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Barbados: Financial System Stability Assessment—Update, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision and Securities Regulation

This update to the Financial System Stability Assessment on Barbados was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on July 11, 2008. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Barbados or the Executive Board of the IMF.

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BARBADOS

Financial System Stability Assessment—Update

Prepared by the Monetary and Capital Markets and Western Hemisphere Departments

Approved by Jaime Caruana and Anoop Singh

July 11, 2008

This Financial System Stability Assessment (FSSA) Update is based primarily on work undertaken during a visit to Barbados from March 26 to April 10, 2008, as part of the Financial Sector Assessment Program (FSAP) Update. The FSAP findings and recommendations were discussed with the authorities during the Article IV Consultation mission in June 2008.

The FSAP team comprised Marco Espinosa-Vega (IMF, Mission Chief); Craig Thorburn (World Bank, Deputy Mission Chief); Joon Soon Lee, Bikki Randhawa (from headquarters), and Florencia Moizeszowicz (all World Bank); Giancarlo Gasha and Eugenio Cerutti (IMF), Diane Mendoza (external expert, formerly with the Resolution Trust Corporation and the OCC, United States), Tanis MacLaren (external expert, formerly with the Ontario Securities Commission, Canada), and Linda Hytry (external expert, currently with the Texas Department of Insurance, United States). Gamal El-Masry (IMF, WHD) participated in the meetings, collected background information for the Article IV consultation, and supported the FSAP team on macro issues.

The main findings are:

- The Barbadian financial system has proved to be resilient and, so far, has not been affected by the turmoil in mature financial markets. Several of the shortcomings identified during the 2002 FSAP have been addressed. However, regulatory reforms are still needed to increase flexibility and stability of the financial system.
- The key reform challenges for the authorities are: (i) establishing a clear legal framework for the consolidated supervision of banking groups and enhancing home/host cooperation, (ii) updating the regulations on capital adequacy, asset classification, and loan-loss provisioning, (iii) ensuring that the mandate and structure of the upcoming Financial Services Commission are adequate for the effective supervision of the non banking financial sector.

FSAP assessments are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAP assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

AML	Anti-Money Laundering
BBA	Barbados Bankers Association
BBL	Butterfield Bank (Barbados) Limited
BCP	Basel Core Principles For Effective Supervision
BDS	Barbados dollar
BNB	Barbados National Bank
BNS	Bank of Nova Scotia
BSD	Bank Supervision Department
BSE	Barbados Stock Exchange
CAR	Capital Adequacy Ratio
CARICOM	Caribbean Community
CBB	Central Bank of Barbados
CFT	Combating the Financing of Terrorism
CIBC	Canadian Imperial Bank of Commerce
CSD	Barbados Central Securities Depository Inc.
CSD	Barbados Central Securities Depository Inc.
CSME	Caribbean Single Market and Economy
CXN	Caribbean Exchange Network
DIC	Deposit Insurance Corporation
FCIB	First Caribbean International Bank Ltd
FIA	Financial Institutions Act
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness indicators
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IFSA	International Financial Services Act
IOSCO	International Organization of Securities Commissions
MCM	Monetary and Capital Markets Department
MFA	Mutual Funds Act
MOU	Memorandum of Understanding
NIR	Net international reserves
NIS	National Insurance Scheme
NPL	Nonperforming Loan
OECS	Organization of Eastern Caribbean States
OSC	Ontario Securities Commission
PDR	Policy Development and Review Department
RBC	Royal Bank of Canada
RBTT	Royal Bank of Trinidad and Tobago Bank (Barbados) Limited
SA	Securities Act
SOIP	Supervisor of Insurance & Pensions
SRO	Self-Regulatory Organization
WEO	World Economic Outlook

EXECUTIVE SUMMARY

The 2008 FSAP Update for Barbados took place in the context of considerable turmoil in global financial markets. Encouragingly, the financial system in Barbados has been little affected by this turmoil, and the macroeconomic situation remains robust, with economic growth remaining strong in response to increased tourism and the unemployment rate has fallen to a historical low. Nonetheless, as has been shown in past cyclical episodes, the economy is vulnerable to a slowdown in Europe (especially in the United Kingdom) and the United States.

The domestic banking sector appears sound and profitable and continues to dominate the financial system. The financial system has benefited from the strong economic expansion, which has boosted credit demand while contributing to a steady improvement in banks' asset quality. Capital adequacy for locally incorporated banks remains above the minimum required, and profits remain at healthy levels.

Stress tests reveal an onshore banking sector that would be resilient to most market shocks, but capital levels may be at risk in the case of more extreme events. In particular, the system is vulnerable to credit quality shocks, and an extreme but plausible decline in tourism receipts, or in construction activity, would reduce banks' capital to below the regulatory minimum. Moreover, even under a credit risk baseline scenario, one bank's capitalization would fall below the regulatory minimum.

Progress has been made in addressing the recommendations of the 2002 FSAP assessment. The Bank Supervision Department (BSD) of the Central Bank of Barbados (CBB) has been moving toward a risk-based supervisory framework, increased the number and training of its staff, and issued many guidelines on risk management. The Financial Institutions Act (FIA) was amended, inter alia, to facilitate the introduction of Deposit Insurance, to require auditors to be approved by the CBB, and to improve the procedures for winding up, restructuring and license revocation.

The crisis management framework was enhanced in mid-2007 with the introduction of a compulsory deposit insurance scheme in mid-2007, but further steps would be helpful. In order to improve market discipline and minimize moral hazard, the authorities should publicize more effectively the features of the deposit insurance and which institutions are covered and consider, at least temporarily, raising premiums to boost the size of the fund, which is low compared with many international benchmarks. Going forward, to complement the financial safety net, the authorities will need to formalize a prompt corrective action system and bank resolution process. There is also a need for closer consultation and coordination with overseas authorities, especially with Canadian supervisors with respect to the banking sector, including by engaging crisis simulation exercises.

Assuring continued financial stability and competitiveness important regulatory and remaining supervisory weaknesses in the financial system also should be addressed. The prudential oversight of the banking sector could be strengthened by enhancing supervisory capabilities, accelerating the transition to risk-based banking supervision, tightening supervision of large exposures and exposures to related parties, improving the criteria for asset classification and provisioning, improving consolidated supervision for banking groups and regional financial conglomerates, and establishing more active home-host supervisory cooperation arrangements.

The lack of adequate supervision of the insurance sector exposes the sector to material risks. Profitability and capital adequacy in this sector are difficult to assess due to incomplete and inadequate data. Single negative events may significantly damage the reputation of a jurisdiction in an increasingly regional and global market. Although the mission noted the introduction of on-site inspections, the sector remains largely self-regulated owing to continuing shortages of qualified staff, inadequate regulation, and out-of-date financial reporting. Greater cooperation and exchange of information, particularly with the authorities in Trinidad and Tobago, are necessary to facilitate effective assessment of financial soundness and the protection of Barbadian policyholders by the supervisor.

Despite some progress toward integration, capital markets remain underdeveloped. Efforts to integrate the Barbados Stock Exchange with the Trinidad and Tobago and Jamaica exchanges through the Caribbean Exchange Network (CXN), pending regulatory approval, are in line with the 2002 FSAP recommendations to adopt common listing, trading, and settlement rules across the exchanges in the region to promote development of capital markets.

The Registrar of the Cooperatives Department is slowly building capacity to adequately supervise credit unions. This agency has continued to carry out joint inspections with the CBB of larger institutions as recommended by the 2002 FSAP team. However, the number of inspections conducted has decreased sharply and the joint inspections are not yet being conducted with the recommended frequency. Smaller banks expressed frustration at the tax breaks and lower compliance costs afforded to the credit unions, since this puts them at a competitive disadvantage.

The authorities are assessing the best way to carry out the supervision of the nonbank financial system under one regulatory umbrella. The Financial Services Commission (FSC) was an initiative devised under the previous government to integrate the regulation and supervision of the non bank financial sector. The recently elected government is currently studying how to best supervise the non bank financial intermediary sector. An early decision regarding FSC's structure and mandate would help ensure that the much-needed improvements in the supervision of the Credit Union and Insurance sectors can be advanced.

The offshore financial sector appears insulated from the onshore banking system, thus limiting the risk of contagion. In particular, "Chinese walls" exist between affiliated on-and off-shore banks, and there are strict legal prohibitions against transactions between the on-shore sector and off-shore banks. Given that many of the off-shore banks operate out of Barbados to take advantage of tax treaties, they have a strong incentive to comply with the prohibitions (lest they lose their license).

Barbados will continue to face competition from offshore financial centers in the region. To differentiate itself, the country is seeking to continue strengthening its reputation for stability and a selective licensing process, and to develop a workforce with strong skills in financial services. However, the authorities still face the challenge of overseeing a large number of very heterogeneous financial institutions with constrained resources, and the need to adapt regulations and supervision to properly monitor and control risk without increasing the burden of compliance.

The new government is re-assessing the extent and timing of the capital account opening in light of an increasingly uncertain global environment. However, the authorities expressed a willingness to pursue a gradual liberalization of the exchange controls vis-à-vis the Organization of Eastern Caribbean States (OECS).[1]

The authorities should revisit the investment strategy of the government-sponsored national insurance scheme. A shortage of permissible local investment opportunities has led to sizable holdings of money market instruments and government liabilities, highlighting the need for a better portfolio diversification strategy.

[1] The anti-money laundering and combating the financing of terrorism (AML/CFT) regime of Barbados has been assessed by the Caribbean Financial Action Task Force (CFATF) and its findings was presented for approval by its Plenary in May 2008.

Box 1. Key FSAP Update Recommendations

Banking

- Strengthen cross-border consolidated supervision, including establishing a clear legal framework for the consolidated supervision of banking groups and enhancing home/host cooperation (H).
- Update regulations on capital adequacy, asset classification and loss provisioning to ensure their effectiveness after the last ten years of structural changes in the banking industry (H).
- Strengthen regulation and supervision for large exposures and related-party exposures, including setting up the regulatory aggregate limits on total large exposures and related-party exposures on a consolidated basis, and defining the related party in a comprehensive way.
- Based on a quantitative impact study, make adjustments to the timetable of adoption of Basel II, including by delaying the implementation schedule, and strengthening the Pillar 2 framework.

Financial Services Commission

- Resolve promptly the mandate and structure of the FSC so as to help advance the planned improvements in the supervision of both the Credit Union and Insurance sectors (H).

Insurance

- Develop standards on corporate governance, market conduct, internal controls (including asset and derivative controls, particularly in the case of the offshore market), asset and liability valuation, and a solvency standard for life insurers with a view to enhancing the observance of the IAIS principles (H).
- Improve the timeliness of supervisory returns, and redesign processes for onsite inspection, and offsite analytical support. (H)
- Collaborate with the Trinidadian authorities in the supervision of larger cross-border groups.

Credit Unions

- Increase the frequency of joint (Cooperatives Department and Central Bank) on-sight examinations (H).
- Consider issuing a specialized Credit Union Law (H).

Securities Markets

- Provide the Securities Commission with statutory power under the MFA and SA to make legally binding rules, inspect and access all information at regulated firms at any time, share information and otherwise cooperate with domestic and foreign supervisors (H).
- Develop and implement a regular inspection program for regulated firms under both Acts and require firms to have adequate internal control and risk management policies and procedures (H).
- Update and harmonize takeover bid rules across the region at the exchange and statutory levels; consider an update of bankruptcy and other commercial legislation.
- Require timely disclosure by mutual funds, public companies and insiders of public companies; consider raising penalties for statutory offences.

Deposit Insurance Scheme

- Formalize early warning and prompt corrective action systems (H).
- Expand and improve the level of public awareness about the characteristics of the new deposit insurance scheme.

Financial Stability Report

- Consider enhancing the financial stability report by supplementing the CBB's macro model with a banking credit-risk model.

Other

- Revisit the NIS's investment strategy.

H = Highest priority

I. Macro Financial and Institutional Setting

A. Macroeconomic Background

1. **Barbados is a small country with a developing infrastructure, boasting one of the highest levels of GDP per capita in the region, at about US$12,400.** Economic growth has been strong (4.1 percent for 2004–2007) in tandem with increased tourism. Robust output growth has helped bring the unemployment rate to a historical low of 8.5 percent in 2007. The country enjoys an investment grade rating and has one of the highest S&P foreign currency sovereign credit ratings in the region. Tourism, real estate and financial services are the most dynamic sectors and represent almost half of GDP and almost 80 percent of foreign currency receipts.

2. **The Barbados dollar is pegged to the U.S. dollar at BDS$2=US$1.** The country maintains a number of exchange controls, and interest rates have typically followed U.S. rates closely. Barbados is a member of the Caribbean Community (CARICOM), which is planning to institute a monetary union in the period 2010-15, and in the run-up to monetary union barriers between the financial sectors of member countries are expected to be gradually removed. Inflation has declined from about 6.75 percent during 2005–06 to 4 percent in 2007. However, in recent months, y-o-y inflation has picked up again, fueled mainly by large increases in food and energy prices and is expected to reach 9 percent by the end of the year.

3. **There has been a deterioration in public finances.** The central government fiscal deficit widened from about 1.5 percent of GDP in 2006/07, to about 3.5 percent of GDP in 2007/08 (April to March), reflecting a rise in current expenditure relative to a moderate increase in tax revenue. Nonetheless, as a result of robust growth in tourism receipts, the deficit in the current account of the balance of payments fell from 8.2 percent of GDP in 2006, to an estimated 6.6 percent of GDP in 2007. The stock of gross central government debt is relatively high at 73 percent of GDP, although roll-over risk is reduced by the high share of domestic liabilities. The official foreign exchange reserves held by the CBB at end-2007 are estimated at about US$776 million or four months of imports.

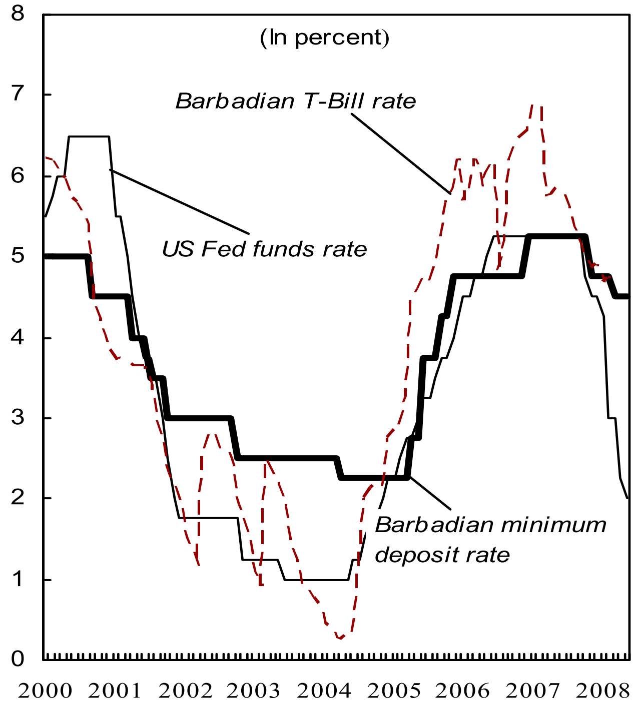
4. **Against the background of an uncertain global environment, efforts to open the capital account are being reexamined by the new government.** Capital controls shield the domestic financial market from shocks to global markets and investor sentiment. The new government that was elected in January 2008 has favored a more gradual approach to capital account liberalization. It has indicated that it would take more time to study the potential costs and benefits arising from the removal of capital controls before proceeding with lifting these controls vis-à-vis its CARICOM neighbors.

5. **The exchange controls and multiple reserve requirements afford the CBB control over its monetary policy in spite of the foreign exchange rate peg.** As a result, the policy rate differs from the U.S. fed funds rate for short periods of time (Figure 1). Monetary policy continues to be conducted through adjustments in the minimum deposit rate. In April 2008 the minimum deposit interest rate was lowered from 4.75 percent to 4.5 percent, broadly in line

with the recent trend in U.S. rates. The average nominal deposit and lending rates were 4.75 percent and 10.5 percent, respectively, at end-January 2008.

6. **In addition, onshore banks are subject to multiple reserve requirements**. These are computed on the basis of a three-week average of their respective deposits. Onshore banks are required to hold a 5 percent cash reserve requirement (CRR) on Barbados dollar deposits (unchanged since 2001), and a 6 percent CRR (held in BDS) on foreign currency deposits that was introduced in April 2006. The CBB also requires banks to hold "stipulated" government securities (SGS) as a percentage of their total local currency deposits.[2] The SGS requirement currently stands at 10 percent, having been reduced by 2 percentage points in November 2007.

Figure 1. Barbados: Comparative Policy Interest Rates, 2002–2007
(In percent)



Source: CBB

B. Macroeconomic Risks

7. **In the context of an uncertain global environment, GDP growth is expected to slow to about 2.3 percent in 2008**. Barbados is a popular destination for affluent U.K., U.S., and Canadian tourists, and tourism receipts are less sensitive to global economic trends than other destinations. In addition, the appreciation of the Pound Sterling, Canadian dollar, and Euro

[2] The SGS was originally introduced in 1973, with only Treasury bills qualifying as recognized government securities. The SGS have since been expanded to include government bonds and other securities issued by state-owned enterprises.

against the U.S. dollar has boosted Barbados' price competitiveness and helped maintain modest growth in tourism arrivals from these destinations. Nevertheless, the U.S. slowdown and its spillovers to other developed economies may affect negatively Barbados' economy in general, and the tourism industry in particular.

8. **Barbados is also exposed to an international oil price shock through its impact on domestic prices and tourism**. Given that Barbados is a net importer of oil, increases in the price of oil would translate into higher domestic prices and represents a substantial negative terms-of-trade shock. Barbados is relatively distant from the main Caribbean cruise market, and higher fuel costs could adversely affect cruise ship arrivals. Thus far, these two channels do not seem to have had a material effect, partially due to government subsidies of domestic gas prices, and the upscale characteristics of Barbados' tourism market.

