Box 2. The East Caribbean Securities Exchange and Regional Government Securities Market

The East Caribbean Securities Exchange (ECSE) was officially launched on October 19, 2001, providing a regional trading platform for primary and secondary securities trading for the eight ECCU member states. The exchange is regulated by a uniform Securities Act of 2001, covering both equity and debt securities. The exchange supports fully electronic trading, remote trading and access, with settlement meeting G-30 standards on a T+1 basis. The ECCB acts as the settlement bank and the ESCE owns separate registry and depository facilities—the Eastern Caribbean Central Securities Registry (ECCSR) and Eastern Caribbean Central Securities Depository (ECCSD), respectively. The exchange has 47 owners, the largest of which is the ECCB, with a 30 percent share. There are 6 intermediaries, all of which are banks.

The ESCE is designed to support both equity trades and government and private debt securities. Secondary trades are executed by a daily call auction. In its first year of operation, the ESCE has been unable to generate much volume. At present, only two companies are listed—the Bank of Nevis Ltd., and the East Caribbean Financial Holding Company Ltd. (holding company of the Bank of St. Lucia), and one debt issue (a 10-year Government of St. Kitts and Nevis bond, issued). Secondary trading volume has been low. Of 27 publicly held companies in the region, about roughly, half are deemed by the ESCE to be eligible for listing. Listing requirements for equities were recently relaxed somewhat to entice further participation.[48]

Listing requirements for the regional government securities market (RGSM) include quarterly reporting, annual audited financial statements, and timely disclosure of material information by issuers. The ECCB acts as the fiscal agent for government issuers. Bonds and bills can be sold under one of three formats—uniform- or multiple-price auctions, or fixed price/quantity. The St. Kitts and Nevis bond, issued in November 2002, was sold at a fixed price, and was slightly oversubscribed.

The viability of both the ESCE and RGSM depends on a substantial build-up in volume. The possibility of opening up the trading platform by the ECCU to other countries in the Caribbean region should be explored. A liquid regional market for government securities would give fiscal authorities added flexibility in debt management, and potentially reduce external vulnerability by replacing foreign-currency denominated with domestic debt. This may be particularly important in the context of the fixed exchange rate. The authorities will need to be cautious that this flexibility does not itself reduce the resolve to reduce the overall debt burden. The overall increase in public debt has largely been financed domestically over the past 5 years, with much of the increase being taken up by governments and government institutions, including the national insurance and pension schemes. Moreover, the currency board arrangement provides little scope for active debt management operations by the central bank, including the support of primary auctions.

[48] The new requirements include (i) semi-annual reporting of (unaudited) financial statements within 30 days, with a two-year grace period for new issuers (previously quarterly, with no grace period); (ii) provision of annual audited financial statements within 120 days (90 days previously); and (iii) disclosure of material changes within 7 days (no change).

V. The Financial Sector: Institutions, Oversight and Risks [49]

A. Financial Institutions and Market Shares

98. **The ECCU has a well-developed banking system, with a ratio of deposits to GDP of 146 percent in 2001.** In addition to banks, savings are mobilized by national insurance funds (18 percent of GDP), private pension funds and insurance companies, as well as smaller institutions such as credit unions. The Eastern Caribbean Securities Exchange was opened in 2001 with two companies listed. The bulk of financial system assets are held by banks, followed by the national insurance scheme (NIS) funds. (See Table 1).

99. Antigua and Barbuda is the largest financial market in the ECCU, with a quarter of total ECCU assets at end-June 2002.[50] Grenada, St. Kitts and Nevis and St. Lucia each had between 15 percent and 17 percent of total financial assets; St. Vincent and the Grenadines 11 percent, and Montserrat 1 percent. While most countries' share of the regional financial market was in line with their share of regional GDP; St. Lucia's was significantly below, while shares for St. Kitts and Nevis, and Anguilla, were much higher. (see Table 2).

100. **Seven foreign-owned banks, with headquarters in Canada, the U.K., Trinidad and Tobago, and France, together accounted for 60 percent of the assets of banks and other deposit taking institutions at end-June 2002.** Nine privately owned domestic banks have a 23 percent share of assets, with four majority state-owned banks accounting for the remaining 17 percent. Foreign banks have a majority share ranging from 54 percent to 90 percent, in the markets of Antigua and Barbuda, Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines. Private domestic banks hold a majority share only in Anguilla, while in St. Kitts and Nevis the state-owned and foreign banks have about equal shares. Only in Montserrat does the state-owned bank account for a majority of assets (see Table 3). Since end-1997, there has been a decline of 2 percentage points in the share of state banks, in favor of foreign banks, as a result of the privatization of 70 percent of the shares of the state-owned commercial bank in St. Lucia.

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[49] Prepared by Delisle Worrell (MAE).

[50] Excluding NIS, pension funds and insurance companies.

