (3) of the Ordinance which requires insurers to have sufficient funds, cash, short term securities or other realizable investments approved by the Commission, in the TCI to match current liabilities, life insurance funds and annuity funds. Amounts held as Cash and Deposit of $6.4mn represented 79.9 percent of Total

Assets. The Retained Earnings for the sector have shown significant improvement as there were positive returns for 2014 and 2015. The positive return in 2014 was influenced by the exclusion of the figures for the Company that was placed in liquidation in January 2015. During the first half of the year Total Liabilities declined by 34.9 percent to $1.4mn and represented the lowest amount recorded by the life insurance industry during the 5-year period 2010 to 2015. Total equity which consists of Share Capital/Head Office Account and Retained Earnings grew by 97 percent as a result of insurers injecting cash into their TCI operations to ensure compliance with the Restricted Deposit requirement. In accordance with the Restricted Deposit guidelines issued by the Commission, insurers are required to maintain term deposits in a local bank; the amounts are held to the order of the Commission and cannot be reduced or released without written permission from the Commission.

Gross Premiums Written by life insurers amounted to $1.5mn and of this amount 68.5 percent was ceded to reinsurers. Reinsurance is a risk management tool used by insurers to reduce its insurance risks, improve its ability to withstand financial shock, reduce the volatility of its financial results and to use its available capital more efficiently. Creditor life insurance was the key component of the life insurance market and represented 64.6 percent of Gross Premiums Written. The life insurance sector is dominated by one insurer, accounting for 73.1 percent of Gross Premiums Written. The sector's profitability continued to improve with reported profit of $0.30mn for the six month period under review compared to $0.49mn for the year ended 3[1] December 2015.

Majority of the aggregate financial indicators for the life sector have improved for the period under review. The 97.0 percent increase in capital mentioned above resulted in significant improvements in the net premium to capital ratio and the capital to total assets ratio. The capital to technical reserves ratio increased by 92 percentage points as a result of the higher levels of capital in the sector coupled with a 31.5 percent decrease in technical reserves. The receivables to gross premiums and reinsurance recoverable ratio increased by 22.7 percentage point because the gross premiums used in the calculation was for six months compared to twelve months for the prior period. The expense ratio declined by 3.2 percentage points due to reduced expenditure reported by the sector. The low ratios reported for investment income to net premiums and investment assets were reflective of the low interest rate environment in the TCI.

Table 4.1: Financial Soundness Indicators

Life Insurers Financial Soundness Indicators						
	2010	2011	2012	2013	2014	June 2015
Capital adequacy						
Net premium/capital	126.1%	594.1%	11908.4%	479.2%	433.0%	59.9%
Capital/total assets	14.4%	17.0%	0.3%	6.6%	5.9%	11.6%
Capital /technical reserves	10.5%	13.2%	0.3%	6.4%	49.1%	141.1%
Asset quality						
(Unquoted equities+ receivables)/total assets	13.8%	5.0%	4.0%	6.4%	12.5%	9.5%
Receivables//(gross premium + reinsurance recoveries)	34.4%	6.5%	5.8%	12.0%	22.3%	45.0%
Equities/total assets	1.6%	4.3%	5.5%	5.2%	0.0%	0.0%
Earning and profitability						
Expense ratio (expenses/net premium)	35.4%	14.6%	48.1%	47.0%	42.9%	38.8%
Investment income/net premium	1.7%	0.8%	2.6%	3.2%	0.7%	2.2%
Investment income/investment assets	0.7%	1.5%	2.0%	1.8%	30.0%	0.2%
ROE (return on equity)	20.9%	6.6%	-15.5%	13.9%	8.7%	5.5%