9. **A protracted global liquidity squeeze could also impact the real estate market and the financial sector.** Real estate and construction are important contributors to GDP. Acquisition of real estate by foreigners has boomed in recent years and is often financed from abroad. A sharp and protracted slowdown in this demand could increase unemployment and credit risk for the domestic banking sector. In addition, if the downturn contributed to a fall in real estate prices, the drop in the value of loan collateral pledged to onshore banks would require an increase in provisions, a possible contraction in credit, and a weakening of bank profits.

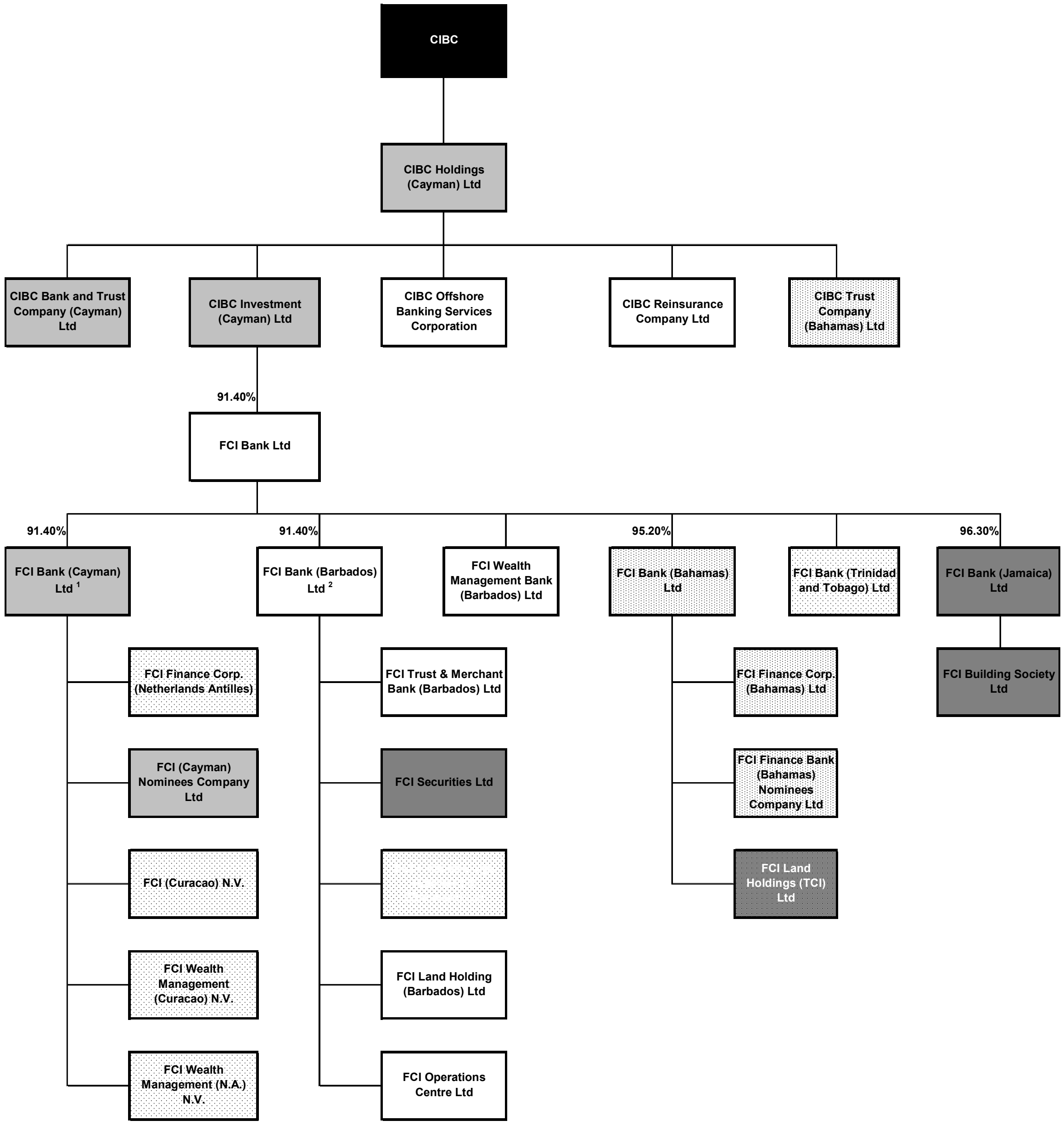
II. Financial System Institutions and Markets

A. Onshore Financial Institutions

10. **The onshore banking sector has grown significantly since the 2002 FSAP and has seen increased consolidation and globalization.** Bank assets have increased from US$3.1 billion in 2002 to US$5 billion in 2007. These assets are equivalent to about 142 percent of GDP, and about 80 percent of all deposit-taking institutions' assets. On-shore banks with increased regional links, as illustrated in Figure 2, focus their operations on consumer and real estate lending; their investment portfolio comprises mostly government bonds (70 percent of investments) held to maturity; and their operations are funded mainly with local deposits (almost 90 percent of liabilities). Off-balance sheet operations are virtually nonexistent. RBC's acquisition of RBTT has recently been approved by their shareholders, and was completed in mid-June 2008.[3]

[3] Currently, the sector comprises six foreign-owned banks (four subsidiaries, two branches) with preeminent Canadian dominance (about 70 percent of system's assets). The Canadian parent banks of the Barbadian institutions remain sound, with a combined CAR of 11.5 percent, and NPLs of only 0.5 percent of loans.

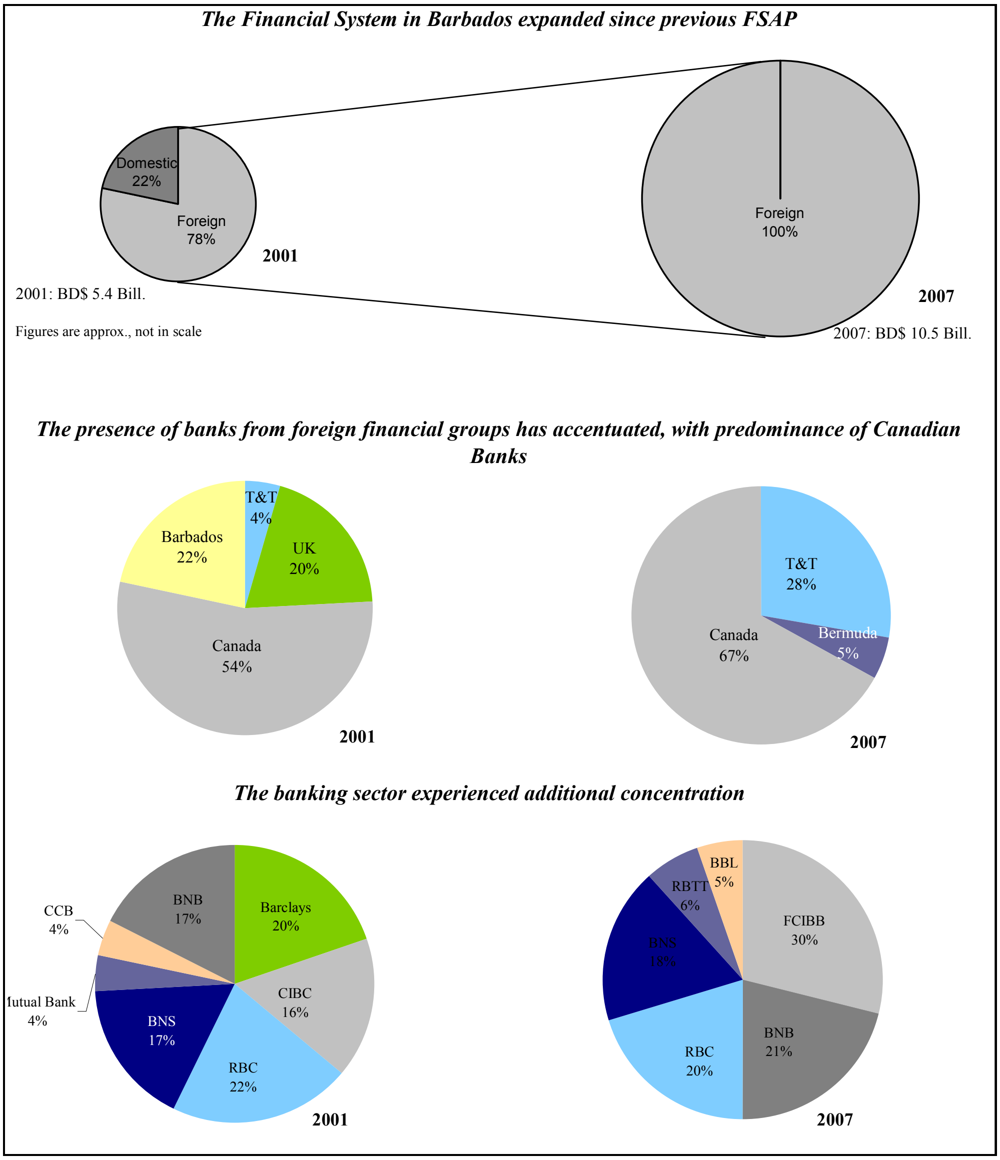
Figure 2: CIBC Structure in the Caribbean



[1] Includes also branches in the British Virgin Islands and St. Marteen.
[2] Includes also branches in Anguilla, Antigua, Belize, Dominica, Grenada, St. Kitts & Nevis, St. Vincent and the Grenadines.

11. **The Barbados Bankers Association (BBA) is working to develop a credit reporting bureau.** A U.S.-based credit bureau is operating in Trinidad and Tobago, and is being considered for development of the Barbadian bureau.

Figure 3: Banking Sector Trends since 2002 FSAP



Source: CBB and FSAP 2002

12. **Onshore banks' CAR exceeds regulatory requirements and nonperforming loans are declining.** At end-September 2007 the sector's CAR stood at 10.8 percent, above the minimum regulatory level of 8 percent. However, the CAR has been declining mainly due to an increase in higher risk-weighted consumer and real estate lending. Supported by the economic expansion, nonperforming loans have sharply declined from 8.2 percent in 2003 to 2.9 percent in 2007.

13. **The system remains profitable and liquid, with moderate positions in foreign currency.** Regulatory requirements on liquidity and foreign exchange exposures have induced banks to remain liquid and only modestly exposed to foreign currency risk. Short-term assets as a ratio to short-term liabilities stand at close to 59 percent. Subsidiaries maintain a long net open position in foreign exchange of 35.3 percent of their capital, and loans and deposits in

foreign currency represent only 3 percent and 17 percent of total loans and total deposits, respectively. For branches, loans and deposits in foreign currency represent 17 percent and 26 percent of total loans and total deposits, respectively.[4]

14. **Consumer credit has expanded faster than other credit activities** (Figure 4). Although private credit has moderated, and is now one of the slowest growing in the region, from 2003–2006, it grew in excess of 15 percent annually.[5] Consumer credit, which includes residential mortgages, has been the most dynamic sector, contributing to the system's hefty profitability. According to published financial sector indicators, rapid credit growth has not, so far, adversely affected banks' asset quality, which is not surprising given the recent sustained period of global expansion. However, the allocation of an increasing share of their resources to consumer and mortgage lending exposes banks to the possibility that the real estate boom might face a correction, especially since consumer and mortgage lending represents as much as 68 percent of total loans.[6]

15. **There are a number of trust companies, finance companies, and merchant banks that are licensed and supervised by the CBB**, with total assets equivalent to 19 percent of GDP. They are not allowed to accept demand deposits, or have access to the central bank's discount facility. A number of these institutions are also licensed by the Securities Commission under the Securities Act to conduct securities market activities.

16. **The securities markets remain illiquid and lack depth owing to the size of the economy, restrictions on capital movements, and investor preference for privately held interests.** The Barbados Stock Exchange (BSE) was established in 1987 and reincorporated under the new Securities Act in August 2001. As of December 2001, capitalization was estimated at around US$1.8 billion or 71 percent of GDP. Even though the number of issues traded on the regular market has not significantly expanded, and, on a net basis, only one additional company has been listed as of December 2007,[7] market capitalization reached US$5.6 billion, or close to 150 percent of GDP.[8]

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[4] Banks can maintain open positions in foreign currency of up to 5 percent of their spot liabilities. If banks have a short position in forwards, they must maintain a long spot position of up to 20 percent of their short position in forwards or 15 percent of their spot liabilities, whichever is higher.

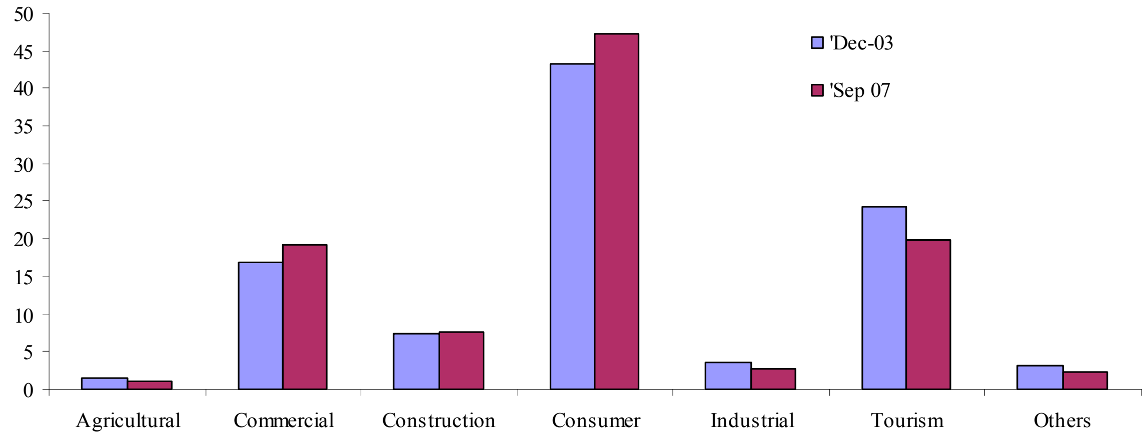
[5] In 2007, Barbados' private non-financial credit growth was close to 8 percent, compared with close to 10 percent for Bahamas, 27 percent for Dominican Republic, 36 percent for Jamaica, and 17 percent for Trinidad and Tobago.

[6] Mortgages grew by about 20 percent in 2007. Most of them carry adjustable interest rates and up to a 95 percent loan-to-value ratio. According to industry participants, the recovery of collateral through a judicial process takes between 6-18 months, relatively rapid compared with the rest of the Caribbean.

[7] There were three new issues over the period and two delistings. Each of the three new offerings was of a substantial size, the most significant one being a demutualization of a local insurance company, producing more than 40,000 individual shareholders.

[8] If cross-listed shares are included, the market capitalization at the end of 2007 reached US$ 9.4 billion or 250 percent of GDP.

Figure 4. Barbados: Credit by Economic Sector, 2003 vs. 2007
(In percent of total loans)

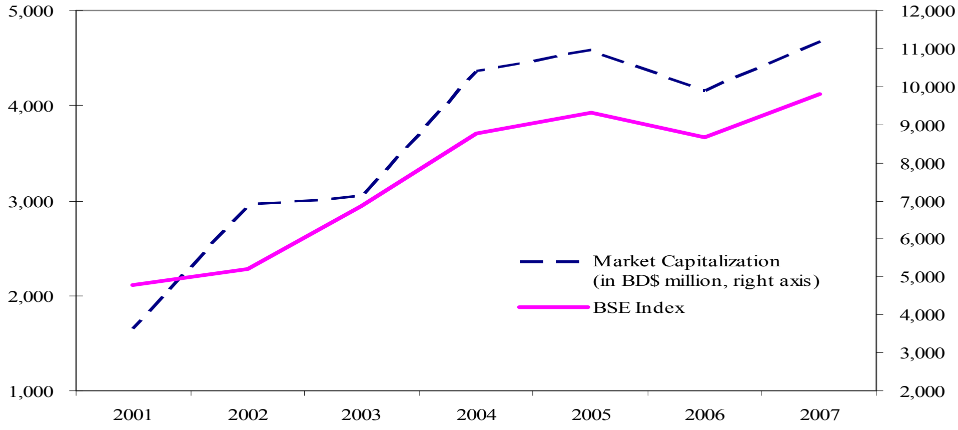


Source: CBB and staff estimates.

17. **The stock market has not yet been affected by the current global turmoil. The BSE index increased by 12 percent in 2007, reversing the 6 percent losses registered in 2006 (**Figure 5**)**. There are currently 26 listed entities and, owing to recent merger activity, two companies are expected to delist in 2008. Of these listings, 18 are domestic Barbadian companies, one is a domestic closed end property fund, seven are regional cross-border listings, and one is a domestic company listed on the Junior Market. Only one company has more than one type of securities listed.

18. **To address the low liquidity and limited number of listed companies available in the region, the Barbados, Jamaica, and Trinidad and Tobago stock exchanges have developed the Caribbean Exchange Network (CXN)**. The initiative uses common electronic trading platforms and connected trading and clearing systems to link the three exchanges into a single network. Phase I (whose regulatory approval is pending) involves a high speed communications network and common trading, clearing and settlement rules to facilitate trading across the three exchanges, although it does not integrate the three trading books. Trades will be cleared and settled between the exchanges' central securities depositories, with payments processed through a major bank operating in all three countries. Phase II would consolidate the three order books, with automated order routing. The linking of the exchanges may create operational interdependences across the jurisdictions that may create challenges for the authorities. As trading volumes on CXN increase, the resulting interconnections will place greater demands on the relevant regulators across jurisdictions, for effective and coordinated oversight of the exchanges, central depositories and clearing facility.

Figure 5. Barbados: BSE Capitalization and Index 2001–2007



Source: BSE.

19. **The mutual fund industry is small, but has more than doubled in size between 2003 and 2007, aided by tax preferences.** In 2003, there were 12 funds with total net assets of BDS$298 million. At the end of 2007, there were total net assets of BDS$759 million in 14 mutual funds, including one closed end property fund listed on the BSE and 13 open-ended funds. Investments in mutual funds and credit unions that are held for at least five years attract a tax credit.