Table 1. ECCU: Financial System Structure

	Dec-97			Dec-99			Dec-01			Jun-02		
	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets
Banks	**44.0**	**7884.7**	**90.1**	**43.0**	**9525.7**	**87.6**	**43.0**	**10466.5**	**88.2**	**43.0**	**11082.7**	**83.8**
Private												
Domestic	8	1793.4	20.5	8	1731.4	15.9	9	2346.2	19.8	9	2534.3	19.2
Foreign	31	4495.1	51.4	30	5671.1	52.1	30	6421.9	54.1	30	6664.9	50.4
State-Owned	5	1596.2	18.2	5	2123.2	19.5	4	1698.4	14.3	4	1883.5	14.2
Institutional Investors	**148**	**n.a.**	**n.a.**	**127**	**n.a.**	**n.a.**	**122**	**n.a.**	**n.a.**	**122.0**	**n.a.**	**n.a.**
Insurance Companies												
Life & Retirement	46	n.a	n.a	39	n.a	n.a	35	n.a	n.a	35	n.a	n.a
Non-life	88	n.a	n.a	76	n.a	n.a	75	n.a	n.a	75	n.a	n.a
Composite 1/	14	n.a	n.a	12	n.a	n.a	12	n.a	n.a	12	n.a	n.a
National Insurance Funds	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	6	1176.9 1/	8.9
Other Nonbank	**109.0**	**865.5**	**9.9**	**107**	**1351.3**	**12.4**	**107**	**1399.6**	**11.8**	**107**	**969.7**	**7.3**
Finance Companies	8	28.4	0.3	8	324.7	3.0	8	371.6	3.1	8	339.1	2.6
Securities Firms	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage Institutions	6	242.5	2.8	5	269.5	2.5	5	301.4	2.5	5	309.9	2.3
Credit Unions	79	468.2	5.4	79	556.4	5.1	80	669.5	5.6	80	320.7	2.4
National Foundation	7	n.a	-	7	n.a	-	7	n.a	-	7	n.a	-
Other	9	126.4	1.4	8	200.7	1.8	7	57.1	0.5	7	n.a	-
Total Financial System	**301**	**8750**	**100**	**277**	**10877**	**100**	**272**	**11866**	**100**	**278**	**13229**	**100**

Source: ECCB

1/Offer both Life and Non-life Insurance

Table 2. Distribution of Assets by Country, Compared with GDP

	Assets, June 2002 (EC$ m.)	Percent of Total Assets	GDP, 2001 (EC$ m.)	Percent of ECCU Total
Anguilla	926	8	240	4
Antigua and Barbuda	2,897	24	1,592	25
Dominica	878	7	601	9
Grenada	1,803	15	888	14
Montserrat	179	1	83	1
St. Kitts and Nevis	2,047	17	796	12
St. Lucia	1,946	16	1,489	23
St. Vincent-Grenadines	1,379	11	785	12
ECCU	12,055	100	6,474	100

Source: ECCB

Table 3: Foreign, Domestic, and State Bank Shares in Total Assets, by Country (Percentages)

	Domestic Private	Foreign	State (51% +)
Anguilla	64	36	0
Antigua and Barbuda	46	54	0
Dominica	0	59	41
Grenada	10	90	0
Montserrat	0	33	67
St. Kitts and Nevis	5	47	48
St. Lucia	28	72	0
St. Vincent-Grenadines	0	63	37
ECCU	23	60	17

Source: ECCB

101. **For the ECCU as a whole, foreign banks, with average assets of EC$952 million at end-June 2002 were twice as large as the government-owned banks, which in turn were twice the size of the average privately owned bank**. However, the government-owned banks were much larger in their domestic markets than was the average foreign bank presence in each market (See Table 4).

102. **Government mobilizes considerable financial resources via national insurance funds, which together held EC$824 million of deposits with the banking system equivalent to 9 percent of bank deposits at end-June 2002.** In addition, the national insurance funds hold government securities, equity and fixed assets. Over 100 insurance companies were reported to be operating in the ECCU, though only a few companies headquartered in non-ECCU /CARICOM countries probably accounted for most of the assets outstanding in the segment. Finance companies, mortgage finance institutions and credit unions each contributed the equivalent of approximately 2.5 percent of the total assets of deposit-taking institutions at end-June.[51]

103. **Antigua and Barbuda, with 22 banks licensed at December 2001, is the only ECCU member with a significant number of banks in the offshore sector**. Most member countries have withdrawn licenses of institutions that were either dormant or not in compliance with legislative requirements (for example, with respect to the qualification of directors and the holding of meetings of directors), leaving a total of only seven banks in the ECCU, apart from those registered in Antigua and Barbuda, according to most recent reports from the ECCB. At December 2001 there were 18 insurance companies registered in the offshore sector in Antigua and Barbuda, and 11 in the rest of the ECCU. There were significant numbers of trust companies registered in St. Kitts and Nevis and St. Vincent and the Grenadines, large numbers of gaming companies in Antigua and Barbuda, large numbers of foreign sales corporations (FSCs) in St. Kitts and Nevis and numerous international business companies in all ECCU member countries (see Suss, Williams, and Mendis, 2002, Table 2, page 13).