4.3 Non-life Insurance

Preliminary data for the six months ending 30 June 2015 showed that total assets in the non-life domestic sector increased by 14.6 percent to $33.0mn. This improvement in the balance sheet signals a steady growth in the non-life sector. In addition, the non-life insurance sector was responsible for a substantial share (82.7 percent) of the domestic sector's asset. The two largest items reported on the Balance Sheet were Cash and Bank Balances and Technical Provisions. The significant increase in the sector's assets was as a result of a 14.2 percent ($2.0mn) increase in Investment Assets. The major component of the increase in Investment Assets was a 10.9 percent ($1.6mn) increase in Cash and Cash Balances as insurers put measures in place to ensure that they were in compliance with Section 8 (3) of the Ordinance. Additionally, amounts held as Cash and Bank Balance represents 41.7 percent of Total Assets. There are limited investment opportunities available in the TCI and as a result insurers sought to diversify their investment portfolio which led to $0.46mn being invested in Equity and Corporate Bonds. During the first half of the year total liabilities increased by 3.9 percent to $26.9mn, compared to 31 December 2014. This was influenced by a 17.8 percent increase in Technical Reserves which was offset by a 52.7 percent reduction in Payables to Related Parties. As at 30 June 2015, Technical Provisions of $22.2mn was the largest item on the balance sheet and includes provisions for items such as unearned premiums, unexpired risks and outstanding claims.

Non-life insurance business has always contributed the lion's share of the domestic sector's Net Income and generated 80.0 percent of net income for the period under review. Gross Premiums Written by the non-life insurance sector was $17.3mn with 65.8 percent of this amount being ceded to reinsurers. Property and Motor Insurance were the major contributors to Gross Premium Written for the period, accounting for 65.2 percent and 17.0 percent respectively. However, Property is heavily reinsured and contributed only 21.8 percent to the Net Premiums Written whilst Motor policies contributed 39.9 percent. The non-life sector is highly competitive with 17.0 percent of Gross Premiums Written attributed to one insurer, four insurers had market share ranging from 10.0 percent to 16.0 percent, while the remaining insurers had market share ranging from 4.0 percent to 6.0 percent.

Overall, the capital adequacy indicators for the non-life sector have improved compared to 31 December 2014. The ratio of net premiums to capital declined by 108.4 percentage points, indicating a lowering of risk arising from insurance operations and was the lowest recorded during the 5-year period. Additionally, there was a 12.1 percentage point increase in the capital to total asset ratio reflecting an injection of capital into the sector. The increase in capital also accounted for the improvement in the capital to technical reserves ratio.

There was an overall improvement in the earnings and profitability ratios for the non-life sector. The expense ratio showed the greatest improvement, reflecting a decrease of 27.4 percentage points as the net premiums recorded for the period under review increased at a faster rate than expenditure. Additionally, the loss ratio improved by 15.8 percentage points to 17.0 percent and is considerably lower than the international maximum benchmark of 100 percent. However, the return on equity (measured as net income divided by capital) declined by 20.3 percentage point as a result of the improvement in the capital base of the sector, *in addition to the lower net income recorded for the 6-month period.*

Table 4.2: Financial Soundness Indicators

Non-Life Insurers Financial Soundness Indicators						
	2010	**2011**	**2012**	**2013**	**2014**	**June 2015**
Capital adequacy						
Net premium/capital	186.5%	254.0%	318.3%	413.5%	215.4%	107.0%
Capital/total assets	20.3%	14.0%	11.6%	9.3%	12.5%	24.6%
Capital (excluding unrealized gains)/technical reserves	39.4%	23.3%	20.7%	16.8%	22.1%	42.1%
Asset quality						
(Unquoted equities +receivables)/total assets	26.4%	21.7%	20.1%	13.0%	14.4%	13.4%
Receivables/(gross premium +reinsurance recoveries)	21.1%	17.1%	14.3%	10.0%	12.5%	17.3%
Equities/total assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.6%
Earning and profitability						
Loss ratio (net claims/net premium)	29.9%	43.8%	29.9%	30.2%	32.8%	17.0%
Expense ratio (expenses/net premium)	30.7%	32.3%	55.9%	53.7%	50.3%	22.9%
Investment income/net premium	1.7%	23.8%	5.9%	2.4%	0.9%	1.4%
Investment income/investment assets	1.3%	21.3%	5.5%	2.3%	0.5%	0.8%
ROE (return on equity)	48.6%	16.6%	43.5%	25.0%	33.5%	13.2%

4.4 Insurance Brokers

As at 30th June 2015 there were thirteen domestic insurance brokers licenced to carry on insurance business in the TCI. During the first half of the year, no insurance broker licence was granted, however, two licensed insurance brokers were not actively trading.