20. **Debt markets are underdeveloped.** From 2003 to 2007, there have been 28 public issues of corporate debt securities for a total of BDS$1,370 million, with slightly over 35 percent of the total being raised in 2006. The BSE facilitates secondary market trading of corporate and government debt securities, but this type of trading is almost nonexistent. The yearly average total value of secondary market trades in government debentures and treasury bills recorded by the CBB as registrar between 2003 and 2007 was BDS$22.4 million. The average number of transfers recorded was 188 per year.

Onshore Banking Stability Analysis

21. **In light of shortcomings in asset classification and provisioning standards identified by the BCP assessors, adjustments were applied to the official data for stress testing purposes.**[9] These adjustments reduced the effective average CAR for the universe of banks analyzed from 10.8 percent to 10.2 percent, with all the banks still complying with the

[9] The adjustments include: (i) provisions for "Special Mention" loans of 5 percent; (ii) increasing the provisioning rate of "Substandard" loans from 10 percent to 20 percent; and (iii) "migrating" 20 percent of the loans in the "Pass" category to the "Special Mention" category.

regulatory minimum level of 8 percent.[10] All the stress tests were conducted considering a benchmark CAR of 10.2 percent.

22. **The stress test analysis suggests that the main vulnerability faced by the domestic banking system is credit risk stemming from a downturn in economic activity.** Specifically, although a credit risk baseline scenario based on WEO projections shows that the capitalization of the on-shore system would remain above the minimum capital requirement, one bank's CAR would fall below the minimum 8 percent.[11]

23. **An extreme but plausible decline in tourism receipts, or in construction activity, would reduce banks' capital adequacy requirement below the regulatory minimum.** A 15 percent decline in tourist arrivals, or a 15 percent decline in the construction sector, would drive the CAR of the system from the current 10.2 percent to 6.7 percent and 5.9 percent respectively. If the system were hit simultaneously by several significant shocks, including a 15 percent decline in both tourism and construction, a 500 bps increase in interest rates, 50 percent increase in oil prices, and a material recession in the U.S., the capitalization ratio of the system would decline to 3.6 percent, and all the banks would be below the regulatory minimum. Some of these shocks are extreme. The tourism shock would be about 30 percent larger than the large tourism drop experienced in 2001; the construction shock would be a sharp reversal of recent year trends (about 9 percent growth on average per year), and much deeper than the previous cycles, where there was only a slowdown in construction activity (e.g. in 1996, 2000 and 2003). However they are also plausible because GDP fell by 4 percent form the last quarter of 2001 through the first half of 2002, and in the early 1990s, GDP fell by more than 6 percent. Also, a 500 bps increase in interest rates would be similar to the major increase in interest rates in the early 1990s, when, for example, the treasury bill rate jumped by 460 bps from March 1991 to March 1992.

24. **Domestic bank vulnerability to market risks is more limited**. In particular:

- **Interest Rate Risk.** An increase in interest rates of 5 percentage points would reduce the CAR to 8.4 percent, and the CAR of one bank with a sizable maturity gap would fall below the regulatory minimum.[12]
- **Exchange Rate Risk.** Changes to the currency peg would have only moderate effects on banks' capitalization. In the event of a currency depreciation, given the long net position in foreign currency held by banks, the negative effect of the quite limited foreign currency induced credit risk would be offset by the direct positive balance sheet effect derived from the long positions. A depreciation would be positive for banking sector CARs. On the other

[10] The stress test covers the four subsidiaries of the on-shore banking system.

[11] The authorities have approached this bank requesting an increase in its CAR because it is currently only slightly higher than the minimum regulatory level.

[12] Subsidiaries and branches have similar ratios of cumulative gaps over assets: -26.8 percent and -24.2 percent respectively. Also, government securities comprised only 14 percent of assets of the subsidiaries, and 17 percent of the assets of the branches.

hand, a 10 percent appreciation would slightly reduce the CAR from 10.2 percent to 9.9 percent, without bringing any bank below the regulatory threshold.

- **Liquidity Risk.** Liquidity risk was tested by assuming a sudden, large deposit run on the subsidiaries of foreign banks (e.g., simulating a reputational shock to the parent company abroad), equivalent to a run on deposits of 30 percent in a 30-day period. No banks become illiquid under this scenario, although two banks would suffer significant strain—the ratio of liquid assets to short term liabilities would decline from 57.3 percent to 31.6 percent for subsidiaries, and from 60.8 to 36.1 for branches. The same deposit run would potentially leave one foreign branch illiquid. Should the external funding dry up, the ratio of liquid assets to short-term liabilities would decline to 50.4 percent for subsidiaries, and to 53.6 for branches, while no banks would become illiquid (i.e. suffer negative cash flow).[13]

Table 1. Stress Testing: Summary of Results

Case	CAR Official Data	Adjusted CAR 1/	Baseline	CAR After Shock	Number of Banks CAR<8%	Number of Banks CAR<0%
Credit Risk						
Baseline 2/	10.8	10.2	8.4	-	1	0
"Perfect Storm" Scenario 3/	10.8	10.2	-	3.6	4	1
Interest Rate Risk						
+500bp	10.8	10.2	-	8.4	1	0
-500bp	10.8	10.2	-	11.9	0	0
Exchange Rate Risk						
10 percent depreciation	10.8	10.2	-	10.5	0	0
10 percent appreciation	10.8	10.2	-	9.9	0	0

Source: authorities and staff estimates.
Notes:
1. Adjusted CAR correspond to the CAR after introducing a 5% provisioning rate for "Special Mention" loans, increasing the provisioning rate for "Substandard" loans to 20 percent, and migrating 20 percent of "Pass" loans to "Special Mention."
2. The Baseline case is based on WEO projection of macroeconomic variables for 2008.
3. The Macroeconomic Scenario includes a 15 percent decline in tourism, a 15 percent decline in the construction sector, a recession in the US of -3.0 percent of GDP, and an increase in oil prices of 50 percent.

[13] No formal inter-bank contagion analysis was carried out due to the lack of individual interbank lending activity data. However, the fact that interbank lending amounts to 5 percent of total excess reserves suggests that interbank contagion is not a significant concern. Contagion from a foreign parent bank may also be limited because funding from foreign parent banks amounts to only 10 percent of total funding.

Credit Unions

25. **The credit union sector has continued to expand and compete with banks in the consumer lending segment.** Although there have been no new registrations in the last five years, the combined assets of the 34 credit unions[14] are equivalent to about 14 percent of GDP**,** compared to 10 percent during the 2002 FSAP. The sector remains highly concentrated with the two largest credit unions accounting for 71 percent of total assets and 73 percent of the total membership. Smaller banks express frustration at the tax breaks and lower compliance costs afforded to the credit unions, because, from their perspective, this puts them at a competitive disadvantage.

26. **Official figures understate the actual loan delinquency rates in the credit union sector.** The official rate was 6 percent rate, as of September 2007, but does not consider arrears on past due loans over 30 days.[15] Return on equity for the largest credit union was 6 percent for 2007, while the loan-to-deposit ratio for the sector stands at 87 percent. Loan origination polices for the largest two credit unions have improved since the 2002 FSAP due to enhancements made to the credit policy guidelines and member financial education programs.

B. Institutional Investors

National Insurance Scheme

27. **The National Insurance Scheme (NIS) is the social safety net program providing pension and other social welfare benefits, including unemployment insurance and severance schemes. It was set up by national legislation in 1967 and is governed by a tripartite board that comprises representatives from government, labor, and employers.** The actuarial review of December 1999 indicated an actuarial deficit and the expectation that, other things being equal, the fund would be exhausted by 2030. In response, a pension reform in 2002 increased contributions and adopted a range of parametric reforms to benefits, including a gradual increase in the retirement age to 67 years by 2018. The reforms significantly lengthened the time horizon for investment of the assets of the NIS. As of February 2008, NIS' assets were valued at BDS$2.7 billion (about 30 percent of GDP) up from BDS$1.4 billion in 2002. Current actuarial estimates indicate that assets will continue to grow until around 2030, or longer under more optimistic assumptions.

28. **A shortage of suitable local investment opportunities has meant the NIS cannot achieve its preferred investment profile and its target investment mix appears sub-optimal.** The current NIS investments include largely domestic instruments: government

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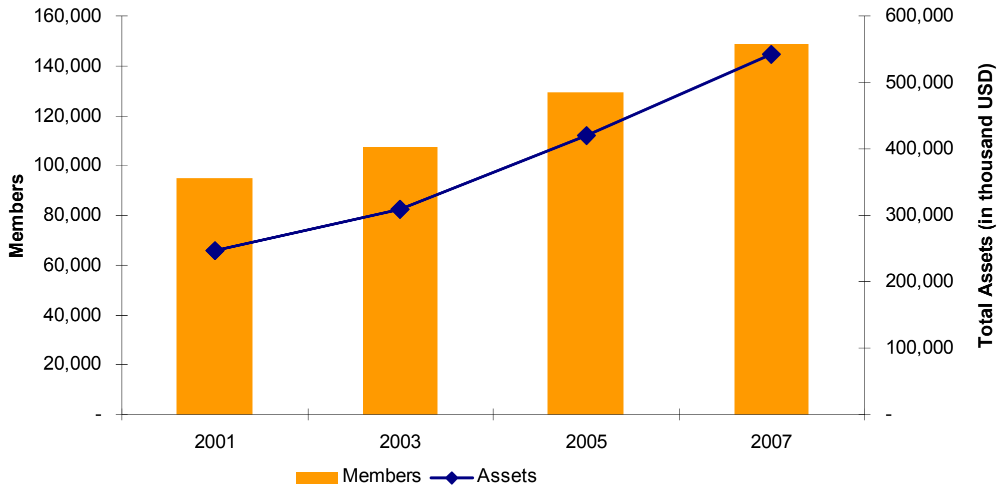
[14] The largest two credit unions have assets of $252 million and $134 million, eight "medium" credit unions have assets which range from $34 million to $7.5 million , and the remaining 24 "small" credit unions have combined total assets of US$28 million.

[15] Late payment is considered past due only after 90 days.

securities, other fixed interest investments and bank deposits (Figure 7). Equity and real estate (including government occupied buildings) represents only 18 percent of the investments. The current portfolio mix is suboptimal compared to the target asset mix developed by the NIS. All NIS's asset classes, other than money market investments, are below the target asset mix—due to a lack of access to investable opportunities. Over 63 percent of assets are directly or indirectly invested in Barbadian government instruments and a sizable 24 percent is held in

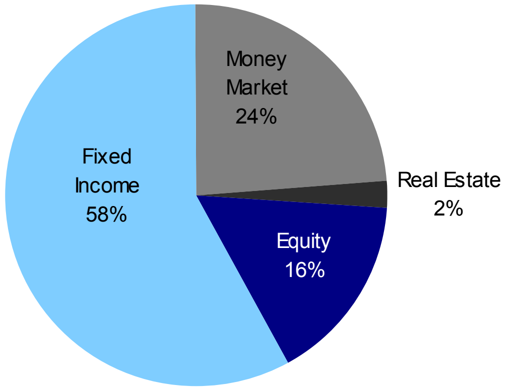
Figure 6. Barbados: Credit Unions Growth (2001–2007)



Source: Registrar, Cooperatives Department for the FSAP questionnaire.

money market instruments (mostly demand deposits). Furthermore, because the liability profile has changed and lengthen as a result of the recent reforms, the optimal investment portfolio strategy should now include a larger share of longer term investments, and in all likelihood, increased investment outside Barbados. Therefore the NIS's investment strategy should be revisited.

Figure 7. Barbados: NIS portfolio structure, 2007



Source: NIS

Insurance Sector

29. **The insurance sector is an important part of the financial system.** Existing market penetration has led the sector to look outside Barbados for growth. The insurance penetration rate—the ratio of premiums to GDP—was equal to 10.3 percent in 2006 (3.3 percent for life insurance and 7 percent for non life insurance).[16] This is the highest figure in the world with respect to non life insurance and 9th highest overall in total as opposed to 2.4 percent for the total Latin American and Caribbean countries. Real and nominal growth has been strong over the last five years. Strong competition in the non life sector, in the context of a moderating market growth outlook, can be expected to continue to drive consolidation in the local market and reliance on regional expansion.

30. **Profitability and capital adequacy are difficult to assess due to incomplete and inadequate data**. The introduction of Minimum Continuing Capital and Surplus Requirements for life companies, a Minimum Capital Test for general companies, and a Branch Adequacy Test for branches of foreign companies are important achievements made possible by the Supervisor of Insurance & Pensions' (SOIP) amendments to the Insurance Act. However, the effectiveness of these regulations is severely limited by the lack of adequate data. Although most companies adhere to provisioning techniques based on the Canadian systems voluntarily, providing a measure of consistency, adequacy and comparability, the system is heavily dependent on the management of the insurance companies. Adopting appropriate accounting and reporting standards under the insurance law would allow the regulator to better assess the stability of the insurance sector.

31. **The exposure to natural hazards in the Caribbean is an important challenge for the insurance sector and is, increasingly, managed through the group head offices of regionally linked companies.** Continued regional diversification has meant that reinsurance programs have become more complex and are often arranged at a group level. Although no issues were identified in terms of the quality of reinsurance programs, continued diligence and assessment is recommended as part of regional cooperation between supervisors. The effectiveness of reinsurance programs is a key issue for supervisory oversight in the Caribbean and, with the regionalization of the sector, can only be adequately addressed through cooperation between supervisors in home and host jurisdictions.

32. **Insurers continue to face challenges in sourcing investable assets.** Insurance companies have difficulty in finding appropriate long-term investment vehicles in the Barbados capital markets that meet the statutory investment regulations. Nonlife companies in 2006 had more than 36 percent of their invested assets in cash balances. In contrast, cash represented only 12.53 percent of the life companies' investment portfolios in 2006, as they

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[16] These figures were computed based on unpublished and incomplete Supervisor of Insurance's report for December 2006.

were more active in mortgage and policy loan transactions as a means of balancing their portfolio.

C. Offshore Financial Institutions

33. **As in the rest of the Caribbean, the importance of regional and global financial linkages has continued to increase.** Motivation for financial linkages includes risk diversification, search for yield and tax avoidance (Box 2), and a desire to increase market share. As documented in the Technical Note, financial conglomerate activity in Barbados has accelerated in size and heterogeneity. The authorities also value the offshore sector as a source of employment opportunity for the professional sector and revenue for the government through license fees.

34. **Offshore financial institutions saw a rapid growth in 2007.** Total assets of offshore banks grew 15 percent in the first nine months of 2007 to BDS$94.78 billion and represented about 1,285 percent of GDP. There are currently 54 offshore banks, but there is also considerable asset concentration. The four largest offshore banks, all members of Canadian groups,[17] represent 75 percent of the system's assets, and the ten largest represent 91 percent. At the end of 2006, there were 441 insurance companies registered to carry on exempt or qualifying business in Barbados. However, of these only 181 exempt and 61 qualifying companies were active. The majority of these insurers are of U.S. and Canadian origin and are associated with either financial institutions in those domiciles or industrial firms. In the case of the industrial firms, the insurer is most likely to be a captive. In the case of the firms associated with financial institutions, some will be captives and some will be companies providing cover to the customer base of the institution.

35. **The gains of global and regional linkages have to be balanced with the risk of contagion, requiring greater cross-border supervisory coordination.** To avoid regulatory arbitrage and contagion risk, harmonization among regulators is paramount. Given the regional and international structure and operations of the commercial and off-shore banks, the CBB has entered into a few MOUs that facilitate the sharing of information. A regional MOU was signed May 2004 among most of the Caribbean jurisdictions, with a number of jurisdictions, including the Eastern Caribbean Central Bank not yet signatory. Despite the long time presence of foreign banks in Barbados, the CBB does not yet have an MOU with either Canada or Bermuda. Also, closer communication with the Canadian financial sector supervisor (OSFI) in the case of banks and with the insurance supervisory staff in Trinidad in the case of insurance, will provide the local authorities with a better understanding of the risks associated with the institutions that they supervise.

36. **Offshore banks are a heterogeneous group.** They differ significantly in terms of size, capitalization structure, activity and presence in the region. Operations of the offshore service

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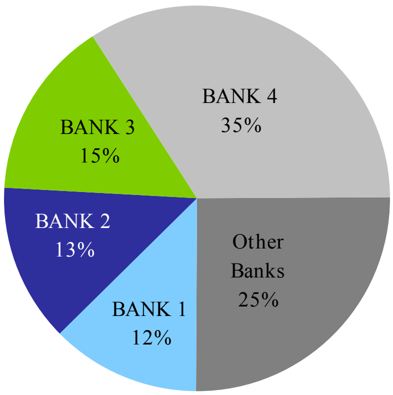
[17] The four largest banks (in order) are CIBC Offshore Banking Services Corporation, Barrick International Bank Corp., National Bank of Canada (Global) Ltd and Bank of Montreal (Barbados) Ltd.

providers include: banks that take non-Barbadian third party deposits; those that offer treasury functions for their related organizations; wealth managers for high-net worth individuals; and a commodities broker.

Figure 8: Offshore Banks distribution in Barbados



Source: CBB

37. **Offshore banks are insulated from the domestic banking system.** Their deposit-taking activities are highly circumscribed, thereby limiting their potential to destabilize the domestic financial system, and effective "Chinese walls" appear to exist between affiliated on- and off-shore banks. Although some financial groups have both types of operations incorporated in Barbados, transactions between their on- and off-shore entities appear to be limited or nonexistent. Domestic banks conduct operations only with residents while offshore banks are prohibited from doing business with local residents and operate only with international clients. Strict prohibitions on activities between on- and off-shore banks and the incentive to comply, given the risk the loss of tax incentives (through the loss of their license), promote a distinct and separate offshore sector.

38. **Reputation risk is a concern among offshore financial institutions.** Foreign banks choose to establish an offshore subsidiary in Barbados not only for its tax advantages, but also for its reputation. Given the importance of reputation to the health of this sector, the CBB is advised to increase the number of staff at the CBB qualified to deal with the complexities of the off-shore sector, and to establish closer working relationship with the home supervisors of foreign banks.

39. **Supervision of the offshore insurance sector is almost nonexistent.** Apart from filing the company's financial statement with the SOIP, little if any contact exists between the SOIP and the sector. Timely information from the sector appears to be problematic, as 2006 financial data had not been compiled at the time of this assessment. Due to resource constraints, there have been no onsite inspections or offsite analytical reviews of these entities.