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[51] The only regional secondary market institution is the Eastern Caribbean Home Mortgage Bank (ECHMB), which has issued EC$70 million in bonds, and has acquired a portfolio of EC$50 million of mortgages from lending institutions in Antigua and Barbuda, Grenada, St. Kitts and Nevis and St. Lucia.

Table 4. Average Size of Banks, by Country
(EC$ million)

	Domestic Private	Foreign	Government
Anguilla	199	331	0
Antigua and Barbuda	410	293	0
Dominica	0	125	354
Grenada	171	367	0
Montserrat	0	58	121
St. Kitts and Nevis	102	230	937
St. Lucia	219	224	0
St. Vincent and the Grenadines	0	202	472
ECCU	282	952 1/	471

Source: ECCB
1/ This does not correspond to the country average because the same foreign banks are represented in a majority of countries.

Table 5. Interest Rates by Country, May 2002
(In Percentage)

	Treasury Bill Rate	Deposit Rate	Loan Rate
Antigua and Barbuda 1/	7.0	6.0	11.5
Dominica	6.4	6.0	10.5
Grenada	6.5	5.75	10.5
St. Kitts and Nevis	6.0	6.0	12.5
St. Lucia	7.0	6.0	10.5
St. Vincent and the Grenadines	6.5	6.0	11.0

Source: International Finance Statistics.
1/ December 2001.

B. Market Infrastructure

104. **Several indicators provide evidence that the ECCU financial market is segmented by country, with low volumes of intra-ECCU financial transactions, apart from trade financing.** First, there has been no tendency towards a convergence of interest rates. At end-May, 2002 loan rates varied across countries, from 10.5 percent to 12.5 percent. Treasury bill rates ranged from 6½ percent for Dominica to 7 percent for Antigua and Barbuda and St. Lucia. There was even some variation in deposit rates, in spite of the fact that the ECCB sets a floor on the deposit rate (see Table 5). Secondly, net asset holdings by banks with other banks in the ECCU were equivalent to less than ½ percent of total assets (end-June 2002), about the same proportion as at end-December 2001. It is likely that these balances reflect trade finance transactions. Thirdly, there is little cross-country holding of government securities among ECCU members. Fourthly, cash-to-deposit ratios varied widely across member countries at end-May 2002, from 11 percent for Grenada to 18 percent for St. Kitts and Nevis.

105. **The ECCB has taken initiatives to strengthen institutional arrangements for intra-ECCU financial transactions.** There is uniform legislation in all members for banking, securities trading and corporate governance. The ECCB fostered the establishment of the Eastern Caribbean Securities Exchange (ECSE), which commenced operations in October 2001, and the Regional Government Securities Market (RGSM), on which the first placement took place in November 2002. The ECCB also provided initiative and finance for the establishment of the Eastern Caribbean Home Mortgage Bank (ECHMB) in 1994.

106. **Arrangements for direct inter-bank borrowing and lending were introduced in October 2001.** Prior to this, the ECCB had in effect acted as intermediary for inter-bank borrowings. From a volume of EC$17 million in the first month of operation, transactions have risen to an average of EC$102 million in the three months to July 2002. Three-quarters of transactions by volume are for a duration of eight to 30 days, with the remainder mostly for one week or less. The term structure of interest rates was inverted initially, but in May 2002, a normal structure emerged. The interest rate for shorter maturities in July was just under 6 percent, compared to 6½ percent for the longer maturities.

107. **Inter-bank foreign exchange transactions vary with the demand for short-term trade financing.** The mean value of monthly changes in banks' holdings of net foreign assets, which reflects these transactions, ranged from negative EC$1.5 million for banks in St. Lucia, to EC$0.5 million for banks in St. Kitts and Nevis, for the period January 1992 to May 2002. Standard deviations ranged from around EC$8 million (Dominica) to EC$23 million (St. Kitts and Nevis). For large transactions, banks periodically buy from and sell foreign exchange to the ECCB. The mean value of changes in the central bank's foreign assets was EC$15 million for the period January 2001 to March 2002, and the standard deviation was around EC$20 million. The commercial banks' foreign exchange exposure is maintained at very low levels. At end-June 2002, net foreign assets, including net balances

with banks abroad and foreign currency loans, were equal to the amount of foreign currency deposits, EC$1½ billion, or 15 percent of bank deposits.

