The Financial System in Barbados

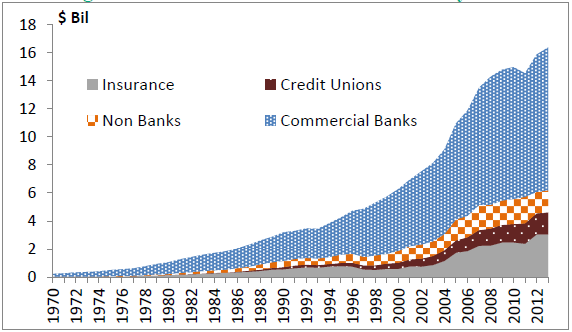
1. Background
   1. Before the global financial crisis of 2008, the financial system in Barbados had grown in size resulting in a number of regulatory improvements[[1]](#footnote-1) made by the Central Bank of Barbados and the Financial Services Commission to keep pace with the changing environment. This, in the most part, has supported the financial structure and the overall stability of the system in an adverse economic environment following 2008. Some of the key financial indicators have worsened since the onset of the crisis with credit quality being particularly noteworthy[[2]](#footnote-2). While resilient areas such as personal mortgages exist, the persistently weak economic environment has contributed to deterioration in credit quality and contraction of viable investment projects, causing a general decline in profitability. In addition, a decline in asset values[[3]](#footnote-3) has raised concerns as to the ability of financial institutions to realize on the value of collateralized loans, lowering the resale value to find final buyers when liquidating these assets. A reduction in the public sector employment of 3000 jobs announced through 2013 and 2014 is expected to further adversely affect the credit portfolios of financial institutions in the short term given the income stability that government employment shows to repay loans.
   2. The purpose of this document is to describe the structure of the financial system in Barbados and to illustrate the limitations of funding for private sector, particularly to the SMEs. While the regulation is not as deep for different for the financial sector participants, and the financial system shows signs of excess liquidity, some of this excess is being used to purchase government bonds and less resources are directed to financing the economy and the SMEs, which contribute to a significant share of the private sector productivity. The document will also analyse (i) the size and structure of the financial system, (ii) financial intermediaries groups, their particular role in the system and their involvement with SME financing, (iii) the constraints the private sector faces when seeking funding for investment projects, (iv) government interventions made so far and their results, and finally, (v) main findings and conclusions.
2. Size and Structure
   1. Barbados has a developed onshore and offshore financial system. Both sectors are dominated by international financial institutions and both serve different clients (residents and non-residents, respectively). Barbados also has a developed insurance sector and a network of credit unions. Barbados’ financial system comprises six commercial banks (which represent 66 percent of the total onshore financial system’s assets), 12 trust and finance companies (9 percent), 35 credit unions (9 percent), and 23 active insurance companies (17 percent)[[4]](#footnote-4). Collectively, the asset base of these institutions amounted to $16 billion at September 2013, equivalent to 185 percent of GDP[[5]](#footnote-5).

**Table 1. Barbados Financial System Structure**



Source: IMF FSAP 2014

**Figure 1. Assets of the Domestic Financial System**



Source: Barbados Financial Stability Report 2013

* 1. The growth in financial development is largely reflective of the development of both bank and non-bank segments of financial intermediation. As shown in Table 2, deposits in commercial banks have significantly increased. While commercial banks remain the dominant subgroup in the financial sector, faster processing times for loans and focus on niche market segments have led to the sustained development of other financial entities. These entities provide support to all the key growth sectors in the economy, including mortgage, motor vehicle purchases. and consumer financing to private individuals. Moreover, the major insurance companies operate both regionally and internationally, and the trust and finance companies are subsidiaries either of other financial institutions or of other conglomerates. Other operations within the financial sector include the securities market, mutual funds and pension funds[[6]](#footnote-6).