Box 2. The Tax Benefits for Offshore Financial Institutions

Offshore entities domiciled in Barbados benefit from a lower corporate tax rate of 1-2½ percent (compared to a standard rate of 25 percent for onshore companies), with some insurance structures enjoying even lower tax rates. There are no taxes on capital gains, and holding companies domiciled in Barbados are exempted from paying taxes on foreign dividend income. Also, Barbados has concluded double taxation avoidance treaties (DTATs) with a number of jurisdictions, most notably Canada and fellow CARICOM countries, which offer special advantages to offshore companies domiciled in Barbados. Accordingly, profits made and taxed in Barbados would not be subject to "double taxation" on repatriation to the parent company (e.g., in Canada). Canada in particular provides special advantages to offshore subsidiaries. Canadian law considers overseas income of Canada-based companies as "tax-exempt surplus," if it satisfies three provisions:

- The subsidiary is resident in a jurisdiction, with which Canada has a DTAT;[1]
- The entity is regulated by a competent and recognized authority; and
- The income is derived from so-called "active business," which is generally understood to mean that the subsidiary employs six or more full-time employees. [2]

Additional benefits accrue if "active business" is conducted with other third-country subsidiaries of the parent company, depending on whether or not they have a DTAT with Barbados. Investment treaties that provide assurances against expropriation, also encourage large conglomerates to channel their investments into these third countries via Barbados. From the perspective of parent jurisdictions, DTATs are concluded with countries like Barbados in order to allow their own large multinational corporations to be internationally competitive and efficiently manage their global cash flow.

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[1] The definition of resident organization is left for the host jurisdiction to determine. Offshore companies are considered domiciled in Barbados if "central management and control" is exercised in Barbados; hence the requirement to hold regular Board meetings on Barbadian soil.

[2] If the subsidiary's income does not satisfy these requirements and is deemed as "passive," it may still benefit, when repatriated, from a credit of tax paid in the subsidiary jurisdiction.

III. Financial System Supervision and Regulation

40. **The Ministry of Finance is responsible for regulating most of the financial system. In particular:**

- The Ministry grants and revokes licenses, other than under the Securities Act (SA) and Mutual Funds Act (MFA), and issues financial regulations.[18]
- The Ministry's Office of the Supervisor of Insurance and Pensions in the Ministry is responsible for the supervision of the insurance sector.

Through delegation and relevant financial Acts:

[18] Although the MOF has the general power to revoke licenses under most of the conditions established by the FIA, in the cases when the CBB decides to intervene in a bank, the CBB does not need approval but does have to notify the MOF before proceeding.

- the CBB's Bank Supervision Department is charged with the prudential supervision of: i) commercial banks; ii) trust and mortgage companies, finance companies and merchant banks (so-called *Part III companies* under the Financial Institutions Act); and iii) offshore banks under the International Financial Services Act; and

- the Securities Commission is charged with the licensing and supervision of the securities companies, mutual funds and their administrators, the BSE, CSD and other market actors.

In addition:

- The Registrar of Cooperatives and Friendly Societies in the Ministry of Commerce, Consumer Affairs and Business Development is responsible for supervising the credit unions.

- The Deposit Insurance Corporation administers the deposit insurance fund.

- The Financial Intelligence Unit, under the Attorney-General, is in charged with the prevention and control of money laundering and financing of terrorism.

41. **The authorities are reviewing a blueprint to reform the regulatory architecture by establishing a Financial Services Commission.** The previous Administration recommended the establishment of an FSC, which would bring together three supervisory agencies (the Supervisor of Insurance and Pensions, the Securities Commission, the Cooperatives Department) and the unit is the International Business Division of the Ministry of Economic Affairs and Development (MAED) under one roof. Economies of scale and the strengthening of the supervision of the non-bank financial sector were the main motivation of this initiative. The current Administration is assessing how to best launch the initiative.

42. **The Bank Supervision Department (BSD) is shifting its scope of operations and the structure of its office to more effectively conduct risk-based supervision.** Currently, it is in a transitional phase, shifting from a pure off-site/on-site model to a portfolio approach. Responsibility for many institutions has been recently re-assigned, and guidelines addressing the existing risks are in various stages of development;[19] risk-based supervision is being implemented and the BSD is preparing to implement the Basel II capital accord. Furthermore, based on a CBB quantitative impact study, the mission recommends making adjustments to the timetable for the adoption of Basel II, including by considering changing risk weights, delaying the implementation schedule, and strengthening the Pillar 2 framework.

43. **The BSD plans to implement Basel II from 2009 although it indicated a possible delay.** According to the BSD's plan, all licensees are required to implement the Standardized

[19] Since the 2002 FSAP, 12 guidelines have been issued as of April 2008 and 3 more guidelines are expected to be issued. The current guidelines range from corporate governance, operational risk, outsourcing, AML, foreign exchange and settlement risk, electronic banking, liquidity risk, credit risk, country risk, and market risk.

Approach for credit risk and market risk, and the Basic Indicator Approach or Standardized Approach for operational risk from 2009. The BSD intends to consider a possible transition to the Advanced approaches for credit risk after 2012. It is recommended that the BSD considers the results of a full-scale qualitative impact study and the risk weightings for retail credit and residential mortgage loans, as well as strengthening Pillar 2, in the planed implementation of Basel II; to prevent any undue reduction in the capital level of the Barbados banking system.

44. **In spite of some progress since the 2002 FSAP, there is still room for further improvement in banking regulation and supervision.** Some weaknesses identified in the BCP assessment include (i) outdated regulations (e.g., capital adequacy, asset classification and provisioning), (ii) deficiency of prudential rules on large exposures and exposures to related parties, (iii) the incomplete state of the supervisory framework (e.g., risk assessment model, prompt corrective actions) for risk based supervision, (iv) the lack of a broader scope for onsite inspections that would review banks' risk management activities, (v) a weak legal framework for consolidated supervision of banking groups and financial conglomerates, and (vi) the insufficiency of cross-border home/host cooperation.[20]

45. **The authorities could further tailor the regulations of the financial institutions licensed under the FIA and the IFSA to better control their diverse risk profile.** All financial institutions under the CBB's supervision are subject to the same regulations, including their capital to risk weighted assets ratio. Because most regulations and guidelines are bank-oriented, they may not be well suited to control certain types of nonbank financial institutions' risk profile. Although the authorities make allowances for differences in the activities, size, and complexity of several of the different institutions, further regulation differentiation across FIA and IFSA intermediaries would better help to keep their risk profile in check.

46. **There is no aggregate limit on banks' large exposures.** Exposures to a single person or group are limited to 25 percent of a bank's stated capital and reserves, and 10 percent of its stated capital and reserves for unsecured exposures. Although the authorities monitor large exposure limits for groups, there is no explicit legal provision dealing with an aggregate large exposure limit. The CBB indicated that it is working on introducing a regulation for an aggregate limit for such exposures. In addition, the CBB is encouraged to expand the guidelines on credit risk management to address concentration risk.

47. **In 2001, a new SA was enacted leading to the creation of the Securities Commission, which is in charge of supervising and regulating the securities markets.** Market intermediaries, public companies, the BSE and the Barbados Central Securities Depository Inc. (CSD) all are required to be authorized under the SA by the Securities

[20] Appendices I and VI provide a detailed list of recommendations.

Commission. In 2002, the new MFA was proclaimed, governing the licensing and operation of mutual funds and mutual fund administrators.

48. **Owing to regional initiatives, such as the formation of CXN and IOSCO developments, the need for improvements in and harmonization of the relevant legislation has been recognized.** A committee has been meeting regularly for several years to identify needed updates. In particular, some gaps in the Commission's authority with respect to on-site supervision and information sharing were noted. The Securities Commission does not have rule-making authority or a general ability to grant exemptions and so cannot react quickly to changing market demands.

49. T**he BSE and CSD are self-regulatory organizations that exercise regulatory authority over securities market activities under the oversight of the Securities Commission.** The BSE has been delegated authority under the SA to approve the listing of securities on the exchange, supervise market activity, regulate daily trading, register and license market actors and monitor market conduct. The CSD is a wholly owned subsidiary of the BSE and it acts both as the central depository for all listed securities and as registrar and transfer agent for listed companies. The CSD has delegated authority to regulate clearance and settlement of transactions, approve new issue prospectuses for registration with the Securities Commission and issue certificates of approval for these prospectuses. Virtually all securities of listed companies are held in dematerialized form at the CSD and all trades on the BSE must be settled at the CSD.

50. **The Securities Commission and BSE are both responsible for licensing and overseeing the activities of broker-dealers.** The Securities Commission does not perform an on-site visit prior to the applicant being licensed. The BSE confirms the appropriate books and records and connections to CDS are in place before granting its approval to an applicant. Neither imposes a specific requirement that firms have adequate internal controls and risk management procedures or a compliance function. The Securities Commission has carried out limited on-site examinations of firms in collaboration with the CBB and is building capacity to perform regular inspections on its own. The BSE is developing an inspection program for its members.

51. **A recent takeover bid highlighted the need for updating and harmonizing the regulatory regime across the region and the application of local rules in a cross-border context.** The takeover bid regulations were made under the 2002 Companies Act and had functioned acceptably for friendly bid transactions. They proved to be less robust during a recent cross-border multiple bidder hostile takeover. The transaction also brought to the surface material differences between the requirements in Barbados and in Trinidad and Tobago, gaps in the overall regime and limits on the Commission's authority to obtain information, such as a valuation of one of the companies involved. Also, the requirements of companies and insiders to disclose material transactions were brought into question. Several industry members commented that the transaction, and how it was handled, had eroded market confidence.

52. **The Registrar of Cooperatives and Friendly Societies is charged with the supervision and regulation of the credit unions and other cooperatives, and is slowly building capacity to conduct adequate supervision.** The Registrar's office has a staff of five supervisors responsible for the oversight of 34 institutions. The authorities have carried out joint Registrar-Cooperatives Department CBB inspections on an annual basis for each of the largest credit unions between 2003–2007. However, there are no planned inspections for 2008 which, given the capacity limitations of the Cooperatives Department, exposes the sector to inadequate oversight.

53. **The Cooperative Societies Act was amended in December 2007 and its regulations updated in January 2008.** In 2002, the authorities were weighing some amendments to the Act, among other things, to strengthen the supervision of credit unions. As an alternative, and recognizing their focus on financial services compared to the rest of the cooperative societies, the mission recommended the issuance of a specialized credit unions law. Specifically, such a law would better tailor the prudential oversight of credit unions, including through credit union-specific inspections, well-targeted regulations and guidelines, clear identification of permissible and prohibited activities, improved definition of the operations a credit union could undertake, and improved loan origination policies. It is unlikely that the amendments will serve as a good substitute for a dedicated Act.

54. **The supervisory and regulatory standards with respect to the insurance sector in Barbados have, hitherto, relied primarily on the good faith of industry participants.** This approach exposes the sector to important risks. A single negative event may significantly damage the reputation of a jurisdiction in an increasingly regional and global market. Steps to formalize and improve regulation would help to protect the reputation and the charter value of the insurance business in Barbados from negative shocks.

55. **The authorities are in the process of improving supervision and regulation of the insurance sector.** The one material regulatory project that has been advanced since the 2002 FSAP is the development of additional capital requirements based on risk assessment. This includes the introduction of the Minimum Continuing Capital and Surplus Requirements for life companies, the Minimum Capital Test for general companies, and the Branch Adequacy of Assets Test for branches of foreign companies operating in Barbados. These provisions are part of the SOIP's proposed amendments to the Insurance Act Cap 310 and are expected to be finalized this year.

56. **Insurance supervision has added resources and commenced a limited on-site inspection program, but continues to need more resources and redesigned processes to enforce the current provisions in the law.** On-site inspections commenced in 2004, although they need to be supported by a more analytical, rather than compliance oriented, off- site analysis. This, in turn, will require better content and more timely information collection. Supervisory independence should be enhanced by greater transparency and public reporting and through the transition to the proposed FSC.

57. **Attention to the development of several standards and circulars would further enhance the observance of the IAIS principles.** In particular, standards on corporate governance, market conduct, internal controls (including asset and derivative controls, particularly in the case of the offshore market), asset and liability valuation, and a solvency standard for life insurers would lead to a considerable improvement in the observance of the principles.

IV. INFRASTRUCTURE

A. Banking Safety Net Arrangements

58. **The CBB is the Lender of Last Resort.** The CBB Act appoints the CBB as the provider of liquidity support. The current framework allows for emergency lending to be channeled through the discount window, which has carried a 12 percent interest rate since 2006 (via collateralized short-term lending), and the purchase of government securities. And there is no explicit individual or aggregate limit on the use of this facility. In order to ensure that the discount window interest rate policy provides proper banks' liquidity management incentives throughout the business cycle, the CBB may want to modify the rate according to market conditions and review its collateral valuation policies.

59. **The authorities introduced a compulsory deposit insurance scheme in mid-2007 for institutions licensed under the Financial Institutions Act (FIA).** The deposit insurance corporation (DIC) was established as a distinct separate entity from the central bank and is in charge of the management of the deposit insurance fund. This Fund covers up to BDS$25,000 (US$12,500) per depositor and per institution registered under the FIA. Membership of these institutions in the DIC is compulsory. The Fund is administered by a seven member Board of Directors appointed by the Minister of Finance. Two members represent the Central Bank, and one represents the Minister of Finance.

60. **The DIC is jointly funded by the CBB and the DIC members.** The premium paid to the DIC by its members is a flat 0.05 percent of the institutions' yearly average deposit liabilities. When the institution first opened, the CBB provided a one-time contribution and also matched the total initial membership fees from members to the DIC. Because the DIC was launched recently, as of January 2008, the DIC's fund represented only about 0.2 percent of total deposits. In the event that these funds prove insufficient, the Deposit Insurance Act authorizes the DIC to issue securities and to borrow from the CBB and the Ministry of Finance. The authorities may also want to assess the possibility of, at least temporarily, raising premiums to boost the size of the fund, which is low compared with many international benchmarks.

61. **Market discipline is an important complement to supervision and regulation.** Information regarding the characteristics of the deposit insurance scheme needs to be transmitted more broadly to the public, including which institutions are not covered by the DIC (e.g., credit unions).

B. Bank Resolution

62. **Even though the deposit insurance Act also gives powers to the DIC to act as a liquidator of failed institutions, the CBB would continue to lead the liquidation process.** The 2006 FIA amendments grant the CBB more bank intervention and resolution powers. In the past, both reorganization and winding-up procedures were subject to lengthy court rulings and predetermined timeframes. The DIC and the CBB are also drafting an MOU, which would include several cooperation areas and would clarify relations and procedures to be followed in the exchange of information and data, including in case of an institution's failure.

63. **Going forward, both the CBB and the DIC will need to work on the design of early warning systems, a prompt corrective action framework, and resolution procedures to complete the safety net framework.** An adequate set of prompt corrective actions would impose (cumulative) restrictions of increasing rigor on the operations of banks in step with deteriorating capital ratios below pre specified thresholds. Since the CBB would have to enforce minimum corrective actions, the DIC' s functions and objectives should be also taken into account in the CBB's design of a more transparent and systematic corrective action framework. Finally, because determining the identity of qualified covered depositors during a resolution can be computationally intensive, it will be important to ensure close cooperation among the government and the CBB and DIC during such events.

C. Crisis Management

64. **An important consideration in planning the response to a crisis would be consultation and co-ordination with overseas authorities, especially from Canada.** In the event of a crisis affecting a Barbadian financial institution with overseas affiliates, it would be important that foreign host authorities be informed. Likewise, in the event of a problem overseas affecting an affiliate of a Barbadian financial institution, it would be important to obtain information from the host and home authorities. In either case, all authorities need to establish a clear understanding regarding their respective roles, information needs, and co-ordination of actions. Exchange of information and consultation with regulatory authorities in Canada does not seem to be as fluid as it should be given the important presence of Canadian banks in Barbados.

65. **Beyond the immediate steps required to diagnose and contain a financial crisis, the authorities need to have clear procedures for the subsequent process of resolving a crisis.** Ideally, such procedures should rely on least-cost criteria. There should be a clear understanding of the circumstances in which emergency lending arrangements for individual institutions should be used; when the provision of such assistance should give way to measures aimed at resolving a solvency problem; how alternative options for resolving such a problem should be selected and implemented; and various institutional arrangements, such as asset management corporations, or bridge banks should be designed and used in the resolution process. In addition, the authorities could establish protocols, based on regular "fire drills" with Caribbean and Canadian financial system supervisors, regarding crisis management procedures and the treatment of a failure of internationally active financial institutions.

Table 2. Barbados: Selected Economic, Financial, and Social Indicators

I. Social and Demographic Indicators (most recent year)

Population (people in millions)	0.274	Adult literacy rate	99.4
Per capita GDP (in US$)	12,426	Population share below poverty line	13.0
Life expectancy at birth in years	75.4	Gini coefficient	42.0
Rank in UNDP Development Index	31	Unemployment rate	7.4

Main products, services and exports: tourism, financial services, rum, sugar, and chemicals.