108. **The largest proportion of securities issued in ECCU financial markets is treasury bills, government bonds and bonds issued by development banks and state enterprises**. Government securities outstanding at end-June 2002 were EC$1.1 billion (17 percent of GDP), evenly split between treasury bills and long-term bonds. The largest issuers were Dominica, with 24 percent of the total outstanding (in comparison with its 9 percent share in the region's GDP); and St. Kitts and Nevis, 25 percent of the amount outstanding (12 percent share of ECCU's GDP). St. Vincent and the Grenadines, with a GDP share similar to that of St. Kitts and Nevis, was responsible for only 7 percent of the amount outstanding. In contrast to other ECCU members, St. Kitts and Nevis has issued treasury bills almost exclusively (86 percent), and banks hold 69 percent of those. Apart from that country, banks held 28 percent of government securities outstanding. Government institutions, including NIS funds, held 38 percent of the total outstanding. ECCB's holdings were 10 percent of the total (see Table 6). Prior to the establishment of the ECSE, the home mortgage bank (ECHMB) was the only institution whose bonds were purchased widely throughout the ECCU. The ECSE has had an extremely modest beginning, with two companies listed, and market capitalization of EC$108 million (1.7 percent of the region's GDP in 2001). St. Kitts and Nevis issued the first government bond to be offered on the exchange, in November 2002.

Table 6. Government Securities Outstanding by Holder, June 2002
(EC$ million)

Holders	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	St. Lucia	St. Vincent and Grenadines	ECCU Total
Treasury Bills								
ECCB	16.2	12.9	13.9	0	5.8	30.7	0	79.5
Banks	10.2	8.9	19.0	0	162.1	15.7	37.5	253.4
OFIs	4.8	3.8	9.5	0	10.9	17.3	4.4	50.7
Govt. Institutions	19.2	21.0	11.9	0	24.8	46.1	2.5	125.5
Pvt. Investors	8.3	0	2.0	0	32.7	0.5	3.2	46.7
Total	**58.7**	**46.6**	**56.3**	**0**	**236.2**	**110.3**	**47.6**	**555.7**
Debentures								
ECCB	14.8	6.5	2.7	0.8	3.5	5.0	4.0	37.3
Banks	12.1	26.2	9.2	0.4	3.5	18.0	14.6	84.0
OFIs	8.6	133.4	7.1	0.4	0.8	26.9	6.0	183.1
Govt. Institutions	37.0	38.7	76.9	2.4	25.0	23.6	4.5	208.1
Pvt. Investors	1.0	12.2	19.0	0	5.5	1.7	1.0	40.4
Foreign Investors	0	1.3	0	0	0	8.1	0	9.4
Total	**73.4**	**218.4**	**114.9**	**4.0**	**38.3**	**83.2**	**30.0**	**562.1**
Total T-bills and Debentures	132.1	264.9	171.2	4.0	274.5	193.5	77.6	1,117.9
In percent by Country	11.8	23.7	15.3	0.3	24.6	17.3	6.9	100

Source: ECCB

109. **The ECCB maintains a manual clearing system for checks, with daily clearings in the bank's representative offices in each country, and settlement over the reserve balances, which all banks maintain with the ECCB**. A private company provides electronic clearing of credit card transactions, which are settled over accounts at one of the foreign banks. Two initiatives are underway on payments reform; a committee including representatives of the ECCB, commercial banks and the credit card clearing company (CCCC) have completed a study for the implementation of an automated clearing house (ACH) for small value payments; and the ECCB is in the process of preparing a proposal for the implementation of an automated settlement process for large value and time critical payments.

C. Regulation and Supervision

110. **The ECCB has responsibility for the regulation and supervision of commercial banks, development banks, mortgage finance companies and other finance companies**. Licenses are issued by national governments—the ECCU has no federal legislative structure—on the recommendation of the ECCB. There is a uniform banking act on the statute books of all members. The Banking Act and the ECCB Agreement Act give the ECCB certain powers of regulation, supervision and intervention, but there is a need for strengthening particularly with respect to closures but there is need for the removal of some restrictive clauses and additional protection for supervisors.[52]

111. **The ECCB's Bank Supervision Department (BSD) is in the process of upgrading techniques for risk-based supervision and financial sector risk assessment**.[53] BSD conducts on- and off-site examinations of all institutions for which the ECCB has responsibility. Analytical reports for off site inspection are provided by the ECCB's excellent statistical database system, which has the capacity to produce a variety of macroeconomic and prudential reports in flexible formats. All institutions that are in violation of the ECCB's prudential norms are on a "watch list," and have signed memoranda of understanding with deadlines for bringing the deficient areas into compliance.

112. **The Monetary Council of the ECCB has initiated a program for the coordination and upgrading of regulation and supervision of firms in the offshore, as well as insurance companies, mutual funds, money transfer agencies and micro-finance organizations providing domestic financial services.** Consolidated supervisory units are to be established in each country, drawing together the functions of a variety of supervisory agencies in a single unit, which will be separate from the agencies that promote offshore activity. The consolidated units will be coordinated by the ECCB, which will provide training and expertise, with technical assistance from CARTAC. The ECCB will share responsibility

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[52] Amendments to incorporate these changes have been drafted, commented on by the Fund's Legal Department and are expected to be enacted by January 2003.