**Table 2: Total Deposits, 1950-2013 (US$ Million)**

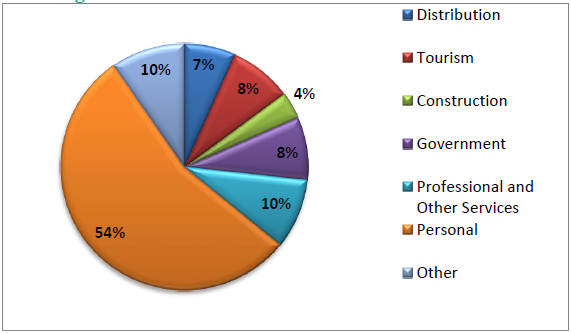
|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Commercial Banks | Friendly Societies/Credit Unions1 | Savings Bank | Trust & Mortgage Finance Companies | Finance Companies |
| 1950 | 11.3 | 0.1 | 5.2 | 0.0 | 0.0 |
| 1960 | 20.5 | 0.1 | 9.8 | 0.0 | 0.0 |
| 1970 | 90.2 | 0.3 | 8.9 | 1.0 | 0.0 |
| 1980 | 371.3 | 1.8 | 0.0 | 34.9 | 6.3 |
| 1990 | 916.3 | 61.9 | 0.0 | 160.2 | 20.2 |
| 2000 | 2,043.6 | 172.8 | 0.0 | 191.7 | 88.9 |
| 2010 | 4,301.8 | 545.9 | 0.0 | 205.5 | 242.7 |
| 2013 | 4,247.52 | 693.63 | 0.0 | 240.82 | 267.32 |

Source: Central Bank of Barbados and Haynes (1995)

Notes: 1 Deposits and shares; 2 November 2013; 3 2013Q3

* 1. The financial system is highly concentrated with cross border interests and ownership structures. In the banking sector, each of the six banks is owned by a foreign parent – three based in Canada, two in Trinidad and Tobago and one in the United States of America. The three Canadian banks account for 75 percent of total bank assets and the loan exposure is concentrated in a few main sectors[[7]](#footnote-7) that drive the economy as shown in Figure 2. While some trust and non-traditional companies are owned by banks, others are associated with insurance companies, credit unions and other non-financial conglomerates. Credit unions also provide loans to members, most of which are consumer personal loans.

**Figure 2. Distribution of Total Loans and Advances**



Source: Central Bank of Barbados, 2014

* 1. The supervision of the financial system is shared between the Central Bank of Barbados and the Financial Services Commission (FSC). Commercial banks, trust companies, finance companies and merchant banks fall under the oversight of the Central Bank, while credit unions, insurance companies, occupational pension plans, mutual funds and the securities market are regulated under the FSC Act. Collaboration between these two regulators is established by a Memorandum of Understanding and is formalized via the Financial Oversight and Management Committee (FOMC)[[8]](#footnote-8) composed by the Barbados Deposit Insurance Corporation (BDIC)[[9]](#footnote-9), the FSC and the CBB.. The BDIC provides a Deposit Insurance Scheme that guarantees each depositor up to $25,000 on domestic currency accounts. As at year-end 2012, 90 percent of qualified accounts in the Barbadian banking system are covered in the event of an institution’s collapse. The fund showed steady growth since its inception in 2007 and is currently valued at $39 million[[10]](#footnote-10).

1. Financial Intermediaries

1. A. Commercial Banks
   1. Commercial banks constitute the largest sector in the onshore financial system, with Individual institutions owned by international financial groups, and are still the largest players within the financial industry both in terms of holdings of deposits as well as public and private sector credit. There are currently six commercial banks operating on the island (see Table 3). The level of public involvement within the financial system has also declined with the government’s divesture of the majority shares in the Barbados National Bank, which has been absorbed by Republic Bank.

**Table 3: Ownership Structure of Commercial Banks**

|  |  |  |  |
| --- | --- | --- | --- |
| Name | Majority Shareholder | Local Rating and Majority Shareholder (S&P) | Majority Shareholder’s Rating (Moody’s) |
| Bank of Nova Scotia | Bank of Nova Scotia | AAA / Canada | Aa2 |
| Republic Bank (Barbados) | Republic Bank | A / Trinidad & Tobago | Baa1 |
| First Citizens Bank (Barbados) | First Citizens Bank | A / Trinidad & Tobago | Baa1 |
| CIBC FirstCaribbean International Bank | CIBC | AAA / Canada | Aa3 |
| RBC Royal Bank of Canada  Citibank Ltd | Royal Bank of Canada  Citigroup Inc. | AAA / Canada  AA+ / USA | Aa3  Baa2 |