II. Economic Indicators

	2004	2005	2006	Prel. 2007	Proj. 2008	2009
	(Annual percentage change)					
National accounts and prices						
Real GDP	4.8	4.3	3.3	3.3	2.3	2.0
Deflator	-0.2	2.3	2.8	3.5	8.7	5.7
Nominal GDP	4.5	6.7	6.2	6.8	11.2	7.8
CPI inflation (average)	1.4	6.1	7.3	4.0	9.0	5.9
CPI inflation (end of period)	4.3	7.3	5.7	4.8	8.6	3.2
Domestic demand (contribution to growth)	7.8	-2.8	-2.7	0.8	1.9	3.5
Foreign demand (contribution to growth)	-3.1	7.1	6.0	2.5	0.4	-1.5
External sector						
Exports of goods and services	5.5	21.8	8.6	7.8	8.3	5.4
Imports of goods and services	14.8	17.9	2.0	5.6	11.5	6.0
Real effective exchange rate (average)	-5.2	1.3	3.8	3.7	...	...
Terms of trade	-3.4	-5.9	-3.8	-0.3	-3.5	0.8
Money and credit (end of period)						
Net domestic assets	43.5	14.1	14.2	9.3	0.2	15.8
Of which: private sector credit	16.7	21.7	13.2	6.4	2.5	7.8
Broad money	17.4	6.9	11.3	13.2	2.8	13.7
Velocity (GDP relative to broad money)	1.2	1.2	1.1	1.1	1.2	1.1
Interest rate on deposits (average in percent per annum)	2.5	4.1	4.7	5.1	4.8	4.6
Interest rate on loans (average in percent per annum)	9.8	10.6	10.7	10.7	10.7	10.7
	(In percent of GDP, unless otherwise indicated)					
Public finances (fiscal year)						
Nonfinancial public sector overall balance	1.4	-3.6	-3.7	-5.0	-4.0	-3.0
Central Government						
Revenue and grants	33.1	35.1	34.2	34.9	35.3	35.1
Expenditure	35.7	36.4	36.3	38.9	37.5	37.3
Interests	4.6	4.8	5.0	4.9	5.2	5.1
Balance	-2.5	-1.3	-2.0	-4.0	-2.2	-2.2
NIS	3.6	3.7	4.2	4.2	3.8	4.3
Public enterprises	-1.0	-4.2	-2.0	-3.3	-3.6	-3.3
Off-budget activities	1.3	-1.9	-3.9	-2.0	-2.0	-1.8
Primary balance	4.5	-0.1	0.0	-1.4	-0.1	0.7
Debt						
Total external debt 1/	39.5	41.3	43.4	39.6	41.2	42.6
Public sector (fiscal year)	87.1	91.6	92.8	94.6	95.7	96.7
External	27.3	28.9	27.6	24.2	26.0	25.6
Domestic	59.8	62.8	65.2	70.4	69.7	71.1
Savings and investment						
Gross domestic investment	23.7	24.8	26.6	26.8	22.1	22.1
Public	7.5	6.9	7.6	7.5	5.6	5.6
Private	16.2	18.0	19.0	19.4	16.5	16.5
National savings	11.2	12.0	17.9	19.6	13.6	13.8
Public	8.9	3.2	3.9	1.0	1.6	2.5
Private	2.4	8.8	14.0	18.7	12.0	11.2
External savings	12.4	12.8	8.7	7.2	8.5	8.3
Balance of payments						
Current account	-12.4	-12.8	-8.7	-7.2	-8.5	-8.3
Capital and financial account	6.9	13.6	8.1	12.4	9.2	7.8
Official capital	-1.8	3.4	1.5	-1.2	1.7	1.5
Private capital 2/	8.6	10.2	6.6	13.6	7.5	6.3
Of which: long-term flows	1.2	1.0	13.7	9.7	4.9	4.0
Overall balance	-5.6	0.8	-0.7	5.2	0.7	-0.5
Memorandum items:						
Exchange rate (domestic currency/U.S. dollar)	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP (in millions of Barbados dollars)	5,634	6,010	6,382	6,818	7,582	8,173

Table 3. Barbados: Financial Soundness Indicators of the Onshore Banking System 1/

	2003	2004	2005	2006	2007 2/
Solvency indicators					
Capital adequacy ratio 3/	-	14.5	13.0	12.0	10.8
Core capital adequacy ratio 3/ 4/	-	13.7	11.5	10.7	10.1
Nonperforming loans net of provisions to capital	16.3	21.2	21.1	17.4	10.1
Off-balance sheet obligations, percent of liabilities	2.5	1.8	2.5	3.4	2.1
Liquidity indicators					
Loan to deposit ratio	53.0	54.7	58.3	64.2	57.5
Demand deposits, percent of total deposits	37.9	39.1	38.5	36.6	35.3
Liquid assets, percent of total assets 5/	15.3	13.3	9.0	4.6	7.2
Credit risk indicators					
Total assets, annual growth rate	8.7	6.3	13.6	9.3	21.9
Loans and advances, annual growth rate	-2.3	15.8	22.0	15.5	11.4
Total mortgage loans, percent of loans and advances 6/	18.9	21.1	21.0	23.1	27.1
Nonperforming loans, percent of total loans	8.2	7.2	5.5	4.4	2.9
Provisions to nonperforming loans, percent of NPL	30.1	26.1	25.7	31.4	37.0
Sectoral distribution of loans to total loans					
Agricultural	1.5	1.0	1.1	1.1	1.0
Commercial	17.0	18.7	19.2	18.7	19.2
Construction	7.3	8.0	7.8	7.8	7.6
Consumer	43.3	43.5	44.3	45.9	47.3
Industrial	3.5	2.9	2.7	2.9	2.8
Tourism	24.2	21.5	22.7	20.8	19.9
Others	3.2	4.3	2.3	2.9	2.3
Foreign exchange risk indicators					
Global position in foreign currency to regulatory capital	17.1	7.7	-28.1	-5.0	-11.4
Share of foreign currency deposits in total deposits	17.8	18.8	21.8	22.5	22.4
Share of foreign currency loans in total credit	8.6	7.6	10.7	8.8	8.3
Deposits in Foreign Exchange, percent of total deposits 7/	13.2	14.4	16.7	14.2	17.3
Net foreign assets, percent of total assets	13.5	12.7	11.6	9.6	12.3
Profitability indicators					
ROA	2.1	2.4	2.1	2.6	2.3
ROE	21.3	23.2	25.2	27.6	21.4
Gross financial spread to financial revenues	24.0	28.0	28.4	32.8	24.4
Financial revenues to total revenues	71.5	73.3	65.6	55.7	50.8
Annualized financial revenues to revenue-generating assets	69.9	67.0	72.5	75.1	76.4
Profit before tax, percent of total assets	2.0	2.3	2.0	2.5	1.6
Total noninterest expense, percent of total assets	3.5	3.4	3.4	3.0	2.1
Spread between lending rate and deposit rate 8/	7.6	7.3	6.5	5.8	5.6
Operational efficiency					
Nonfinancial expenditure to total revenues	50.4	49.2	46.9	36.7	35.6
Nonfinancial expenditure to total revenue-generating assets	4.3	4.2	4.1	3.8	2.8
Memorandum Items:					
Banks' credit card loans to total loans	3.8	4.0	4.8	4.9	5.0
Banks' consumer loans to total loans 9/	27.2	27.7	28.1	28.6	24.1
Banks' mortgage loans to total loans	18.9	19.9	21.0	23.1	27.1
Banks' mortgage loans (BDS$ millions)	541.7	666.3	858.1	1089.1	1314.8
Trust & mortgage companies ' mortgage loans (BDS$ millions)	598.6	607.5	624.3	692.4	741.9
Banks' mortgage loans, growth rate	17.2	23.0	28.8	26.9	20.7
Banks' credit cards loans, growth rate	-	21.6	47.6	17.6	7.0
Banks' consumer instalment credit, growth rate 10/	-2.4	35.3	27.3	20.0	-2.3

1/ As of Sep. 2007, the two foreign branches are Bank of Nova Scotia and Royal Bank of Canada; and the four foreign subsidiaries are Barbados National Bank, Butterfield Bank, RBTT Bank, and First
2/ Preliminary data as of September 2007.
3/ Does not include branches of foreign banks.
4/ Tier-I capital.
5/ Sum of excess cash reserve requirements and excess of the statutory requirement to invest in government securities in percent of total assets.
6/ Other loans, including personal loans, may be used to finance real estate activities.
7/ It includes both resident and non-resident deposits in foreign currency.
8/ This spread does not fully reflect the intermediation margin due to fees, commissions, etc.
9/ Consumer loans excluding mortgages.
10/ It includes car loans, durable goods loans, home improvement loans and debt consolidation loans.

Table 4. Barbados: Financial Sector Structure

	2003	2004	2005	2006	2007 1/
Number of Institutions					
Banks 2/	6	6	6	6	6
Domestic private banks	0	0	0	0	0
Public banks	0	0	0	0	0
Foreign banks	6	6	6	6	6
Branches	2	2	2	2	2
Subsidiaries	4	4	4	4	4
Non-bank Financial Institutions	14	13	13	13	13
Credit unions	39	38	37	37	34
Offshore banks	52	55	54	52	57
Insurance companies 3/	-	-	-	31	31
Assets (as percent of GDP)					
Banks	126.4	129.3	134.2	132.2	141.8
Branches	44.9	45.7	53.2	51.3	54.2
Subsidiaries	81.5	83.6	80.9	80.9	87.6
Nonbank financial institutions	20.0	20.9	24.5	22.6	22.5
Credit unions	11.5	12.9	13.6	13.9	14.7
Offshore banks	1164.5	1102.4	1029.4	1202.6	1285.1
Insurance companies 4/	15.7	20.5	28.5	27.8	-

1/ Preliminary data as of September 2007

2/ As of Sep. 2007, the two foreign branches are Bank of Nova Scotia and Royal Bank of Canada; and the four foreign subsidiaries are Barbados National Bank, Butterfield Bank, RBTT Bank, and First Caribbean International Bank.

3/ As of 2006, seven of the 11 life companies, and 16 general insurance companies were actively writing business.

4/ Investment Assets of domestic general insurance and life insurance companies.

Table 5. Barbados: On-shore Banks and their Parent Institutions

Commercial Banks incorporated in Barbados	Affiliated Financial Conglomerate	Headquarter
First Caribbean International Bank (Barbados) Ltd (FCIBB) [1]	CIBC	Canada
Barbados National Bank Inc. (BNB)	Republic Bank of Trinidad and Tobago	Trinidad and Tobago
RBC Royal Bank of Canada (RBC)	RBC Royal Bank of Canada	Canada
Bank of Nova Scotia (BNS)	Scotiabank	Canada
Royal Bank of Trinidad and Tobago Bank (Barbados) Ltd (RBTT)	RBTT Financial Holdings Ltd	Trinidad and Tobago
Butterfield Bank (Barbados) Ltd (BBL)	The Bank of N.T. Butterfield & Son Ltd	Bermuda

[1] FCIBB is owned by First Caribbean International Bank, a holding company that consolidates regional operations in Barbados.

Table 6. Barbados: Credit Union Indicators

	Sep-03	Sep-04	Sep-05	Sep-06	Sep-07
I. Structure of the Credit Union Sector					
Number of Institutions	39	38	37	37	34
Number of Members	107,417	118,472	129,129	139,639	148,864
Share of the 3 largest credit unions, percent	73	83	84	84	85
Assets (as percentage of GDP)	11.5	12.9	13.6	13.9	14.7
Assets (as percentage of GDP, 3 largest credit unions)	8.4	9.6	10.2	10.7	11.4
Loans (as percentage of GDP)	8.0	9.5	10.6	10.9	11.5
Loans (as percentage of GDP, 3 largest credit unions)	5.9	7.3	8.3	8.7	9.2
II. Selected Financial Soundness Indicators					
Solvency indicators					
Reserves to total Liabilities 2/	12.4	12.1	11.6	12.3	12
Liquidity indicators					
Loan to deposit ratio	78.0	82.2	87.0	88.1	87.0
On call deposits, percent of total deposits		N/A			36.9
Liquid Assets to short-term liabilities					57.7
Credit risk indicators					
Total assets, annual growth rate	9.2	17.4	15.3	13.6	13.8
Loans, annual growth rate	-	24.1	22.6	14.3	12.8
Total mortgage loans, percent of loans	34.1	34.3	39.9	39.6	N/A
Nonperforming loans, percent of total loans	6.0	5.0	4.0	5.0	6.0
Provisions for Nonperforming loans, percent of total loans		N/A			31

Source: Registrar of Cooperatives

Table 7. Mutual Funds—Total Assets under Management

(as at end of year, unless otherwise indicated)

	2003	2004	2005	2006	2007
Number of mutual funds	12	12	14	14	14
Net Assets (millions BDS$)	$298.3	n/a	$502.9[1/]	$611.9	$758.9
Number of mutual fund administrators	n/a	n/a	n/a	n/a	4

Source: BSE and Securities Commission

[1/] As at October 31, 2005.

Table 8. Insurance Sector: Summary Statistics

Year	2001	2002	2003	2004	2005	2006
Domestic sector						
General Insurance						
Gross written premia BDS$ million	310.0	348.9	343.2	360.8	418.0	467.4
As a percent of GDP	6.0	6.9	6.3	6.4	6.8	7.0
Investment assets BDS$ million	280.0	331.2	354.9	400.2	413.8	481.4
As a percent of GDP	5.4	6.6	6.5	7.1	6.7	7.2
Life Insurance						
Gross written premia BDS$ million	141.6	172.0	179.1	186.9	213.6	224.3
As a percent of GDP	2.8	3.4	3.3	3.3	3.5	3.3
Investment assets BDS$ million	492.9	426.0	499.4	754.9	1332.7	1374.6
As a percent of GDP	9.6	8.4	9.2	13.4	21.8	20.6
Offshore Sector [21]						
Net premiums (BDS$ billion)	7.89	5.92	8.84	8.39	8.54	6.30
Assets	17.903	24.075	26.40	39.97	35.39	25.68

Source: Ministry of Finance; Supervisor of Insurance—unpublished data.[22]

Table 9. Insurance Sector: Asset Composition—Life Insurance

Year	2001	2002	2003	2004	2005*	2006**
Bonds and debentures	22.54	21.19	24.23	27.00	34.00	35.59
Ordinary shares	14.43	26.03	26.19	23.00	21.00	16.54
Preference shares	0.03	0.09	0.07	0.00	0.00	0.06
Mortgages and Loans	22.31	20.98	17.69	13.00	21.00	22.74
Real estate and leaseholds	8.51	6.41	10.33	10.00	10.00	9.48
Cash balances	15.35	21.76	18.40	20.00	11.00	12.53
Other instruments	16.83	3.54	3.09	7.00	3.00	3.06
Total	100.00	100.00	100.00	186.9	213.6	100.00

Source: Ministry of Finance; Supervisor of Insurance—unpublished data

[21] Totals for 2006 only includes companies from U.S. and Canada.
[22] Figures for 2006 are, in some cases, not available and in other cases represent estimates.

Table 10. Insurance Sector: Asset Composition—Non-Life Insurance

Year	2001	2002	2003	2004	2005*	2006**
Bonds and debentures	24.05	24.17	29.31	32.70	35.63	34.17
Ordinary shares	13.68	10.94	11.50	13.62	12.00	7.03
Preference shares	0.58	0.65	0.60	0.54	0.43	0.00
Mortgages and Loans	5.20	7.89	6.86	5.75	4.11	5.80
Real estate and leaseholds	13.83	14.18	15.10	14.54	11.69	7.65
Cash balances	33.75	31.15	26.71	23.58	25.89	36.66
Other instruments	8.93	11.02	9.92	9.27	10.25	8.69
Total	100.00	100.00	100.00	186.9	213.6	100.00

Source: Ministry of Finance; Supervisor of Insurance—unpublished data

[1] Figures for 2006 are, in some cases, not available and in other cases represent estimates.

Table 11. BSE Main Indicators 2003–2007

	2003	**2004**	**2005**	**2006**	**2007**
Number of listed companies—Total	24	24	26	27	26
Number of listed companies—Regular market	22	22	25	26	25
Number of listed companies—Junior market	2	2	1	1	1
Number of cross listed companies	5	5	6	7	6
Number of instruments listed[1/]	25	25	27	28	27
Number of new issues	1	0	1[2/]	1	0
Value of new issues (millions BDS$)	455.0	0	556.1	409.0	0
Number of brokers	n/a	n/a	n/a	9	7
Market Capitalization[3/] (millions BDS$)	9,920.9	12,145.9	22,784.9	20,516.1	18,857.7
Market Capitalization (% of GDP)	184.1	215.0	368.5	299.0	255.7
Total annual trading volume (millions of shares)	130.3	122.3	44.7	643.4	162.4
Total annual trading value (millions BDS$)	394.8	190.1	100.6	2,072.9	597.3
Annual turnover[4/] (%)	3.25	2.21	0.85	10.10	3.17
Nominal GDP (millions BDS$)	5,389.0	5,648.0	6,183.0	6,860.9	7,375.1

Source: BSE and Securities Commission

1/ One is a closed end fund, the rest are equities
2/ Cross listing of Jamaican company.
3/ Includes cross-listed securities
4/ Total Trading Value/ Composite Market Capitalization

Appendix I. Observance of Financial Sector Standards and Codes—Summary Assessments

This appendix contains summary reassessments of two international standards and codes relevant for the financial sector. The assessments have helped to identify the extent to which the supervisory and regulatory framework is adequate to address the potential risks in the financial system. The following detailed assessments of financial sector standards were undertaken.

- The Basel Core Principles for Effective Banking Supervision (BCP), by Diane Mendoza (external expert, formerly with the Resolution Trust Corporation and the OCC, United States) and Joon Soo Lee (World Bank); and
- The IOSCO Objectives by Tanis MacLaren (external expert, formerly with the Ontario Securities Commission, Canada).

The assessments relied on several sources including:

- Self-assessments by the supervisory authorities;
- Reviews of the relevant legislation, regulations, policy statements, and other documentation;
- Detailed interviews with the supervisory authorities;
- Meetings with the BCB, MoF, and other authorities; and
- Meetings with financial sector market participants.

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

General

1. **This assessment of the Basel Core Principles (BCP) was assessed against the BCP methodology issued in October 2006.** At the request of the FSAP team, the authorities conducted a self assessment; however they did not assign ratings.

2. **The Financial Institutions Act (FIA) governs the regulation and supervision of all entities conducting banking business in Barbados, and the International Financial Services Act (IFSA) governs the regulation and supervision of the off-shore financial institutions.** Under both acts, the Minister of Finance (MoF) is charged with licensing. Under the FIA, the MOF has the authority to issue regulations and the IFSA grants the Central Bank of Barbados (CBB) has the authority to issue regulations; while the Bank Supervision Department (BSD) of the CBB is responsible for the supervision of the institutions.