[53] See Polius-Mounsey and Millington (2001) and Polius-Mounsey and Sahely (2002).

for the supervision of offshore banks with the country supervision bodies, with areas of responsibility defined in memoranda of understanding.

113. **A CARTAC expert, to bring Grenada's provisions in line with Basel principles, has drafted amended legislation for the offshore sector. This legislation is intended as a model for the other ECCU members, except Antigua and Barbuda**, and all are expected to adopt it by January 2003. Antigua and Barbuda has already completed updates of the legislative framework for its IFSC. A joint ECCB/CARTAC team, with participation of Caribbean and international supervisors, has completed a review of the offshore sector in St. Vincent and the Grenadines. A similar review for Grenada is underway.

114. **Following the U.S. model, their own regional non-governmental, jointly operated institution, the Caribbean Council of Credit Unions (CCCU), which has its business center in St. Kitts and Nevis, supervises Credit Unions.** It provides training and other technical assistance to its members, with the assistance of the international credit union federation. The federation sets prudential guidelines for credit unions based on a system analogous to the CAMEL rating system. It is known by the acronym PEARLS (protection, effective financial structure, asset quality, rates of return and cost, liquidity, signs of growth).[54] CARTAC is cooperating with the CCCU in a program to strengthen the offices of the registrars of cooperatives, and to assist credit unions with procedures for ensuring that they observe the PEARL guidelines. The Monetary Council of the ECCB has recommended legislation to regulate the activities of money transfer agencies. CARTAC has agreed to provide technical assistance for drafting, and a uniform law is to be put in place by all ECCU members by early 2003. The trading of private securities is supervised by an independent Securities and Exchange Commission, and the trading of government securities by an intergovernmental committee. They both draw on ECCB expertise and services.

115. **The ECCB will need to expand the resources of its regulatory, supervisory and risk management functions, in view of the growing scope of its responsibilities.** In addition to the supervision of offshore banks, the co-ordination of the country consolidated supervisory units and the servicing of the securities regulators; the ECCB is in the process of developing its capability for assessment of the financial sector and conducting of stress tests. The central bank has a strategy for upgrading its capability, with the assistance of CARTAC. It includes improvement in prudential data collection, introduction of new assessment techniques and the revision of supervision manuals.

D. The Contingency Framework

116. The high proportion of ownership of the banking system by large, well-capitalized foreign banks may provide a "first line of defense" in case of a crisis of confidence

[54] See Richardson, 2001.

in the domestic banking sector. Foreign banks would be a haven in case of a flight to quality, and, because they are much larger, they can readily absorb any additional liquidity, which would result from a switch of domestic currency deposits away from indigenous banks. The failure of a domestic bank thus would not necessarily trigger a systemic crisis.

117. **However, the failure of any large financial institution could raise questions of credibility about the ability and commitment to maintain the currency peg.** Such concerns could shift depositors' preferences from domestic to foreign currency-denominated assets. As a currency board, the ECCB has a commitment mechanism to deal with such capital flows, to support the fixed exchange rate parity. The ECCB maintains a ratio of 97 percent of net foreign assets to its demand liabilities,[55] and the ratio has not fallen below 90 percent since 1990. However, because it is not a pure currency board, the ECCB is able to act as a lender of last resort for illiquid but solvent banks. Each year the central bank budgets a maximum amount of short-term accommodation, for approval by the Monetary Council, for banks and governments, the latter by way of purchase of marketable securities. The budgeted amount is designed to ensure that the reserve cover (the ratio of foreign reserves to demand liabilities) remains above 80 percent.

E. Macroeconomic Risks to the Financial Sector

118. **Banks in the ECCU have a high level of loan concentration to households (24 percent of total loans), for mortgages, construction and repair.** A combination of shocks and adverse market developments affecting the region's major tradable commodities—tourism, bananas and sugar—has depressed household incomes in some countries, and some household incomes are adversely affected by shortfalls in government revenues, leading to arrears in government payments, including salaries in some cases. No clear evidence of a deterioration of the banks' portfolio of household-related loans has yet emerged, but that remains a possibility. There is no anecdotal evidence, to date, of a decline in property values as a result of economic contraction. (There are no statistics on real estate prices.) This is a potential source of difficulty for financial institutions, because of the impact on collateral values. **Large exposure by banks to the public sector (governments and enterprises) poses a major risk in the event of a failure to rollover debt.**

119. **Other risks to the financial sector from the international economy appear to be contained.** Banks' credit exposure to the major tradable sectors is very modest. Loans to the tourism sector were 7 percent of total loans at end-June 2002, loans for sugar cultivation were 3 percent of total, and loans to other agriculture were less than 1 percent. Financial institutions, which are licensed for the domestic market, are permitted to open accounts for IFSC firms only for operating expenses, and the balances are consequently very

[55] As at June 2002.

small. Contraction of the offshore sector has not had a measurable impact on the domestic financial market. There is no significant portfolio capital inflow, and therefore little exposure to risk of financial contagion from international markets as a result of a change in their appetite for foreign investment.