Source: Central Bank of Barbados

* 1. Three institutions dominate the banking system: Scotiabank, Republic Bank and CIBC First Caribbean International Bank. Between 2009 and 2011, the assets of commercial banks have stagnated due to a decline in foreign currency assets. These have increase from 2012, resulting in resurgence in commercial bank asset growth, mostly driven by holdings of government debt, which have nearly doubled. The increased holdings of government debt appear to have been the result of both supply and demand factors. On the demand side, banks have been seeking alternatives to lending, especially corporate credit, as domestic credit demand has slowed, while on the supply side, the government’s fiscal policy has led to an increase in the value of government securities available on the market[[11]](#footnote-11).
  2. Concerns remain that limited avenues to deploy funds and the government’s increased issuance of treasury bills have resulted in a build-up in cash and other short-term assets. At the end of November 2013, liquid assets accounted for 17.7% of total assets, which is almost double the value at the end of 2007. Most of the liquid assets are held in Barbados T-bills (approximately 80 percent). However, banks that have made significant investments in Barbados treasury securities, have proved a steady stream of income. Total holdings in government securities moved from $1.3 billion in 2008 to $2.2 billion as at September 2013, representing a 70 percent increase in government securities[[12]](#footnote-12).
  3. The commercial banking sector has weathered the global financial crisis and local recession relatively well, with capital adequacy ratios remaining well above the 8% minimum required by the Central Bank of Barbados. Furthermore, banks appear to have taken a conservative position in relation to asset quality, thus increasing their capital position as a result throughout the recession (see Table 4).

**Table 4: Financial Indicators for Commercial Banks**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013Q3 |
| Solvency |  |  |  |  |  |  |  |  |  |
| Capital adequacy ratio (%) | 15.9 | 14.4 | 16.4 | 16.1 | 17.5 | 17.1 | 19.3 | 21.0 | 21.8 |
| Liquidity |  |  |  |  |  |  |  |  |  |
| Loan to deposit ratio (%) | 60.0 | 63.0 | 56.0 | 63.7 | 65.5 | 67.2 | 70.9 | 73.6 | 71.1 |
| Demand deposits to total deposits (%) | 38.5 | 36.4 | 36.6 | 34.9 | 36.6 | 35.2 | 32.1 | 29.3 | 30.5 |
| Liquid assets to total assets (%) | 9.3 | 7.9 | 9.5 | 9.0 | 10.8 | 11.5 | 12.0 | 14.6 | 17.7 |
| Credit risk |  |  |  |  |  |  |  |  |  |
| Total assets, annual growth rate2 |  |  |  | 3.9 | -5.4 | -1.5 | -4.7 | 15.8 | 2.6 |
| Nonperforming loans to total loans (%) | 5.6 | 4.4 | 2.8 | 3.4 | 7.9 | 10.8 | 11.1 | 12.9 | 11.3 |
| Substandard loans to total loans (%) | n.a | n.a. | n.a. | 2.5 | 6.7 | 9.1 | 8.7 | 9.9 | 7.7 |
| Doubtful loans to total loans (%) | n.a. | n.a. | n.a. | 0.4 | 0.4 | 1.0 | 1.8 | 2.3 | 3.0 |
| Loss loans to total loans (%) | n.a. | n.a. | n.a. | 0.6 | 0.9 | 0.7 | 0.6 | 0.8 | 0.6 |
| Provisions to nonperforming loans (%) | 25.3 | 31.7 | 52.4 | 60.1 | 43.6 | 37.4 | 32.9 | 33.9 | 44.4 |
| Foreign exchange exposure |  |  |  |  |  |  |  |  |  |
| FX deposits to total deposits (%)1 | 16.7 | 14.2 | 18.9 | 14.8 | 13.3 | 12.9 | 6.6 | 4.9 | 3.8 |
| Profitability |  |  |  |  |  |  |  |  |  |
| Return on equity (%) | 9.7 | 14.3 | 13.5 | 11.5 | 9.9 | 11.7 | 6.1 | 4.9 | 3.8 |
| Return on assets (%) | 1.6 | 2.0 | 1.7 | 1.4 | 1.6 | 1.1 | 1.0 | 1.1 | 1.0 |

Source: Financial Stability Report (Central Bank of Barbados), 2011 and 2013 editions, IMF FSAP 2014

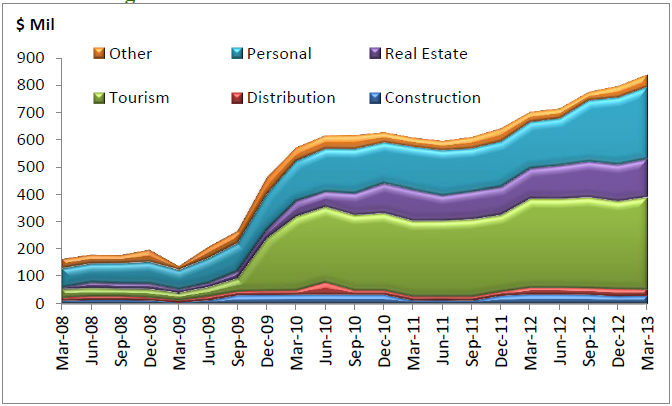
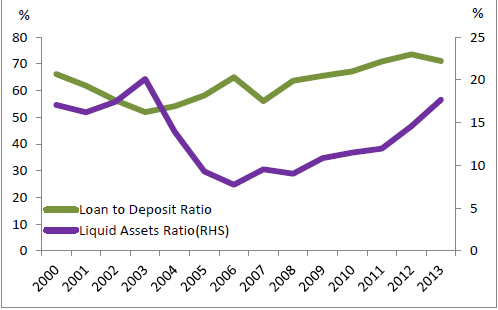
n.a. Not available