3. **Operations of domestic financial institutions include the commercial banks and Part III licensees such as finance companies, trust companies, merchant banks and mortgage lending associations.** Operations of the off-shore service providers include: banking (taking third party deposits), treasury functions for related organizations, wealth management companies (for high-net worth individuals) and a commodities brokerage.

4. **The CBB has a single regulatory framework, which requires all financial institutions to maintain the same percentage of capital to risk weighted assets**; and with some distinctions, all institutions technically have the same permissible activities. Although the authorities make allowances for differences in the activities, size and complexity of several of the different institutions, further regulation differentiation across FIA and IFSA intermediaries would aid in keeping their risk profile in check.

5. **This assessment corroborated that the domestic banking sector is insulated from the off-shore sector, and the primary risk that either sector poses to the other is reputational risk.** It was established through interviews of representatives of domestic and off-shore banks that “Chinese walls” existed between affiliated on- and off-shore banks. Strict prohibitions exist on transactions between the on-shore sector and population and off-shore banks. Given that many of the off-shore banks operate out of Barbados to take advantage of tax treaties, they have a strong incentive to comply with the prohibitions (lest they risk losing their license).

6. **The much-touted liberalization of exchange and capital controls has slowed—indefinitely, due to the change in government administration and the global financial turmoil.** However, it is important for the BSD to continue to preemptively review guidelines and regulations regarding foreign exchange exposures to ensure that the supervisory processes, adequately controls the risks associated with the removal of these controls.

Main findings

7. **The supervision of the banking system and structure of the supervisory department at the CBB have undergone significant changes since the 2002 FSAP.**

Upgrades have been made to the legislative framework and the BSD recently reorganized its structure to facilitate the risk-based monitoring of the institutions. Since the 2002 FSAP, a considerable number of guidelines have been issued, and during the FSAP update, additional guidelines were finalized and one issued. Frequent risk-focused inspections are being conducted, and it was estimated that nearly half of the institutions have been inspected; however, no institution has received a comprehensive risk-based inspection. Since the 2002 FSAP, each institution was inspected for AML/CFT compliance. Additionally, training has been provided to supervisors; outreach and consultations have been held with the on-shore and off-shore sectors, other domestic supervisory agencies, as well as other stakeholders. Supervisory operating procedures and guidance to the licensees refer to international standards, and practical application is based on the home supervisors' methodology. As the BSD is still in the transitional stage, it is too soon to evaluate the effectiveness of some of these practices.

Objectives, independence, powers, transparency, and cooperation (BCP 1)

8. **The central bank is the primary authority for the supervision of the financial institutions operating in and from Barbados, which is implied in the purpose in the Central Bank of Barbados Act "to promote a sound financial structure."** The regulation and supervision of the financial sector is shared between the MoF and the CBB. The Governor and all the members of the CBB's Board of Directors are appointed by the Minister of Finance, operationally, the CBB is independent. The CBB issues guidelines covering a range of topics; conducts on-site inspections and performs monitoring of the licensed financial institutions.

9. **The Banking Supervision Department's (BSD) resources are being strained, as the supervisors are responsible for 6 large internationally active commercial banks, 14 Part III financial institutions and 54 off shore banks.** Given the range and level of heterogeneous operations undertaken by the various licensees it is anticipated that the human resources will be further strained. In an effort to streamline the supervisory function, the off-site monitoring and analysis group was recently disbanded and merged with the on-site supervisors to create three "streams" to oversee the institutions on a "portfolio" basis. Each supervisor is charged with the oversight of a number of institutions, which includes a continuous monitoring program, participates in the on-site inspections (although not necessarily as the in-charge inspector), follows up on supervisory issues and maintains a dialogue with the management of the institutions.

10. **Since the 2002 FSAP, amendments have been made to the Central Bank of Barbados Act and the Financial Institutions Act.** Both the FIA and the International Financial Services Act (FSA) should be updated to address the issues highlighted in the detailed assessment. In particular, clarity regarding the applicability of regulations drafted under the FIA, to the off shore sector is required. No regulations have been issued or upgraded since 1998, and the CBB and MoF are encouraged to identify where additional regulations should be developed and to upgrade the existing regulations to provide for continuing relevancy. In particular, the FIA Institutions (Asset Classification and Provisioning) Regulation and the FIA Institutions (Capital Adequacy) Regulation should be upgraded. Guidelines are jointly issued under the FIA and IFSA, however they do not have the power of law, and while

compliance is reported to be generally appropriate, the CBB does not have the authority to enforce compliance.

11. **Given the regional and international structure and operations of the commercial and off-shore banks, the CBB has entered into a few MOUs that facilitate the sharing of information.** A regional MOU was signed March 2006 among most of the Caribbean jurisdictions, with a number of jurisdictions, including the Eastern Caribbean Central Bank not yet signatory. Despite the long time presence of foreign banks in Barbados, the CBB does not yet have an MOU with either Canada or Bermuda.

Licensing and structure (BCPs 2–5)

12. **The MoF retains the authority to grant and revoke licenses but in practice, relies on the advice of the CBB, after it has conducted a review of the license application.** A standard application format and licensing criteria have been developed by the CBB, however, it is not publicly available. The home country supervisor's consent is required when the proposed owner or parent organization is a foreign bank. Permissible activities for the institutions are determined by the type of license it holds: commercial bank, Part III institution and off-shore "licensee." Approval granted by the CBB to expand the range of permissible activities is handled on a case-by-case basis and no notice is provided to the industry of "new permissible activities." To improve the CBB's transparency, it is recommended that the application process be formalized by issuance of either a regulation or guideline and that all licensees be notified when a permissible activity has been approved. The use of the term "bank" is restricted, and the FIA provides for fines and imprisonment for unauthorized use of the term or any variation of the term "bank."

13. **Legal provisions exist for the transfer of significant ownership, which requires the approval of the MoF, upon the recommendation of the CBB and any excess unauthorized acquisition must be disposed of at the direction of the CBB.** The Barbados Fair Trading Commission (FTC—a statutory body under the Minister of Commerce) is responsible for promoting and maintaining competition and consumer protection. As part of carrying out that mandate, the FTC polices mergers and pre-approval is required when a merger would result in one company holding 40 percent or more of the market. In the case of financial institutions, the definition of "market" has not been defined (whether it is based on loans or deposits). The FTC considers the views of the CBB regarding financial institutions' mergers.

14. **The FIA limits a licensee's investment in real estate—at market value, to the stated capital of the bank.** Approval of the MoF or the CBB is required for certain specified acquisitions by licensees. However, outside these narrow transactions, the types and amounts of acquisitions or investments are not clearly defined, nor are criteria provided by which to evaluate proposals.

Prudential regulations and requirements (BCPs 6–18)

15. **Under the Capital Adequacy Regulation 1998, the capital requirement is established at 8 percent of risk weighted assets in line with the Basel I recommendations.** The CBB has the authority to impose a higher minimum capital ratio based on the potential risk

exposure. Thus, the capital requirements may vary depending on the type of license (commercial bank, Part III licensee or off-shore licensee taking third party deposits or nondeposit taking). Currently, there are no capital requirements for market risk in the trading book. The BDS is considering revisions to the capital regulation in the context of the Basel II implementation.

16. **According to the BSD's Basel II implementation plan, all licensees are required to implement the Standardized Approach for credit risk and market risks, and the Basic Indicator Approach or Standardized Approach.**

17. **[1] for operational risk from 2009.** The BSD intends to consider a possible transition to the Advanced approaches for credit risk after 2012. The Basel II implementation survey conducted by the BSD shows that some institutions are expected to realize a significant decrease in capital requirement due to improved risk weightings[2] for some asset classes under the Standardized approach while 75 percent of the banks do not foresee any significant changes in capital requirements. The CBB is encouraged to conduct a full-scale quantitative impact study of the Basel II implementation on the capital level of the banking system. Based on the result of the QIS, any needed adjustments of the Pillar I or Pillar II schemes should be considered. Special attention should be paid to the risk weighting for retail credit and residential mortgage loans as well as Pillar II.

18. **The Asset Classification and Provisioning Regulation is outdated, and loss provisioning requirement should be reviewed.** Under the current rule, there is no minimum provision requirement for "Pass," "Special Mention," and three to six months past due residential mortgage loans classified as "Substandard" while 20 percent for other "Substandard," 50 percent for "Doubtful," and 100 percent for "Loss" are applied. It is recommended that the CBB consider raising the required minimum loan loss provisions for "special mention" and "substandard," given the widening loan loss reserves surplus over the required reserves. Also, the special treatment for three to six months past due residential mortgage loans should be reconsidered. In addition, the regulation should clearly state that all relevant Off Balance Sheet items are classified and provisioned. Furthermore, the CBB is encouraged to issue guidance on collectively assessed loan provisions or general provision in line with the IFRS. Also, it is recommended that the CBB collect more detailed asset quality data such as delinquency ratio, and past due loans over one month by the time bucket, among others.

19. **Exposures (any advance or credit, financial guarantee or liability) to a single person or group are limited to 25 percent of the licensee's stated capital and reserves, and 10 percent of the licensee's stated capital and reserves for unsecured exposures.** Although

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[1] Only licensees that meet the qualifying criteria will be allowed to use the Standardized Approach for operational risk.

[2] According the BSD's implementation plan, the risk weights for residential mortgage will decrease from 50 percent to 35 percent (50 per cent for those with over 90 per cent loan to value ratio) while the risk weight for loans to individuals or small business will decrease from 100 percent to 75 percent.

the authorities monitor large exposure limits for groups, there is no explicit legal provision dealing with an aggregate large exposure limit. The CBB indicated that it is working on introducing a regulation for an aggregate limit on such exposures. Moreover, the CBB is encouraged to issue guideline on credit risk management including concentration risk.

20. **The FIA restricts unsecured lending or guarantee to each of the related parties (including a bank's directors, holding company, subsidiary, or affiliate or any director thereof) up to $40,000 or 1 percent of the stated capital of the licensee (whichever is the greater).** Also, the FIA requires that credit facilities to the related parties should not be granted on more favorable terms and conditions generally applicable to borrowers. However, there is no comprehensive definition of "related parties" in the FIA. It is recommended that the CBB define "related parties" comprehensively, covering the bank's subsidiaries and affiliates, any party that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, directors, senior management and key staff, their direct and related interests, their close family members, and corresponding persons in affiliated companies. In addition, there is need to place aggregate limit on the total exposures to the related parties. The CBB is encouraged to require exposures to related parties to be deducted from bank's capital.

Methods of ongoing supervision (BCPs 19–21)

21. **Since the second half of 2007, the BSD is moving toward risk-based supervision and has provided guidance to the financial institutions on risk management processes.** The BSD's structure was reorganized into "Policy," "Approval & Licensing," and three "Supervision" units conducting off-site monitoring as well as on-site inspection for allocated institutions. Responsibility for many institutions has been re-assigned and supervisors are in the process of "learning their institutions." The BSD is developing and simulating risk assessment system (RAS) modeled after Canadian supervisory framework in consultation with the OSFI. According to the new RAS risk template, the CBB started assessing risk profile of some banks and banking groups on a quarterly basis. In addition, the CBB monitors and assesses trends, developments and risks for the onshore banking and offshore banking sector as a whole. The CBB is encouraged to keep building up supervisory capacity including highly skilled staff by the risk type (e.g., credit risk, market risk, liquidity risk, and IT risk, among others), information system for the processing, monitoring and analysis of prudential information.

22. **The CBB has placed more emphasis on offsite monitoring and risk focused targeted onsite inspection than full scope comprehensive onsite inspection.**[3] On-site inspections have been conducted in about half of the on-shore and off-shore institutions on the risk-based approach. The supervisors assess the strength of the risk management processes on a "principles" basis, with the level of testing determined on a case-by-case basis. The BSD is

[3] The BSD conducted 36 onsite inspections (onshore banks: 7 full-scope, 2 targeted, 2 AML, offshore banks: 9 full-scope, 16 AML) during 2005, 13 onsite inspections (onshore banks: 3 full-scope, 6 AML, offshore banks: 2 AML) during 2006, and 4 inspections (onshore banks: 3 full-scope, 1 special) during 2007.

encouraged to include sufficient testing as part of the risk-based approach to supervision. Considering the current developing stage of risk based supervision framework, a sharp decrease of onsite inspection is not desirable or advisable. Therefore, the BSD is recommended not to decrease onsite inspection too much until the risk assessment system is believed to be sound. Also, the transition process should be expedited.

23. **Although the new regulatory reporting forms were also introduced recently, they should further expanded into more detailed information about risk profile of the banks and banking groups.** The current quarterly prudential returns mainly cover capital adequacy ratio, classified asset and provisions, large exposures and exposures to related parties. It is recommended that more information about overall risk profiles by the risk type should be filed with the CBB in line with the RAS. Especially, given the large credit portfolio, more detailed information on credit risk, (inter alia, sectoral distribution, delinquency ratio, past due loans by the time bucket, loan to value ratio, and debt to income ratio, among others) should be collected and monitored.

Accounting and disclosure (BCP 22)

24. **Audited financial statements are prepared in accordance with International Financial Reporting Standard, and published annually.** An auditor is approved by the CBB by the amendment to the FIA 2006. Where the CBB is not satisfied with the annual report of an auditor, the CBB may appoint another auditor to make an independent report. It is recommended that financial institutions are required to disclose the quarterly financial returns including any statements that are to be re-filed. According to the Asset Classification and Provisioning Regulation (Part 2. 3), three to four months past due residential mortgage loans are not defined as nonaccrual loan, thereby interest can be accrued. Nonaccrual of interest on residential mortgage loans at three months' delinquency should be implemented. In addition, the CBB is encouraged to publish aggregate information (e.g., capital ratio, income earning capacity, and risk profiles) on the banking system to facilitate public understanding of the banking system and the exercise of market discipline.

Corrective and remedial powers of supervisors (BCP 23)

25. **Although the CBB has a broad range of enforcement powers, there is a need for more transparent and systematic framework to bring about timely corrective and remedial actions.** The CBB can exercise a range of options, such as requesting behavioral changes, changes in management/Board, restricting activities, delaying approvals, suspension of license, and recommendation of revocation. However, there are no criteria against which adequate level of supervisory tools would be determined for each case. Since this lack of transparency of the enforcement framework may provide for a room for either lenient enforcement actions or court challenges, the CBB is encouraged to have more explicit framework for corrective and remedial actions.[4] In addition, it is recommended that the CBB

[4] The CBB indicated that it is drafting "a Ladder of Intervention" to document and improve transparency for corrective actions.

use penalties and sanctions (monetary) for directors, managers and other individuals as well as remedial measures and recommendation for institutions if deemed.

Consolidated and cross-border banking supervision (BCPs 24–25)

26. **There is no clear legal framework for group-wide consolidated supervision of banking groups and/or financial conglomerates.** In the current FIA and relevant regulations, there are no explicit provisions on legal definition of a banking group and consolidated supervision of a banking group such as licensing of a bank holding company and applying consolidated prudential rules or limits to a banking group. Especially, there are no explicit regulations, rules, guidance or instructions requiring that larger exposure limits and related party exposure limits are applied on a fully consolidated basis at the whole (and sub) group level. The fact that the top parent bank or bank holding company is a license under the FIA doesn't warrant that all prudential rules and limits are applied on a consolidated basis. Therefore, amendments to the FIA are recommended to explicitly require banking groups to comply with all prudential ratios on a fully consolidated basis. Also, more in-depth risk analysis and monitoring of banking groups' cross-border activities are needed. Special attention should be paid to potential double gearing, risk contagion from cross-border operations or non-financial activities, group-wide risk concentration, and group-wide internal control and risk management. In addition, consolidated prudential reports appear to lack information on group wide risks of the banking group, which should be monitored. Moreover, there is a need to conduct joint onsite inspections every three to five years for significant foreign subsidiaries of the local financial group with the host supervisors.

27. **Given the systemic importance of Canadian banks in the Barbados financial system, the CBB is strongly recommended to be more proactive in home-host cooperation with the home supervisor.** The CBB has established a multilateral MOU with regional regulatory authorities (Barbados, Bahamas, Belize, Trinidad and Tobago, The Cayman Islands, BVI, Jamaica, Turks and Caicos, Nederlandse Antillen) for the exchange of information and cooperation and consultation. This seems to have led to on-going dialogue and discussions on common issues among home and host supervisors in the region. However, the CBB hasn't reached an MOU yet on cooperation in banking supervision with significant home supervisors, especially Canada and Bermuda. Information exchange with the home and host supervisors does not seem to be active enough for the Canadian banks' dominance in Barbados. The CBB is encouraged to conclude those two MOUs on information exchange and cooperation.[5] In addition, for regional financial groups such as First Caribbean International Bank, a group specific MOU is strongly recommended among all relevant supervisors including OSFI (home supervisor), CBB (sub-home supervisor), and other significant host supervisors. The CBB is encouraged to get the information on the comprehensive risk profile of the parent banks at least annually from the home supervisors including Canadian OSFI, the Central Bank of Trinidad and Tobago, and Bermuda bank supervisors to monitor soundness of the parent bank.

[5] According to the CBB, an MOU with the OSFI is in discussion as of now.

Appendix II. Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
Objectives, Autonomy, Powers, and Resources (BCP 1 (1) (2))	CBB should pursue acquiring delegated authority from the MoF. Keep building up supervisory capacity and resources.
Legal framework (BCP 1(3))	Update and revise laws and regulations (including the capital adequacy and the asset classification and loan loss provisioning regulation) in a timely manner.
Cooperation (BCP 1(6))	Engage in discussions proactively with foreign banking supervisors regarding the condition of the parent banks; and complete the negotiations of the MOUs with other supervisors.
Licensing Criteria (BCP 3)	Formalize the licensing requirements through regulation or guideline and make them publicly available.
Major acquisitions (BCP 5)	Identify the limits and the various types of exposures that require approval.
Capital Adequacy (BCP 6)	Introduce capital requirement for market risk Conduct full scale quantitative impact study of the Basel II implementation and make needed adjustment.
Risk Management Process (BCP 7)	Conduct a higher level of transaction testing to augment the principles-based assessment of risk management activities.
Credit Risk (BCP 8)	Conduct onsite inspection to be satisfied that the new guideline on credit risk management is complied by the banks.
Problem assets, provisions & reserves (BCP 9)	Update and strengthen asset classification and provisioning regulation including clear definitions of various terms and increase of required reserves.
Large exposure limits (BCP 10)	Establish an aggregate limit for large exposures. Consider setting guideline on concentration risk management at the portfolio level.
Exposures to related parties (BCP 11)	Develop guideline for related party transactions, including comprehensive definition of related parties, setting an aggregate limit for related parties and providing for a deduction in the capital computation for exposures to related parties.
Country or transfer risk (BCP 12)	Reconsider the language in the guideline for country and transfer risk, the supervisor should be satisfied that the provision for credit risk is sufficient to cover both the credit and the country risk. Conduct onsite inspection on this and increase banks' risk awareness.
Market risk (BCP 13)	Introduce capital requirement for market risk. Complete guideline on market risk measurement and increase banks' risk awareness.