F. Financial Soundness Indicators

120. **At end-December 2001, banks in ECCU were well capitalized, with a risk-weighted capital asset ratio (RW-CAR) of 17.5 percent, almost all of which was in Tier 1 paid up capital and reserves.** The ratio of capital to total assets including government obligations, which have zero risk weight, was 11½ percent. Unsatisfactory assets were high and well above the ECCB's norm of 10 percent, at around 14 percent of total loans, largely on account of the indigenous banks, and provisions were sufficient to cover only about 28 percent of unsatisfactory assets. Banks were heavily exposed to the household sector, but not to any single producing sector. Their vulnerability appears to be to a general economic downturn, rather than a shock to single sector. Banks were profitable across the region, the foreign banks rather more so than the indigenous banks. Both domestic and foreign banks were highly liquid (see Table 7).

121. **High levels of bank capitalization were typical of all ECCU member countries.** Banks in Anguilla had low ratios of unsatisfactory assets, in contrast to those in Dominica and St. Kitts and Nevis, where ratios were comparatively high. (Montserrat, where the economy has been devastated by volcanic eruption, is a special case.) Provisions vary from adequate (Anguilla and Montserrat) to low (for Antigua and Barbuda, Grenada, St. Lucia, and St. Vincent and the Grenadines) to very low (for Dominica and St. Kitts and Nevis). Net returns in Antigua and Barbuda and St. Vincent and the Grenadines are considerably below those for the rest of the region. The reasons may be that the net interest margin of banks in those countries is at the bottom of the range for the ECCU, and the rates of operating to total expenses for Antigua and Barbuda is second only to Grenada's. Net interest margins, average returns on loans and costs of funds varied across the ECCU, with a range of 180-210 basis points between countries with the highest and lowest rates. The liquid assets ratio for banks in St. Lucia was much lower than for banks elsewhere in the ECCU. (FSIs by country are shown in Table 8.)

122. **The financial condition of banks has broadly improved over the period 1997-2001.** Risk weighted capital to assets ratios were already high in 1997, and they have since improved. The ratio of unsatisfactory assets for the system as a whole declined slightly. For indigenous banks the rates was slightly lower in December 2001 than at the end-1997, while for foreign banks the situation worsened somewhat. Nevertheless, the ratio for the foreign banks remained only half as large as that for the indigenous banks, at the end of 2001. Average provisions to unsatisfactory assets were somewhat higher; though still less than 30 percent. Profitability increased up to 1999, but thereafter it fell. The return on assets of 2.1 percent in 2001 was lower than for 1997. There was an improvement for indigenous banks, while the profitability of foreign banks fell somewhat, although at December 2001, the

foreign banks remained significantly more profitable. Liquidity ratios for the system as a whole, and for foreign and domestic banks, rose steadily over the period, except for a temporary reversal in 2000, for indigenous banks only. (Trends in FSIs are shown in Figures 1-3, for the ECCU as a whole, and for indigenous and foreign banks.)

Table 7. ECCU: Financial Sector Indicators, Domestic and Foreign Banks, December 2001
(Percentages)

	ECCU	Domestic	Foreign
Capital Adequacy			
RW-CAR	17.5	17.5	Not Applicable
Tier 1 RW-CAR	16.4	16.4	Not Applicable
Capital/Assets	11.4	11.4	Not Applicable
Asset Quality			
Past Due/Loans	5.4	7.0	3.6
Unsatisfactory/Assets	13.6	n.a	n.a
Provisions/Unsatisfactory	27.8	25.6 1/	34.9 1/
Contingent/Assets	8.5	6.3	11.3
Largest Sector/Loans	46.6	50.1 1/	42.1 1/
Largest Group/Loans	n.a.	4.4	n.a
Earnings			
RoAA	2.1	1.9	2.3
RoAE	27.8	16.9	Not Applicable
Net Interest Margin	5.0	5.0	5.1
Interest on Loans/Loans	11.0	11.0	11.0
Avg. Cost of Funds	4.4	4.6	4.2
Operating/Total Expenses	44.4	44.0	44.1
Liquidity			
Loans/Deposits	81.1	79.7	82.7
Liquid/Total Assets	24.3	27.2	29.6
Liquid Assets/Current Liabilities	n.a	12.5	n.a

Source: ECCB

Table 8. Financial Sector Indicators, Domestic Banks by Country, December 2001
(Percentages)