1 The decline in the ratio of foreign currency deposits to total deposits mainly reflects the transfer of funds from one bank to its affiliate in the international financial services industry. In 2013, there was also a widespread reduction in foreign currency deposits across all banks.

2 Values for 2012 include effect from merger between financial companies.

* 1. However, the main impact of the economic downturn has been an increase in default rates. The nonperforming loans to total loans ratio increased from a low of 2.8% in 2007 to a high of 12.9% in 2012 and 11.3% at the end of the third quarter of 2013[[13]](#footnote-13). While the bulk of the nonperforming loans are in the substandard category, there has been a notable increase in doubtful loans tied to the overall macroeconomic conditions. In its 2012 Financial Stability Report, the Central Bank noted that at the end of September 2013 there were three main categories of non-performing loans: 24% of non-performing loans were to the hotel and restaurant sector[[14]](#footnote-14); 19% were to the real estate industry; and, 42% were to individuals[[15]](#footnote-15).
  2. As a result of the high default rates, commercial banks have increased their provisions, which have contributed to the deterioration in their net income. Commercial banks are required adhere to the following provisioning guidelines: substandard loans require 10% provisioning; doubtful loans require 50% provisioning; and loss loans require 100% provisioning. Despite these guidelines, the Central Bank noted that banks hold well in excess of these guidelines, possibly due to the high volume of classified debt[[16]](#footnote-16).
  3. The liquidity position has also changed since 2008. In 2005 and 2006, the sector was coming out of a construction-related credit boom that resulted in very rapid loan growth relative to deposit accumulation. In 2007, however, the looming global economic downturn led to a rapid accumulation in deposits and, with credit stagnating, liquidity rose accordingly. Since 2008, commercial banks have actively tried to discourage time deposits (by reducing interest rates), thus shifting their deposit mix into demand and savings deposits. Deposit growth has therefore declined since 2007, falling by 6.2% between the end of 2007 and the end of 2013. Although these trends have led to an increase in the loan to deposit ratio (60 percent in 2006 to 71 percent as of September 2013), the liquid assets ratio grew sharply over the last two years from 12 percent at the end of 2011 to 18 percent at end of the third quarter for 2013. The interest rate spread among banks continued to trend downwards reaching 5.6 percent at September 2013, compared to the last peak of 7 percent in 2009.

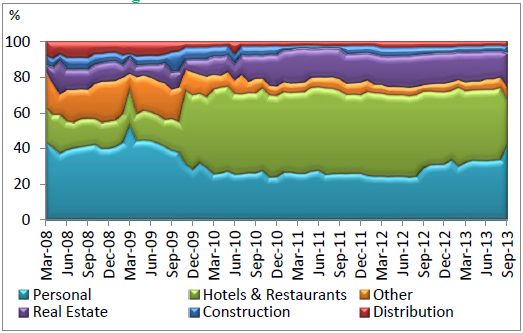
**Figure 3. Liquidity Indicators and Sectorial Distribution of Classified Debt**



Source: Central Bank of Barbados and Financial Stability Update, August 2013

* 1. In addition to the significant portions of non-performing assets, weak loan demand and the absence of viable projects have constrained the overall profitability of banks. Nevertheless, they continue to generate positive levels of profitability. The negative loan performance in the system, after peaking in June 2013 at 13.9 percent, the aggregate non-performing loans (NPL) ratio declined to 11.3 percent at the end of September 2013[[17]](#footnote-17) . Eighty-five percent of the total NPL falls in three large categories: hotels and restaurants now account for 24 percent of the NPL ratio, real estate 19 percent, and personal 42 percent, see Figure 3.