The Commission issued a directive for all domestic insurance brokers to submit audited financial statements effective for the year ended 31st December 2014. A review of the audited financial statements for the year ended 31st December 2014 revealed total assets of $14.7 million and total liabilities of $10.5 million. Accounts receivables and cash and deposits were the two largest asset categories reported, representing 31.7% and 23.0% of total assets respectively. Total revenue of $5.6 million was generated for the year ending 31st December 2014, however; this was eroded by expenses of $5.9 million resulting in a net loss of $0.2 million.

Table 4.3. Condensed Balance Sheet and Income Statement for the year ended 31st December 2014

Balance Sheet	$'000	Income Statement	$'000
Cash and Investments	3,392	Commission Income	4,970
Accounts Receivable	4,670	Other Income	605
Other Assets	6,667	**Total Revenue**	**5,575**
Total Assets	**14,729**	Operating Expense	**5,783**
Accounts Payable	3,943	**Net Income/(Loss)**	(208)
Loans Payable	3,025		
Other Liabilities	3,548		
Total Liabilities	**10,516**		
Capital & Reserves	4,213		
Total Liabilities, Capital & Reserves	**14,729**		

4.5 International Insurance

International Insurers provide insurance and reinsurance services to residents of other jurisdictions and the risk that is being insured is not situated within the TCI. This sector includes Captive Insurers, Producer Owned Reinsurance Companies ("PORCs"), and Insurance Managers and is by far the largest sector by number of insurance licensees. The Commission does not collect data on the international sector except for the number of active licences.

For the period January to June 2015, the international sector grew by 4.1 percent compared to 31 December 2014, with credit life PORCs accounting for a significant percentage of the increase. Captive insurers declined by 4.3 percent to 66, however, Insurance Managers remained unchanged at 7 licensees for the period.

Table 4.4. TCI International Insurance Licensees

	As at 31 December 2015	As at 30 June 2015
PORCs		
- Credit Life	5,529	5,838
- Non- Credit Life	517	462
Total PORC's	**6,046**	**6,300**
Captives	69	66
Total International insurers	**6,115**	**6,366**
Insurance Managers	7	7
International Licensees	**6,122**	**6,373**

For the six month period ending 30 June 2015, 319 international insurer licences were issued, a decrease of 17.6 percent compared to the same period for 2014. Of the 319 international licences issued 318 were issued to PORCs as follows, 299 credit life and 19 non-credit life. Additionally, 10 non-credit life companies were converted to credit life companies. During the period a total of 68 licences were surrendered. Table 4.5 provides a summary of the movements in international insurance licensees for the period January to June 2015.

Table 4.5: Movements in the number of International Insurance Licensees

International Insurance Licensees for the period 1 January 2015 to 30 June 2015					
Description	**Total**	**PORCs**		**Captives**	**Insurance Managers**
		Credit Life	**Non-Credit Life**		
New licences issued	319	299	19	1	-
Conversion	-	10	(10)	-	-
Surrenders	(68)	-	(64)	(4)	-

As at 30 June 2015, there were a total of 6,373 international insurance licensees of which 6,300 were PORCs, 66 Captives and 7 Insurance Managers.

CHAPTER 5: ASSESSMENT OF RISK

In the near term, TCI banks on aggregate seem to have the capacity to withstand a range of adverse scenarios, although one bank shows signs of weak governance. While legacy nonperforming loans (NPLs) remain high and credit has been contracting since the 2009 financial crisis, demand-side issues appear relatively more relevant: the contraction is concentrated in the construction sector, and banks have sufficient capital to write off most of the existing NPLs.

The recent findings of the IMF's Financial Stability Assessment Program (FSAP) concludes that the FSC has made progress toward aligning its banking supervision practices with international best practices. The findings further states that ample financial resources have allowed staffing in appropriate number and quality (including experienced external consultants); a formal offsite supervision process has been implemented; and a suite of Guidelines has been issued. All of these efforts by the FSC is to ensure that banks are effectively supervised, with the aim to ensuring financial stability. Based on the efforts put forward by the FSC, it can be concluded therefore, that there is no short-to-medium term financial stability risk in the TCI.

The FSC is progressing the recommendations of the FSAP assessors report with regards to the modernization of the Banking Ordinance (BO), the Insurance Ordinance (IO) as well as the creation of a framework for crisis prevention and management.

Further, the FSC is progressing towards a macroprudential policy framework which will begin with expanding its capacity for macroeconomic analysis relevant to the assessment of risk within the financial sector.