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FINANCIAL SYSTEM STABILITY ASSESSMENT

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This Financial System Stability Assessment on Barbados was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on January 27, 2014.

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FINANCIAL SYSTEM STABILITY ASSESSMENT

January 24, 2014

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This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited Barbados in July and September-October 2013. The FSAP findings were discussed with the authorities during the Article IV consultation mission in December 2013.

- The FSAP team was led by Marco Piñon (IMF, Mission Chief) and Erik Feyen (World Bank, Mission Chief) and comprised of David Grigorian (IMF, Deputy Mission Chief), Steen Byskov (World Bank, Deputy Mission Chief), Claudio Visconti, Nobuyasu Sugimoto, Joonkyu Park, Yugo Koshima, Jiaqian Chen, Kalin Tintchev (all IMF), Craig Thorburn, Pierre-Laurent Chatain, Claire McGuire, Ines Gonzalez Del Mazo (all World Bank), Jonathan Katz, and Jose Tuya (external experts). Kristine Vitola (IMF, WHD) participated in the first mission and supported the FSAP team on macro issues.

- FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- This report was prepared by Marco Piñon Farah and David Grigorian, with contributions from the rest of the FSAP Update team.

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ANNEXES

Glossary

AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
BCP	Basel Core Principles For Effective Supervision
BDIC	Barbados Deposit Insurance Corporation
BDS	Barbados dollar
BNB	Barbados National Bank
BSD	Bank Supervision Department
BSE	Barbados Stock Exchange
CAR	Capital Adequacy Ratio
CARICOM	Caribbean Community
CBB	Central Bank of Barbados
CLICO	Colonial Life Insurance Company
CXN	Caribbean Exchange Network
DIA	Deposit Insurance Act
EIC	Exempt Insurance Company
FCI	FirstCaribbean International Bank
FCIB	FirstCaribbean International Barbados Bank
FIA	Financial Institutions Act
FOMC	Financial Oversight Management Committee
FSAP	Financial System Assessment Program
FSC	Financial Services Commission
FSMP	Financial Stability Management Plan
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IBC	International Business Company
ICP	Insurance Core Principles
IFSA	International Financial Services Act
MCM	Monetary and Capital Market Department
MoF	Ministry of Finance
MOU	Memorandum of Understanding
NIS	National Insurance Scheme
NPL	Nonperforming Loan
PPS	Policyholder Protection Scheme
QIC	Qualifying Insurance Company
RRP	Recovery and Resolution Plan
WEO	World Economic Outlook

EXECUTIVE SUMMARY

Barbados has a relatively well-developed financial system, including a large offshore sector.[1] The onshore system is dominated by large, regionally active banks. Banking services to the population are also provided by the credit union sector. The system also includes a mature but concentrated insurance sector with extensive international affiliates, and other non-bank financial institutions provide credit and other instruments for savers. The offshore sector is financially segregated from the domestic economy and is dominated by international banks mainly conducting treasury and wealth management operations. The financial system has increasingly been funding the government and residential mortgages, reflecting fiscal pressures and the limits imposed by capital controls on investments abroad.

Systemic risks

With a deteriorating fiscal situation and weak growth prospects, Barbados faces considerable macroeconomic vulnerabilities. Sovereign risk is a concern, given a large public debt, high fiscal deficits, and slow growth, and policy options are limited by a fixed exchange rate regime. While long-standing capital controls provide some protection against disorderly scenarios, they are likely to become less effective over time unless fiscal vulnerabilities are addressed. The authorities are committed to the announced fiscal consolidation plan, but full efforts should be deployed to secure timely and successful implementation.

While the financial system does not appear to be a source of immediate risk, its position appears to be deteriorating, with implications for systemic stability. Credit quality of domestic banks and credit unions has weakened considerably since the global crisis and, with growth expected to remain slow in the years ahead, is projected to deteriorate further. Weaker bank balance sheets could dampen credit supply, amplify the economic decline, and exacerbate broader macroeconomic vulnerabilities.

Moreover, stress-tests illustrate that the financial system would be vulnerable in the face of severe shocks. Relatively large capital and liquidity buffers mean that onshore banks can generally withstand moderate shocks without breaching regulatory requirements. However, vulnerabilities emerge in the case of severe shocks, particularly in a branch of a strong foreign bank and in the credit union sector. The latter is also vulnerable to medium-sized liquidity shocks. The offshore financial sector does not appear to be a major source of risk given that it is prevented from carrying out financial transactions with domestic residents, but common ownership links and reputational risks should be monitored closely.

[1] The term "offshore" is used throughout the report for consistency with internationally recognized terminology. However, the term "international bank" is used instead by the authorities as defined in the International Financial Services Act (IFSA) of 2002.

Data limitations prevent a quantitative analysis of the insurance sector, but vulnerabilities are emerging. In particular, the sector's soundness could not be assessed owing to inadequate liability valuation standards and lack of data on foreign affiliates. However, the presence of a major regional holding company based in Barbados and significant expansion of its non-insurance financial operations create the potential for significant vulnerabilities.

Supervision and regulation

Barbados has improved its legal, regulatory, and supervisory frameworks in line with the 2008 FSAP Update's recommendations. On the banking side, consolidated risk-based supervision was introduced along with several formalized supervisory methodologies. Established in April 2011, the Financial Services Commission (FSC), equipped with adequate powers under the FSC Act, took over supervisory responsibilities for the non-bank financial institutions, upgrading substantially regulation and supervision of these sectors.

Nevertheless, there are important areas where regulations and practices need to be strengthened. While bank supervision is generally appropriate, there is a need to strengthen the independence of the Central Bank of Barbados (CBB), enforcement actions and loan loss provisioning, and anti-money laundering/combating the financing of terrorism (AML/CFT) oversight in the offshore sector. Given that the FSC is a recent creation, supervision of credit unions and the insurance sector, as well as data quality and reporting standards remain work in progress. Key areas where further progress is needed in the insurance sector include liability valuations, capital adequacy standards, cross-border group supervision, and risk management. In the credit union sector, there is a need to establish a two-tiered supervisory approach, given the significant heterogeneity of the sector, and to strengthen resolution procedures.

Crisis management and safety nets

Financial safety nets can be strengthened as the deposit insurance fund remains small. There is a need for a deposit insurer strategic plan, a target ratio, and improved payout procedures. Judicial remedies for challenges to decisions to seize a bank should be limited. Across all sectors, efforts should be made to ensure cost effectiveness of resolution and to safeguard the financial condition of entities in the safety net. Credit unions currently fall outside the financial safety net. However, before the safety net is extended adequate prudential oversight should be established.

Given the vulnerabilities identified in the stress testing, there is a need to strengthen group supervision, cross-border coordination, and crisis management. Priority should be given to improving data on cross-border linkages and conglomerates and enhancing supervisory colleges. While there is a legal basis and good cross-border communication within the Caribbean, crisis management plans, including those for internationally active nonbank groups, should be finalized. The mandate and tools of the Financial Oversight Management Committee (FOMC) should be improved.