**Figure 4. Sector Distribution of NPL**



Source: Central Bank of Barbados

1. B. Credit Unions
   1. Activity in this sector is heavily skewed, as 3 (out of 35) credit unions account for more than 79 percent of total assets, membership, loans and deposits. Credit unions are owned by members who are also depositors in the entity. At the end of the second quarter of 2013, there were 35 credit unions with 159,921 members, or roughly 74% of the adult population of Barbados.
   2. The three main institutions are: Barbados Public Workers’ Cooperative Credit Union Ltd, Barbados Workers’ Union Cooperative Credit Union Ltd. and City of Bridgetown Cooperative Credit Union Ltd. The largest of these credit unions, the Barbados Public Workers’ Cooperative Credit Union Ltd., is almost as large as the smallest commercial bank. At the end of the 2012/13 financial year this entity had a loan portfolio worth almost US$400 million, close to 59 per cent of total credit union loans, and a membership of nearly 65 thousand persons (see Table 5). The IMF estimated that the industry was concentrated and very heterogeneous: there were three large credit unions, ten mid-sized institutions (mainly connected to private firms) and several community-based institutions (with average assets of Bds$2 million) with a wide sophistication of the services and risk management across the industry.

**Table 5: Key Indicators for Top 3 Credit Unions in Barbados (US$ Mil)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Barbados Public Workers’ Cooperative Credit Union Ltd.  (March 2013) | Barbados Workers’ Union Cooperative Credit Union Ltd.  (March 2012) | City of Bridgetown Cooperative Credit Union Ltd.  (March 2012) |
| Total Assets | 475.7 | 40.9 | 165.9 |
| Investments | 36.9 | 6.2 | 15.8 |
| Loans | 387.3 | 31.8 | 140.0 |
|  |  |  |  |
| Deposits | 386.1 | 35.7 | 106.0 |
|  |  |  |  |
| Net Interest Income | 22.7 | 2.0 | 7.6 |
| Net Income | 6.6 | -0.4 | 1.4 |
|  |  |  |  |
| Number of Members (thousands of persons) | 64.7 | 16.3 | 51.4 |
| Number of branches | 4 | 2 | 2 |

Source: Credit Unions Annual Reports

* 1. Credit unions are consumer finance specialists and during the economic downturn, households have proved resilient. As a consequence, the ratio of nonperforming loans to total loans has remained below that of commercial banks (8.7% compared to 11.3% as of September 2013, respectively).

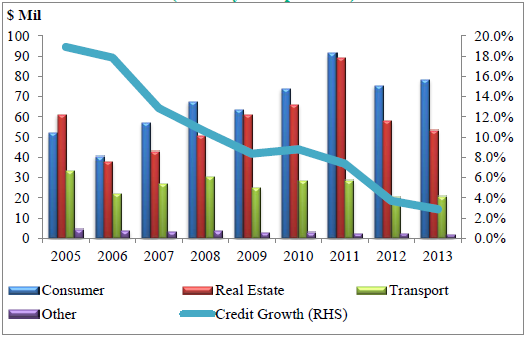
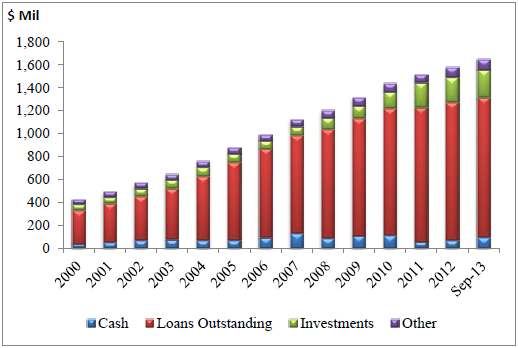
**Table 6: Credit Unions Financial Indicators**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 2008 | 2009 | 2010 | 2011 | 2012 | 2013Q3 |
| Solvency |  |  |  |  |  |  |
| Reserves to total liabilities (%) | 10.3 | 10.5 | 10.4 | 10.7 | 11.4 | 13.3 |
| Liquidity |  |  |  |  |  |  |
| Loan to deposit ratio (%) | 96.4 | 102.6 | 114.8 | 113.6 | 117.1 | 111.5 |
| Credit Risk |  |  |  |  |  |  |
| Total assets, annual growth rate (%) | 7.4 | 9.1 | 9.7 | 6.1 | 4.4 | 5.8 |
| Loans, annual growth rate (%) | 10.4 | 8.0 | 8.6 | 6.5 | 3.2 | 2.9 |
| Nonperforming loans ratio (%) | 5.3 | 6.5 | 7.2 | 6.9 | 8.2 | 8.7 |
| Arrears 3-6 months/Total loans (%) | 1.6 | 2.1 | 2.1 | 2.0 | 1.9 | 1.9 |
| Arrears 6-12 months/Total loans (%) | 1.3 | 1.8 | 1.9 | 1.6 | 1.9 | 1.8 |
| Arrears over 12 months/Total loans (%) | 2.3 | 2.7 | 3.2 | 3.5 | 4.4 | 4.9 |
| Provisions to total loans (%) | 1.8 | 1.9 | 2.2 | 2.8 | 3.2 | 3.3 |
| Profitability |  |  |  |  |  |  |
| Return on Assets | 2.0 | 1.6 | 1.2 | 1.2 | 1.3 | 0.6 |