	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	St. Lucia	St. Vincent and Grenadines
Capital Adequacy								
RW-CAR	17.4	14.3	35.4	14.1	31.1	29.0	13.9	17.7
Tier 1	16.2	12.9	34.1	11.7	25.8	33.5	11.5	18.4
Capital/Assets	11.8	10.3	23.3	9.7	11.5	11.9	9.8	11.5
Asset Quality								
Past Due/ Loans	1.3	6.8	11.8	4.5	16.0	11.3	7.5	6.4
Unsatisfactory/Loans	9.7	17.5	31.5	9.3	27.1	17.2	24.5	18.8
Provisions/ Unsatisfactory Loans	21.4	25.8	18.0	40.7	67.9	28.2	23.7	30.4
Contingent/Assets	4.4	8.5	18.2	7.2	9.5	2.0	7.5	7.2
Largest Sector	51.8	36.1	29.8	55.8	69.7	29.5	38.7	50.3
Largest Group	5.9	5.1	3.3	3.4	5.2	3.0	3.9	4.4
Earnings								
RoAA	2.5	0.5	3.0	2.2	2.1	3.4	1.6	1.0
RoAE	22.3	44.6	13.5	23.5	18.8	28.6	16.6	8.3
Net Interest Margin	4.9	4.5	5.0	5.9	4.6	5.0	5.2	4.1
Interest on Loans	11.3	11.1	9.9	10.9	9.7	11.5	11.4	9.8
Avg. Cost of Funds	3.7	5.3	4.1	4.1	3.4	4.7	5.5	4.0
Operating/Expenses	43.7	47.7	47.1	49.6	34.6	32.6	42.0	45.6
Liquidity								
Loans/Deposits	69.9	88.5	85.9	76.2	27.9	77.4	91.1	71.1
Liquid/Curr.Lia.	20.5	8.9	11.4	14.9	18.4	16.7	7.1	8.4
Liquid/Total Assets	37.9	22.4	23.3	23.2	41.3	38.1	15.7	33.2