Reference Principle	Recommended Action
Operational Risk (BCP 15)	Conduct a higher level of transaction testing to augment the principles-based assessment of operational risk management.
Interest Rate Risk (BCP 16)	Issue a guideline addressing interest rate risk and increase risk awareness.
Supervisory approaches and techniques (BCP 19, 20)	Expedite the transition process to risk-based supervision. Do not decrease onsite inspections too much until the transition is completed (e.g., reduce the time between the conduct of full scope inspections).
Supervisory reporting (BCP 21)	Expand prudential returns to cover more information on risk profiles of the licensee.
Accounting and disclosure (BCP 22)	Require nonaccrual of interest on residential mortgage loans at three months' delinquency. Require the publication of the quarterly financial returns including any statements that are to be re-filed.
Corrective and remedial powers of supervisors (BCP 23)	Establish the necessary framework to apply sanctions and penalties for statutory breaches. Provide disclosure of corrective action taken.
Consolidated supervision (BCP 24)	Enhance the prudential returns for consolidated statements. Establish clear legal framework for consolidated supervision.
Home, host relationships (BCP 25)	Develop institution-specific MOU to facilitate cross-border supervision; re-establish the coordinated inspections conducted on the banks.

Authorities' response

The Authorities wish to commend the assessors on their efforts to understand the regulatory framework in Barbados. The Authorities are of the view that the assessors have made practical suggestions that can further enhance the quality of supervision and regulation of banks in Barbados. In this regard, the Authorities intend to consider the recommendations in the planned revisions to the legislation and the development of Regulations and Guidelines to industry.

Notwithstanding the above, the Authorities consider that the assessors' conclusions and ratings were flawed in some areas.

In particular, while the authorities recognize the need for further legislative enhancements with respect to the Asset Classification and Provisioning Regulations, large exposures and consolidated supervision, they do not consider that the assessment in these areas adequately or accurately reflects the circumstances in which banks are regulated in Barbados. Certainly, the Authorities' ability to achieve compliance in these areas is not impeded. Favorable consideration of these issues would also impact the assessment of the legal framework.

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

General

1. **This assessment of the observance of the IOSCO Objectives and Principles of Securities Regulation (the IOSCO Principles) was conducted as part of an update to the Financial Sector Assessment Program of Barbados.**[1] Because the 2002 assessment was conducted before the Securities Commission was fully operational and before the development of the IOSCO Methodology for Assessing the Implementation of the IOSCO Objectives and Principles of Securities Regulation (the Assessment Methodology) (December 2003 version), an assessment was performed on all the IOSCO Principles. Material contained in the 2002 IOSCO Assessment Report was used when applicable.

Description of regulatory structure and practices

The securities regulatory environment & legal framework

2. **The Securities Commission was created in 2001 when a new Securities Act (SA) was enacted.** The Securities Commission has regulatory authority over all market participants. Market intermediaries, public companies, the BSE and the Central Securities Depository (CSD) all are required to be authorized under the SA by the Securities Commission to do business. In 2002, the new Mutual Funds Act (MFA) was proclaimed governing the licensing and operation of mutual funds and mutual fund administrators in Barbados. Owing to regional initiatives, such as the formation of the Caribbean Exchange Network, and IOSCO developments, the need for improvements in and harmonization of securities legislation has been recognized and an update of the relevant legislation in Barbados is under consideration.

3. **The Securities Commission is a functional regulator.** A person or company that wants to carry on most securities activities in or from Barbados must obtain a license from the Securities Commission. Even banks, insurance companies and other financial institutions licensed under the FIA must fulfill the requirements set out in the securities legislation in order to obtain a license.

Self-regulatory organizations (SROs)

4. **The BSE and CSD are self-regulatory organizations that exercise regulatory authority over securities market activities under the overall supervision of the Securities Commission.** The BSE has been delegated authority under the SA to approve the listing of securities on the exchange, supervise market activity, regulate daily trading on the exchange, register and license market actors and monitor their market conduct. The CSD is a wholly owned subsidiary of the BSE and it acts both as the central depository for all listed securities and as registrar and transfer agent for the listed companies. The CSD has been delegated authority to regulate clearance and settlement of transactions, approve new issues' prospectuses

[1] The assessment was conducted by Tanis MacLaren.

for registration with the Securities Commission and issue certificates of approval for these prospectuses. Virtually all securities of listed companies are held in dematerialized form at the CSD and all trades on the BSE must be settled at the CSD.

Market Structure

5. **There are very few registered firms actively participating in the securities markets**. As of December 31, 2007, there were [seven] securities companies, seven brokers, two dealers, two investment advisers, two traders and five underwriters licensed and operating in Barbados. The 25 registrations are held by just nine firms, as most are registered in multiple categories. Of these, several firms are not very active in the markets; their licenses are held to facilitate private banking operations for the customers of affiliated financial institutions. The BSE has 16 ordinary members, including two firms associated with major international accounting firms and six related to banks or insurance companies, and four designated members: the Barbados Bar Association, the Barbados Chamber of Commerce, the Barbados Institute of Banking and Finance and the CBB. There were four licensed mutual fund administrators and 14 mutual funds with total net assets of BB$758.9 million.

The BSE was established in 1987 and reincorporated under the new Securities Act in August 2001. As of December 2001, capitalization was estimated at around US$ 1.8 billion or 71 percent of GDP. Even though the number of issues traded on the regular market has not significantly expanded, and, on a net basis, only one additional company has been listed as of December 2007, the market capitalization reached US$ 5.6 billion, or close to 150 percent of GDP. (If cross-listed shares are included, the market capitalization at the end of 2007 reached US$ 9.4 billion or 250 percent of GDP.)

6. **The debt markets, like the equity markets, are underdeveloped.** From 2003 to 2007, there have been 28 public issues of corporate debt securities for a total of BB$ 1,369.6 million. Slightly over 35 percent of the total was raised in 2006. The BSE facilitates trading of corporate and government debt securities in the secondary market, but this type of trading of debt is almost nonexistent. The average total value of secondary market trades in government debentures and treasury bills between 2003 and 2007 was BB$22.4 million, at an average of 188 trades per year.

Preconditions for effective securities regulation

7. **The general preconditions for effective securities regulation in Barbados appear to be present, but the legislative framework governing commercial law is outdated.** On the positive side, there are no significant barriers to entry and exit for market participants; competition is encouraged and foreign participation is welcomed; the legal and accounting system supports the operations of the Securities Commission and effective regulation of market participants; the regulator has legally enforceable powers of decision and action; and the taxation framework is supportive of the operations of the industry in the jurisdiction. However, much of the commercial law was drafted years ago based on even older legislation in England and Canada and does not reflect the demands posed by cross-border trade, modern financial

instruments and current corporate governance standards. The legislation regarding bankruptcy, insolvency and winding up in the jurisdiction is also very outdated.

Principles relating to the regulator (Pr. 1–5)

8. **The Securities Commission is an operationally independent body with clear responsibilities set out in legislation to regulate the domestic securities and mutual funds markets.** However, there are significant gaps in its powers in the areas of inspections, access to information at regulated firms, information sharing and cooperation with other regulators. It does not have rule making authority, nor does it have general authority to grant exemptions from the legislation where appropriate.

9. **It is publicly accountable for its actions through dissemination of its annual report and subject to review of its decisions by the courts. It engages the public through the publication of regulatory initiatives for comment and by investor education efforts.** The Commission does not publish its own bulletin, nor does it have a website to disseminate information of interest to the public. The legislation and regulations are not easily obtainable outside the country. Most regulatory actions are published in the Official Gazette.

10. **Resources at the Securities Commission have increased substantially since the 2002 assessment, but current levels may still not be sufficient to meet the demands of active regulation of the markets, particularly in light of regional developments such as the CXN.** Staff are paid on the general government salary scale which makes it difficult to hire and retain personnel with the requisite skills and experience.

Principles of self-regulation (Pr. 6–7)

11. **The jurisdiction places appropriate reliance on its SROs and the Commission's oversight of their activities is adequate for its stage of development.** The SROs operate in a professional manner and observe standards of fairness and confidentiality that are equivalent to those at the Commission.

Principles for the enforcement of securities regulation (Pr. 8–10)

12. **The Commission has sufficient powers to investigate and take action on a breach of securities legislation.** The development of an enforcement program is in its early stages and will be assisted by the additional staff resources that are in the process of being hired. The fines set out in the legislation may be too low to be effective deterrents in the marketplace.

13. **There are gaps in the regulatory regime regarding inspection and compliance matters.** The Commission's legal authority to inspect or obtain information from regulated entities outside the context of an investigation is severely constrained. Human resource limitations have prevented the implementation of an on-site inspection program, although that is under development. Registered entities under the MFA or SA are not required to have controls and procedures in place to appropriately ensure compliance and manage risk.

Principles for cooperation (Pr. 11–13)

14. **The Commission has authority to share regulatory information with domestic regulatory counterparties, a domestic MOU is in place and information is being shared in practice.** The ability to share information with foreign regulatory authorities and enforcement agencies is much less clear. The ability to obtain information from market participants to assist either foreign or domestic entities is limited. These limitations may prove problematic in addressing issues arising from CXN in a timely manner and will prevent the regulator from becoming a signatory to the IOSCO Multi-lateral MOU.

Principles for issuers (Pr. 14–16)

15. **Public issuers, whether domestic or foreign, are subject to the same extensive initial and on-going disclosure requirements.** Annual financial statements must be prepared and attested to in accordance with international standards of accounting (IFRS) and auditing. The BSE requires listed companies to prepare quarterly financial statements. Public disclosure of material changes must only be made within seven days of the change, which is a fairly long time period by international standards. The requirements for insiders to disclose their securities holdings should be made clearer and more timely. The 2002 Assessment also recommended improvements in the timely disclosure of material change and insider reporting.

16. **Issuers that wish to offer their shares to the public in several jurisdictions in the region must meet the requirements set by each country for initial offering documents and continuous disclosure obligations.** Some consideration has been given to reduce the inefficiencies in this system by adopting a model used in Canada to coordinate regulatory actions. This model would allow an issuer to deal with the regulator in its local regulator and that regulator would coordinate the necessary review and approvals with the other regulators.

17. **The disclosure rules, governance requirements and the take over bid rules that apply to public companies are spread across two statutes and the stock exchange rules.** The routine corporate reporting, governance and proxy requirements are part of the Companies Act, as are the takeover bid regulations. There are also prospectus requirements in that Act. These are supplemented by some rules for listed companies in the BSE rules and the prospectus and financial statement requirements of the SA. Only the BSE rulebook includes some of the recent initiatives in good corporate governance practices. No one body has clear authority to interpret the rules where there might be conflict or ambiguities. Consolidating these rules for public companies in securities legislation, supplemented as necessary by stock exchange requirements, simplifies both amending the requirements and their administration.

Principles for collective investment schemes (Pr. 17–20)

18. **Mutual funds must be licensed by the Securities Commission, as must their administrators, following detailed qualification requirements.** The same registration requirements apply to foreign funds and foreign administrators. Reputation, fit and proper qualifications for key individuals at the operator and administrator and minimum capital requirements for the administrator are addressed. Each fund and administrator must undertake

to comply with the law. The regime does not require that mutual fund operators and administrators have in place adequate internal control policies and procedures.

19. **Funds may be organized using a wide range of legal structures, all of which limit the exposure of an investor to liability to their investment in the fund.** The organizational form, and the overall risks of the investment, must be disclosed in the offering document. The mutual fund's assets must be held in trust by a custodian and registered in that custodian's name.

20. **Full disclosure of all material facts required to make an informed decision must be set out in the offering document and this must include acceptable valuation and redemption provisions.** There are valuation rules in the legislation and the IFRS requirements for fair market valuation would also apply. The portfolio statement of the fund, containing valuations of the securities, is audited as part of the annual financial statements. There are no rules or procedures at the Securities Commission addressing pricing errors. Suspensions of redemptions are only permitted in exceptional circumstances.

Principles for market intermediaries (Pr. 21–24)

21. **All market intermediaries have to apply to the Securities Commission and meet the minimum licensing standards for registration, even if they also carry a license issued by the CBB or Supervisor of Insurance.** The Commission has full authority to grant, refuse, withdraw or impose conditions on a license, subject to the right of the applicant/licensee to be heard. As for mutual funds, there extensive requirements regarding many aspects of business conduct—such as know your client and the suitability obligation— but there are no specific requirements that a firm have in place adequate internal controls and risk management procedures, nor is there a general requirement that client assets be segregated from the firm's assets.

22. **Despite the fact that the minimum capital requirements do not vary with the risks undertaken by the firm, they appear to meet the objectives of a capital requirement: they provide a cushion to absorb losses and allow for an orderly liquidation of the business if the firm fails, without losses to clients or disruption to the markets.** Capital takes the form of liquid assets on deposit with an arm's length financial institution that may be used for meeting claims against the firm, without notice to the Commission. The funds must be immediately repaid if drawn down. There are no early warning mechanisms in place to alert the Commission to a licensee's deteriorating financial position or contingency plan in place at the Commission to deal with a firm's failure.

Principles for the secondary market (Pr. 25–30)

23. **The BSE is subject to a registration and oversight regime as a precondition to being permitted to operate as a stock exchange.** Its rules and any amendments must be approved by the Commission following a publication for comment process. Trading on the BSE is subject to surveillance both at the Exchange and at the Commission. There is real time

transparency of trading data available to members and the timeliness of information available to the public will be improved with the launch of a new BSE website.

24. **Rules regarding market abuse transactions appear in the SA and the current BSE rules, with expanded provisions appearing in the common rules being adopted across the CXN exchanges.** The coordination mechanisms in place among the regulators do not set out clear lines of responsibility for pursuing these offences or how matters will be dealt with when they involve cross border activities. The overall market abuse regime needs to be examined to ensure it is comprehensive. In particular, trading on insider information about any public company, not just a listed one, should be made an offence.

25. **Given the level of market activity and the way the business is conducted, the actual risk of a market disruption from a default is fairly slight, but if conditions change the dated nature of the bankruptcy and other commercial laws in Barbados will be of concern.** The bankruptcy law is based on an English statute that dates from the early 20th century and does not recognize investment market needs such as orderly close out procedures. The personal property laws are similarly outdated and may not recognize pledges or transfers of securities held in electronic form.

26. **CSD, as a clearing agency, is subject to oversight by the Commission as an SRO**. The settlement cycle for securities is three business days after the trade date. Listed securities are held in dematerialized form at CSD that also acts as registrar and transfer agent for listed companies. Virtually all clients have an account at CSD and most of the positions are held in the name of that client as the beneficial owner. CSD settles the securities on a gross basis with the brokers for their clients, while the cash is settled on a net basis, through CSD's account at the CBB.

Appendix III. Recommended Action Plan to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (P. 1–5)	The Securities Commission should be given legislative authority to grant exemptions and make legally binding rules under both the SA and MFA. Elimination of the Minister's exceptive power under the MFA would enhance the Securities Commission's independence. The authorities should develop a website that would contain information about its activities, the securities laws, registered firms and public companies. Increased visibility benefits investors and the markets. The Commission should be provided with comprehensive authority to inspect all firms registered under either the MFA or SA and to have full access to all information held by the firms at any time. Additional resources may be needed, particularly in the compliance and enforcement areas, and recognition should be given to the difficulty of attracting additional staff with the required specialized skills at government salary levels.
Principles of Self-Regulation (P. 6–7)	The Commission should consider doing on-site inspections of the SROs.
Principles for Enforcement (P. 8–10)	The Commission must establish an effective program for on-site supervision of firms registered under both the SA and MFA. Where appropriate, these reviews could be coordinated with the inspection activities of the CBB and the BSE. Registered firms should be required to have compliance programs in place. The levels of fines that may be imposed under the SA and MFA should be reassessed. Consideration should be given to raising these to provide a greater deterrent.
Principles for Cooperation (P. 11–13)	The Commission requires detailed and clear authority to share information and provide assistance to other regulators, both domestic and foreign.
Principles for Cooperation (P. 11–13) (continued)	The MOU among the securities commissions involved in CXN should be finalized and the three exchanges should have an MOU to govern their relationship.
Principles for Issuers (P. 14–16)	The disclosure requirements for public companies should be amended to provide for: • Public disclosure of material changes to be made immediately, with the filing of the report with the regulator promptly thereafter. Prompt confidential filings should be made where the matter is sensitive and the public disclosure should be made as soon as possible. • At least semi-annual financial statements to be included in offering documents and made available to

Reference Principle	Recommended Action
	shareholders. The rules governing public company disclosure (annual reporting, management reporting, financial statements, proxy requirements), voting (proxies etc,) and take over bids, which are presently in the Companies Act, should be consolidated in the SA. The takeover bid rules need to be updated, harmonized across the region, particularly with Jamaica and Trinidad and Tobago, and imported into the SA. Insiders of all public companies should be required to make prompt public disclosure of their shareholdings in the company and keep that information up to date.
Principles for Collective Investment Schemes (P. 17–20)	The MFA should be amended to contain a clear requirement that mutual fund operators and administrators have in place adequate internal control policies and procedure, which would be tested on inspection by the Securities Commission. The Securities Commission should consider requiring the custodian to be completely at arm's length to the fund and the administrator. The Securities Commission should introduce a comprehensive set of duties that would apply to the mutual fund, its operator, administrator and portfolio manager owed to the fund investors.
Principles for Market Intermediaries (P. 21–24)	Requirements that all registered firms have adequate internal control policies and procedures in place; be required to segregate client assets; have a duty of best execution; and not front run client orders should be added to the SA. The authority should consider recommending that firms establish a compliance function: someone responsible for monitoring the compliance of the firm with all applicable requirements. The authorities should develop a contingency plan to address the failure of a registered firm.
Principles for Secondary Markets (P. 25–30)	The regulator needs to put in place an effective on-site examination program for both the firms that trade on the BSE and for the BSE itself. The market abuse prohibitions rules in the BSE rules and securities legislation should be reviewed to ensure they are comprehensive. In particular, trading on insider information about any public company, not just a listed one, should be made an offence. Some significant modernization of bankruptcy and insolvency laws is needed to prevent the outdated provisions from being a significant impediment to development of the markets.