Source: Financial Stability Report (Central Bank of Barbados), 2011 and 2013 editions

* 1. Between 2000 and 2013, loans and advances from credit unions more than quadrupled, ending the period at US$631.1 million, mainly due to a more than 7-fold increase in their mortgage portfolio. In fact, during the period, mortgages increased from 25.1% of all credit union loans to 44.2%. Although mortgage growth has been the main driver of the strong growth in credit union assets, consumer loans – which could include loans to the informal small business sector – have more than tripled from US$113.1 million in 2000 to US$352.4 million in 2013.
  2. At the end of September of 2013, there were 35 registered credit unions operating in Barbados. The sector reported membership of approximately 159,921, representing an increase of 7.5 percent over the comparable period of the previous year. For the same period, the consolidated assets of the sector were $1.65 billion. Assets grew by approximately 5.7 percent between September 2012 and September 2013 to reach approximately $1,650.5 million (Figure 5). This increase was primarily due to an increase in loans to members ($35.3 million or 2.9 percent), investments ($34.9 million or 16.3percent) and cash ($16.7 million or 21.9 percent). As at September 2013, the largest asset on the combined balance sheet for the credit unions are loans, accounting for approximately 76 percent of total assets, although its growth declining every year since 2005. This illustrates a slowdown in the rate of expansion of credit, a reflection of the weak loan demand in the wider economy is still present across the industries too.

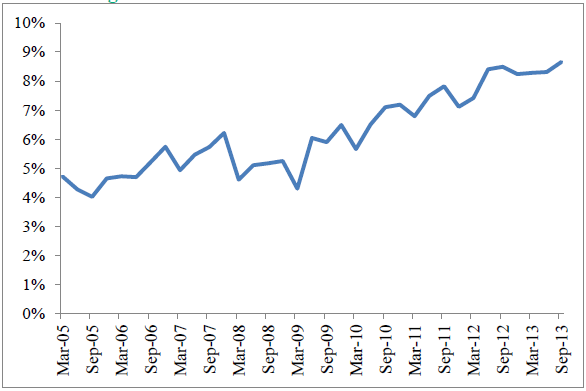
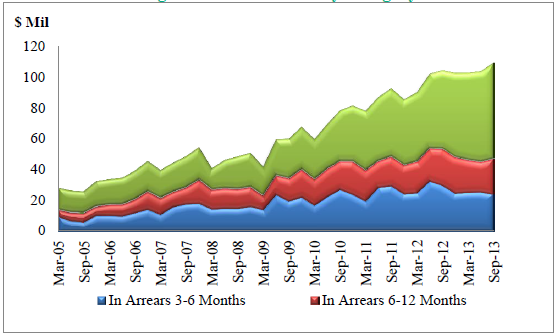
**Figure 5. Credit Unions Total Assets and Net Credit Issued with Total Credit Growth**



Source: Financial Stability Report, 2013

* 1. Between September 2012 and September 2013, gross loans to members increased by 2.9 percent to reach $1,262.3 million. Consumer loans accounted for the majority of loans to members (51 percent) followed by real estate loans (35 percent) and transport (13 percent). Consumer credit increased marginally by 3.8 percent, in contrast, real estate loans fell by 8.1 percent during the same period.
  2. There is also significant variation on the quality of the loan portfolio across the sector with NPL among the smaller credit unions (in terms of asset size) being substantially higher than among the larger entities. The ratio of the loan loss provision to gross classified loans increased from 36 percent in September 2012 to 38 percent in September 2013. Most of the NPL have been in arrears in excess of twelve months (approximately 57 percent).