Source: ECCB

Figure 1. All Banks: Trends in Financial Soundness Indicators

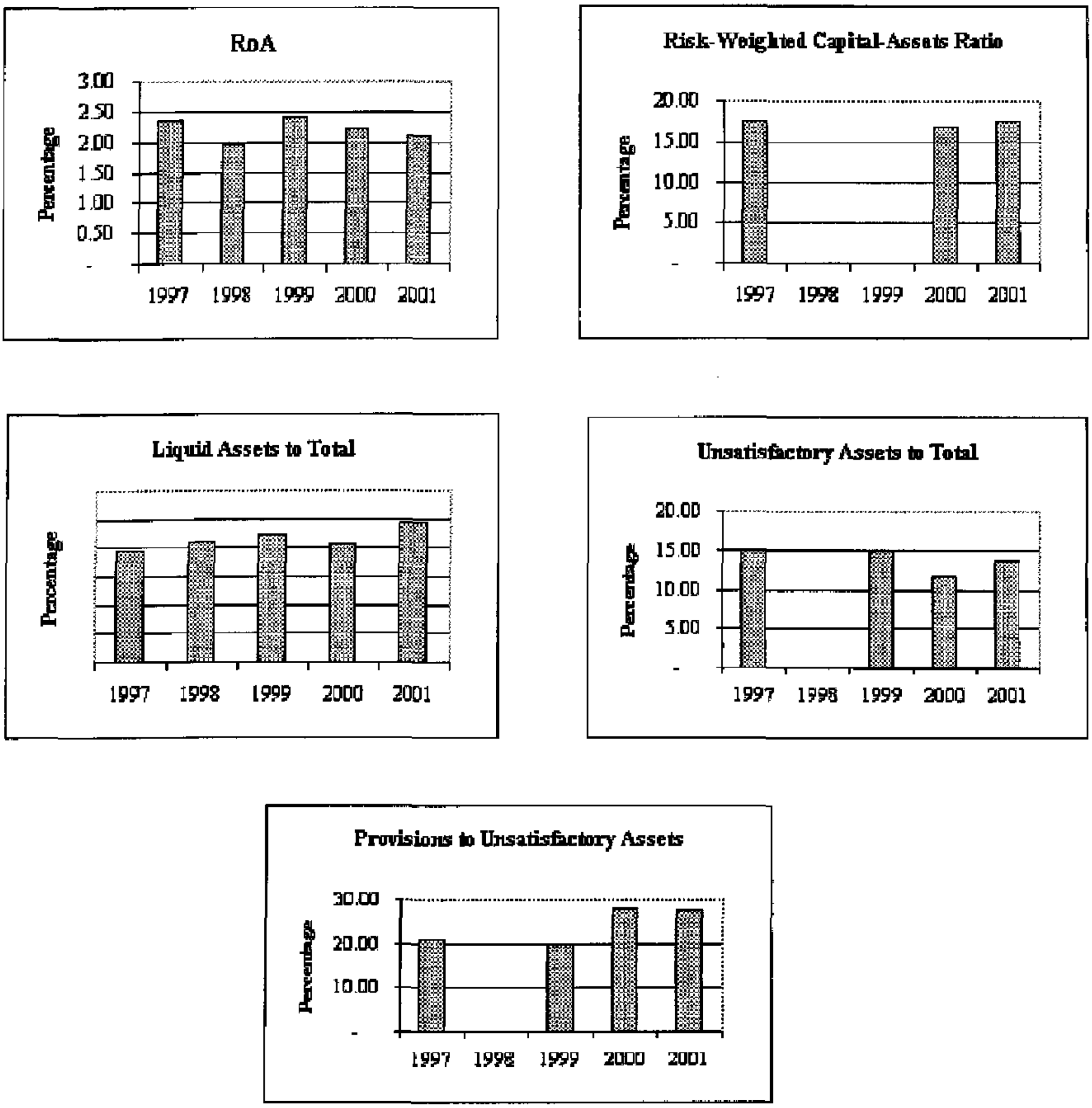

Figure 2. Foreign Banks: Trends in Financial Soundness Indicators

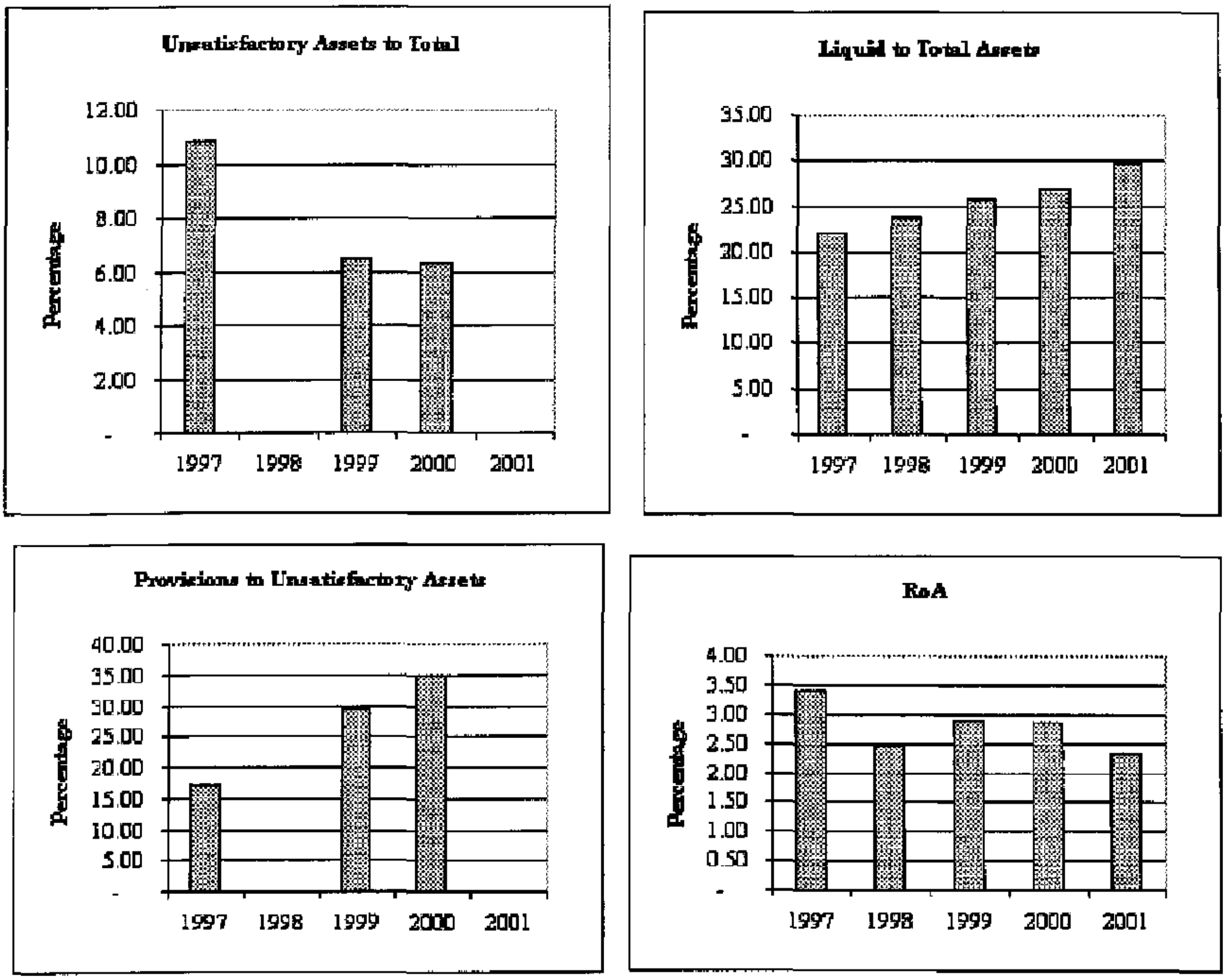

Figure 3. Indigenous Banks: Trends in Financial Soundness Indicators