Authorities' response

The Commission agrees with the assessment to some extent as indicated in our previous submission. However, as explained to the Assessor, the Commission has recognized some of the deficiencies highlighted in relation to the legislation and prior to the assessment had co-ordinated a Legislation Committee which is reviewing the Securities Act and all Related Legislation, also with a view to completing our application for signatory to the IOSCO MMOU albeit Appendix B. This work is in progress and will continue.

To date the Committee has finished its review of the Securities Act and is in the process of reviewing the impact of the amended securities legislation on the Companies Act *inter alia* Division J. The Committee will also review the Mutual Funds legislation. Hopefully all of the required updates and amendments to the legislation will be completed by December 2010 which is also the deadline for application to IOSCO FOR signature to the MMOU.

Other deficiencies highlighted such as the absence of internal controls highlighted in the assessment will also be addressed with the continuing review of the securities and related legislation.

Appendix IV. Stress Testing Procedures, Assumptions, and Outcomes

1. **This appendix describes the methodology and results of the stress tests that were carried out as part of the Barbados FSAP Update.** The assessment is based on a bottom-up estimation of the vulnerabilities of onshore subsidiaries to various exceptional but plausible shocks. However, it is important to recognize that scenario analysis is not general equilibrium analysis, and is considered an imperfect guide to gauge the resilience to the shocks analyzed if macro policy framework, and/or the financial system were to diverge fundamentally from the current one. The shocks and scenarios used in the stress test analysis were chosen in collaboration with the CBB. The CBB provided individual bank data as of September 2007.

Coverage—Institutions and Risks

Institutions

2. **The stress test covers the four subsidiaries of the on-shore banking system, and it is based on data as of September 2007**. The two foreign branches of the on-shore system were not included in the exercise given that minimum capital requirements do not apply for them.

3. **The stress test assesses the resiliency of the system to a number of shocks, including to the economic activity, interest rate, exchange rate, liquidity, as well as shocks to macroeconomic variables for the world economy.**

Summary of Methodology

Credit Risk

4. **The credit risk analysis consisted on tracking the impact on commercial banks' CAR of shocks to default rates of the banks' loans.** This was accomplished by first estimating a one-year horizon, 95 percent confidence level simplified value at risk (VaR) for each bank. Assuming that the portfolio loss distribution can be characterized by its mean and its variance, and that the vector of default probabilities are given exogenously, the VaR of the loan portfolio delivers the expected and unexpected losses. The adjustment of banks' CAR after each shock or scenario was calculated from the sum of expected losses and unexpected losses, net of existing provisions under the assumption of a uniform probability of default for all borrowers in the same bank, and a Gamma probability distribution for loan losses. The following parameters/assumptions were used in the calculations:

- The loss given default (LGD) was assumed to be the same for all loans, at about 25 percent, based on discussion with commercial banks (indicating a 0-40 percent range).

- The unsecured share of bank assets was assumed to be about 20 percent of total assets across banks. An 80 percent ratio of secure assets is a conservative assumption based on some banks' broad estimations during meetings. Credit card loans and consumer loans seems to have the lowest levels of collaterization.

- Loan default probabilities (PD) were assumed to be homogeneous and independent from each other, and were approximated using the evolution of NPLs and their expected levels after each shock or scenario. Expected NPLs were projected based on historical relationships between NPL levels and key macroeconomic variables (GDP growth, nominal interest rates and inflation).
- The effective loan portfolio concentration was estimated by computing a Herfindahl-Hirschman index using the most disaggregated loan category available.

In addition, to compare the results of the 2002 FSAP stress test analysis, the mission also tracked the impact on each bank's CAR of an increase in each bank's provisioning associated with different hypothetical increases in NPLs (see Stress Testing the Banking System technical note).

Interest Rate Risk

5. **Changes in the nominal interest rate in Barbadian dollars were considered.** The impact of an upward parallel move in the yield curve on banks capitalization was assessed over a one-year horizon. The test combines:

- The direct effects on the balance sheet for interest bearing assets and liabilities; a gap method was used. The indirect effect over the quality of the portfolio is included in the credit risk stress test.
- The effects of potential mark-to-market losses derived from banks' holdings of fixed rate government papers; according to authorities estimates most of the portfolio—90 percent approximately—is held to maturity; a duration model was used.

Exchange Rate Risk

6. **Depreciation/appreciation of the Barbadian dollar was considered.** These results include:

- The direct effect on the balance sheet derived from any currency mismatch.
- The indirect effect of any impact on the banks' portfolios quality. Discussions with CBB's staff suggested that an x percent depreciation would lead to an x/20 percent of new NPL of foreign currency loans.

Liquidity Risk

7. **The test assesses whether banks would be able to survive liquidity drains without resorting to outside sources of liquidity (CBB).** The scenarios considered include:

- A dry-up of up to 50/100 percent of the funding from parents institutions.
- Deposits run of up to 50 percent in a 30-day period.

Scenario Analysis

8. **Given that shocks tend to hit small open economies simultaneously, a scenario analysis is also presented.** The system is subject to shocks to the tourism and construction domestic sectors, as well as to shocks to the U.S. economy and international oil prices.

Appendix V: Barbados: Follow-Up on Key Recommendations of the 2002 FSAP

FSAP Recommendations	Status as of April 2008
Banking Sector	
Financial Institutions Act: The FIA should be amended to strengthen the independence of CBB, impose aggregate limits on large exposure and connected lending, facilitate license revocation and distressed bank resolution, and require CBB's prior approval of the external auditor for licensees.	The FIA (Amendment, 2006) did not address the independence of CBB, aggregate limits on large exposure and connected lending and license revocation. Distressed bank resolution and CBB's prior approval of the external auditor were addressed in the amendment. Most of the outstanding items are in a proposed amendment currently being worked on by the CBB.
On-site examinations: Supervisory resources of the CBB should be boosted to enable it to conduct regular onsite examinations of all onshore and offshore banks on an 18–24 months cycle.	BSD's supervisory staff has increased from 28 at 2002 to 32 at March 2008. However, regular on site examination cycle has lengthened due to an increase in other mandates.
Deposit Insurance Act: The potential for financial instability may be contained by a well designed deposit insurance scheme in a properly supervised banking system.	The deposit insurance scheme was introduced in mid-2007 for institutions licensed under the FIA. It covers up to BDS$25,000 per depositor and per institution, and its fund represents about 0.2 percent of total deposits. Aspects related to the organization, the MOU with the Central Bank; and staffing are in progress.
Credit Unions	
CBB assisted on site examinations: A high priority should be assigned to completing the CBB assisted on site examinations of the five large credit unions and such examinations should be made regular.	The focus of the joint inspections has shifted from the largest five to the largest two credit unions. The two largest are not being inspected on an annual basis. Consideration should be given to adding the third largest to the joint inspection process as it has significantly higher assets than its peers (medium sized category).
Credit Union Law: Consideration could be given to introducing a separate credit unions law in light of the experience gained with these examinations. In the meantime, the capacity of the Registrar of Cooperatives to effectively supervise credit unions should be strengthened.	The Cooperative Societies Act was amended in December 2007 and its regulations updated in January 2008, however, the amendments are unlikely to serve as a good substitute for a dedicated Act. Plans are being considered to establish a Financial Services Commission which will bring under one roof the supervision of all nonblank institutions, including the insurance companies, credit unions, and the stock exchange. The IDB project will provide training in risk based supervision to the Cooperatives Department.
Insurance Sector	
Supervisory resources: Supervisory resources need to be increased to allow the instigation of an on-site inspection process supported by a more analytical off-site review using timely and sufficiently detailed returns from companies.	On-site inspections commenced in 2004. However, these inspections need to be supported by a more analytical off-site review, with attention to standard procedures, rather than compliance oriented off site analysis. This, in turn, will require better content and more timely information collection. Staff has increased since the last assessment, however four positions created in 2006 have yet to be filled.

FSAP Recommendations	Status as of April 2008
Solvency margins: A solvency margin requirement can be developed for life insurance companies which, if supplemented by a review of provisioning rules and asset requirements will greatly improve the regulatory framework.	Proposed amendments regarding solvency margins and capital requirements have been drafted but not implemented.
Circulars: The development of several circulars would codify presumed understandings between market participants and the supervisor. In particular, attention to corporate governance and internal controls would offer ready improvement. Such circulars would assist in ensuring that reputational risk is minimized.	Several circulars and standards were recommended from the previous assessment, in particular, standards on corporate governance, market conduct, internal controls (including asset and derivative controls, particularly in the case of the offshore market), asset and liability valuation. Except for one circular covering segregated cell companies distributed in October 2007, no other circulars were issued.
Independence and Transparency: The supervisor has not published information about the operations of the office or the market. A draft has been prepared. Improved transparency would promote independence and would be the most cost effective way to deliver better compliance with the core principles.	Returns from the industry continue to be delinquent. At the time of this assessment, the Supervisor of Insurance's 2005 Report was still in draft form. The 2006 information had not been compiled. The Financial Services Commission (the single regulatory agency of the nonbank sector), which has not been approved as of the date of this re-assessment. If approved, it will increase the independence and transparency of the regulation of the insurance sector.
Capital Markets	
Securities Commission: The new legislation and the authorities' efforts to promote a more efficient and transparent market have been reflected in the assessment of the IOSCO Principles. Full implementation of many of the Principles requires effective exercise of the SC's powers in practice. However, as the SC is not yet fully staffed or operational, this is not yet in place.	The authorities report that inspection and enforcement of the Securities Act has improved since the Securities Commission became fully operational in 2003. Some joint inspections done with CBB. Three new inspection/compliance examiners to be added in 2008 and own inspection program to commence. BSE in process of establishing own inspection program for member brokers.
Public company reporting: Disclosure could be improved by immediate disclosure of material events by public companies and immediate disclosure of transactions in company's securities by insiders of company.	No change.
Securities settlement period: Securities clearing and settlement should move toward DVP principles and T+3 settlement cycle.	Effective January 1st 2006, the securities clearing and settlement cycle was reduced to T+3, or three business days after trade day.

Appendix VI. Barbados—Detailed Recommendations of FSAP Update

BANKING

Legal and regulatory framework

Short-term

- Update existing regulations (capital adequacy regulation, classification of assets and loss provision) and issue new regulations (large exposures; related party transactions; licensing activities—to include holding companies).
- Increase transparency by sharing with the industry licensing requirements and permissible activities.

Medium-Term

- Amend Financial Institutions Act (to grant CBB authority to issue regulations, similar to text in the International Financial Services Act, and to get clear, delegated authority from the MoF).
- Develop methodology for imposing sanctions and penalties.

Off-site and on-site supervision

Short-term

- Accelerate development of risk assessment model. This would include identifying the criteria for evaluating the inherent risks; and the risk management and mitigation activities; determining the frequency and timing of the risk assessments; the definitions and level of risks to be assigned, and the impact the assessment will have on an institution's supervisory strategy.
- Maintain a proper level of a broader scope onsite inspections (resume inspection frequency, reduce the current "exam cycle" of 18–30 months).
- Conduct higher level of transaction testing to support assessment of risk management activities.
- Develop program to document significant changes that arise between the completion of the inspection to the issuance of the report of inspection (primarily the changes of asset classification, changes to the loan loss provision).
- Develop mechanism for notifying the FIU when inspections determine that a licensee should have filed a suspicious transaction report but failed to do so.

Medium-Term

- Keep building up supervisory framework to assess, monitor, address risks in the banks and banking system.

- Improve data gathering and analysis to identify incipient system-wide vulnerabilities.

Basel II implementation

Short-term

- Conduct full-scale Quantitative Impact Study to assess the impact on capital level of banking system as well as macro-economy and financial markets.
- Based on the result of the QIS, make any needed adjustments including changes in risk weights, delay of implementation schedule, and strengthening Pillar 2 framework, among others.

Cross-border consolidated supervision and home/host cooperation

Short-term

- Complete MOUs with OSFI, Bermuda and other jurisdictions.
- Expand and document home/host information sharing on risk profiles of parents and subsidiaries to assess the impact of parent/related party on Barbados banks.
- Conduct comprehensive scope, coordinated cross-border inspections of Barbados-based bank.

Medium-term

- Establish clear legal framework for consolidated supervision of banking groups or financial conglomerates including explicit provisions on legal definition of a bank group and consolidated prudential rules or limits.
- Strengthen surveillance of regional cross-border financial groups through more frequent and comprehensive group-wide risk assessment taking account .of risk contagion across the region.
- Develop multilateral MOU for specific holding company or group.

Short-term

- Provide the Securities Commission with statutory power under the MFA and SA to:
  - make legally binding rules and give exemptions;
  - inspect and access all information at regulated firms at any time; and
  - share information and otherwise cooperate with domestic and foreign supervisors.

Medium-term

- Elimination of the Minister's exemptive power under the MFA would enhance the Securities Commission's independence.

Commission

Short-term

- Develop and implement regular inspection program for regulated firms under both Acts and require all registered firms to have adequate internal control and risk management policies and procedures. Where appropriate, these reviews could be coordinated with the inspection activities of the CBB and the BSE.
- The Securities Commission should consider requiring the custodian of mutual fund assets to be completely at arm's length to both the fund and the administrator.
- The authority should consider recommending that firms registered under either Act establish a compliance function: someone responsible for monitoring the compliance of the firm with all applicable requirements.

Medium-term

- The Commission should develop a website that would contain information about its activities, the securities laws, registered firms and public companies. Increased visibility benefits investors and the markets.
- The Commission should consider doing an on-site inspection of the SROs.

Commission and government

Short-term

- The market abuse prohibitions rules in the BSE rules and securities legislation should be reviewed to ensure they are comprehensive. In particular, trading on insider information about any public company, not just a listed one, should be made an offence.
- Require (i) immediate public disclosure of material changes regarding mutual funds and public companies; and (ii) insiders of public companies to make prompt public disclosure of their shareholdings and keep that information up to date.
- All registered firms should be required to have adequate internal control policies and procedures in place; be required to segregate client assets; have a duty of best execution; and not front run client orders.
- The levels of fines that may be imposed under the SA and MFA should be reassessed. Consideration should be given to raising these to provide a greater deterrent.

Medium-term

- Consider obtaining technical assistance to identify and propose recommendations to address limitations on capital market development.

- Study ways (including offering higher salaries) to attract additional staff with the required specialized skills in the compliance and enforcement areas.
- A comprehensive set of duties should be introduced that would apply to the mutual fund, its operator, administrator and portfolio manager and be owed to the fund investors.
- Update and harmonize takeover bid rules across the region (particularly with Jamaica and Trinidad and Tobago) at the exchange and statutory levels; consider importing the takeover bid rules into the SA.
- The disclosure requirements for public companies should be amended to provide for the most recently released financial statements (including semi-annual statements) to be included in offering documents and made available to shareholders.

Financial sector authorities (including the BSE)

Short-term

- Develop a contingency plan to address the failure of a registered firm.
- The MOU among the securities commissions involved in CXN should be finalized and the three exchanges should have clear arrangements in place (via an MOU or contract) to govern their relationship.

Medium-term

- The rules governing public company disclosure (annual reporting, management reporting, financial statements, proxy requirements), voting (proxies etc,) and take over bids, presently in the Companies Act, should be consolidated in the SA.
- Some significant modernization of bankruptcy and insolvency laws is needed to prevent the outdated provisions from being a significant impediment to development of the markets.

INSURANCE

Short-term

- Efforts to improve the timeliness and usefulness of supervisory returns should have a high priority.
- Bring regulation of the insurance sector in line with best international practices to protect the reputation and the charter value of the insurance business in Barbados from negative shocks.
- Develop standards and circulars to enhance the observance of the IAIS principles. In particular, standards on corporate governance, market conduct, internal controls (including asset and derivative controls, particularly in the case of the offshore market),

asset and liability valuation, and a solvency standard for life insurers would lead to a considerable improvement in the observance of the principles.

- Study ways to increase enforcement resources. On site inspections need to be supported by a more analytical rather than compliance oriented off site effort. This, in turn, will require better content and more timely information collection.
- Pursue practical collaboration with respect to the supervision of larger groups in Barbados with the authorities in Trinidad and Tobago. Effective supervision of the sector can only be done by supplementing the solo approach with a group wide assessment.

CREDIT UNIONS

Short-term

- Consider issuing a specialized Credit Union Law. The amendments to the Cooperative Societies Act are not a substitute to a separate Act. The legislative changes have not kept pace with the accelerated growth of the sector and the risks associated with the high degree of concentration in the largest two to three credit unions in terms of total assets and membership base. In addition, loan delinquency rates need to be measured accurately.
- Increase the on-site examination of the systemically important credit unions by undertaking joint inspections (Cooperatives Department and Central Bank) on an annual basis and consider adding the third largest to the joint inspection process.
- Increase the number of inspections conducted by the Cooperatives Department such that an annual inspection is conducted on all 34 credit unions. Increase the number of examiners and continue to provide training on risk based supervision.

DEPOSIT INSURANCE

Short-term

- Expand and improve the level of public awareness about the characteristics of the new deposit insurance scheme.
- Complete the process of organization, the MOU with the Central Bank; staffing, and necessary systems.