**Figure 6. New Credit and Total NPL ratio for Credit Unions**



Source: Central Bank of Barbados

* 1. Members’ savings which comprise both members’ deposits and members’ shares increased by 6.1 percent growing from $1,309.1 million in September 2012 to $1,388.9 million at the end of September 2013. The increase in members’ savings was primarily as a result of an increase in members’ term deposits which increased by 18.3 percent or $67.8 million. This increase in members’ term deposits resulted from the more attractive interest rates offered on, and increased visibility of these products.
  2. The credit unions are regulated under the Co-operatives Societies Act, 1995 and the Financial Services Commission Act, 2010, which outline the scope of activities that credit unions may partake in[[18]](#footnote-18). Generally, the industry follows international guidelines for credit unions. The credit unions industry has developed quite substantially since the 1980s and the largest credit union now has a larger asset base and loan portfolio than the smallest bank. Banks have from time to time complained that the credit union have an unfair advantage, especially in the personal loans segment, because they operate under legislation that is less strict than the banking legislation, given that credit unions do not offer all the products that the banks do. Despite this observation, no change has been made to bring the two industries closer in line in terms of regulation, possibly because most credit unions are small and unsophisticated and greater compliance requirements may stifle the industry[[19]](#footnote-19).

1. C. Non-Bank Financial Institutions
   1. Trust and finance companies (Non-Bank Financial Institutions) focus primarily on providing mortgages and vehicle loans; the vehicles and title deeds under the individual contracts predominantly secure these loans. In recent years, the lending portfolio of these institutions has been diversified to provide business loans, accounting for 6.5% of their lending portfolio[[20]](#footnote-20). These institutions also earn income from leases, trading and brokerage income, management fees as well as dealer commissions.
   2. Of the thirteen trusts and finance companies: five are affiliated with commercial banks, one is a subsidiary of a credit union; and, the remaining seven are members of large conglomerates..

**Table 7: Financial Indicators of Non-Bank Financial Institutions1**

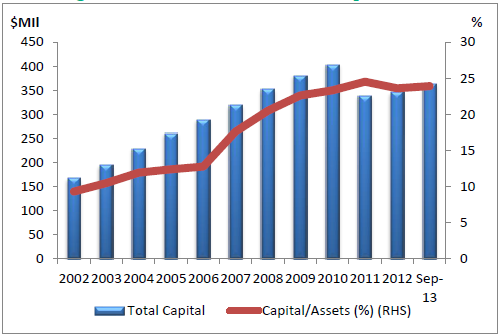
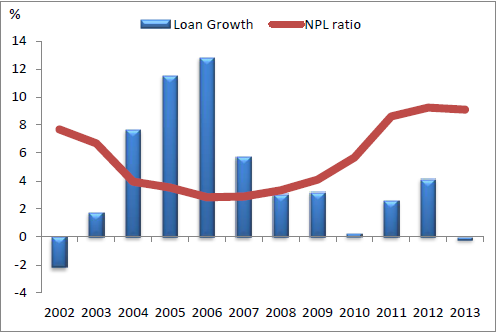
|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 2008 | 2009 | 2010 | 2011 | 2012 | 2013Q3 |
| Solvency |  |  |  |  |  |  |
| Capital/assets (%) | 19.5 | 21.6 | 22.3 | 23.2 | 22.3 | 22.6 |
| Liquidity |  |  |  |  |  |  |
| Loan to deposit ratio (%) | 180.0 | 175.5 | 178.8 | 106.3 | 101.5 | 90.2 |
| Liquid assets/total assets (%) | 13.3 | 8.9 | 10.8 | 15.0 | 17.8 | 8.6 |
| Credit Risk |  |  |  |  |  |  |
| Total assets, annual growth rate (%) | -5.0 | -2.4 | 2.8 | 5.3 | 6.2\* | 2.6 |
| Nonperforming loans ratio (%) | 3.4 | 5.3 | 5.7 | 8.6 | 9.3 | 9.1 |
| Substandard loans to total loans (%) | 3.1 | 4.9 | 5.2 | 6.7 | 6.1 | 6.0 |
| Doubtful loans to total loans (%) | 0.1 | 0.1 | 0.1 | 1.0 | 2.0 | 1.9 |
| Loss loans to total loans (%) | 0.2 | 0.3 | 0.3 | 0.9 | 1.2 | 1.2 |
| Reserves to nonperforming loans (%) | 21.2 | 16.2 | 11.6 | 24.8 | 36.8 | 29.0 |
| Profitability |  |  |  |  |  |  |
| Net income/Capital (%) | 10.9 | 11.2 | 10.6 | 10.8 | 6.3 | 8.7 |
| Return on Assets (%) | 2.1 | 2.4 | 2.4 | 2.5 | 1.4 | 2.0 |

Source: Financial Stability Report (Central Bank of Barbados), 2011 and 2013 editions

1 Includes trust companies, finance companies, mortgage finance companies and merchant banks

* 1. While trust and finance companies have also been negatively impacted by the economic challenges, their focus on consumer finance, similar to credit unions, has resulted in lower default rates than their banking counterparts. However, Non-bank financial institutions have also seen a general rise in their NPL since 2008, but at a less severe rate than commercial banks. As with banks, impaired loans are heavily weighted in the substandard classification and the institutions have made adequate levels of loan-loss provisions to cover these weaknesses in their portfolios. At the end of the reporting period of September 2013, total capital covered about 25 percent of assets, with total loans grew for the second consecutive year.

**Figure 7. Non-Bank Loan Growth, NPL and Capitalisation Levels**



Source: Central Bank of Barbados

* 1. Trust companies, finance companies, mortgage finance companies and merchant banks are all regulated under the Financial Institutions Act; but unlike the commercial banks who are licensed under Part II of the Act, these institutions are licensed under Part III. The main differences in the regulations relate to the holding of deposits: Part III institutions are not allowed to take deposits from the public and must fund their operations from other sources. As noted earlier in this section, many of these companies are affiliated with other, larger companies, who provide the necessary capital. Some companies could raise funds on the money market by issuing certificates of deposits and bonds. Most of these companies are important players in the personal loans market, but not yet considered significant in the business or corporate loans segment. In fact, most can only compete successfully with banks with leases and are less successful with traditional loans. There is scope for these institutions to become more significant players in the small business segment throughout not only their lease products but due to their greater flexibility for loan products. However, the fact that non-bank financial institutions are being less regulated than banks could pose an additional layer of supervisory risk in the medium term for the business loan portfolios, compared to the banks.

1. D. Insurance Providers
   1. The insurance sector represents a considerable part of the financial system and is highly concentrated, especially life insurance (Table 8). There are 23 active insurance companies operating in Barbados offering both life as well as general insurance products. Following strong growth in the 1970s and 1980s, the increase in assets slowed appreciably in the 1990s to an average of 1.8%, with a modest improvement in asset growth in the following decade. There were three important recent changes within the sector: the demutualisation of the 162-year old Barbados Mutual Life Assurance Society in 2000 to form Sagicor Life Inc. (a part of the Sagicor Financial Group); the privatisation of the Insurance Corporation of Barbados in 2006; and, the collapse of the CL Financial Group, the parent of local insurance company CLICO-Barbado[[21]](#footnote-21). All three events have changed the landscape of the insurance industry through changes in ownership, and the latter may have negatively impacted the reputation of the sector. Of the 23 active companies, 6 provide life and health insurance, 16 provide general insurance with a focus on property and commercial insurance and 1 company provides both types of insurance. One large insurer that controls 83% of the assets of the life insurance industry dominates the industry since the collapse of CL Financial Group. Insurance companies are not big players in the corporate finance market.

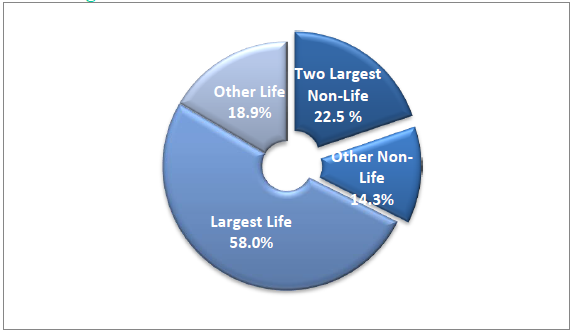
**Table 8: Financial Indicators of Insurance Providers**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 2009 | 2010 | 2011 | 2012 | 2013Q1 | 2013Q2 |
| Domestic Sector |  |  |  |  |  |  |
| General Insurance |  |  |  |  |  |  |
| Gross written premia BD$ million | … | 515.2 | 499.5 | 512.6 | 117.2 | 121.5 |
| Investment assets BD$ million | … | 675.6 | 718.6 | 726.3 | 725.1 | 725.7 |
| Life Insurance |  |  |  |  |  |  |
| Gross written premia BD$ million | … | 170.3 | 163.7 | 190.8 | 43.8 | 39.0 |
| Investment assets BD$ million | … | 1,387.0 | 1,345.0 | 1,391.0 | 1,434.0 | 1,431.0 |
| Offshore Sector |  |  |  |  |  |  |
| Number of active companies | 223 | 225 | 223 | 221 | … | … |
| Net premiums (BD$ billion) | … | 31.2 | 56.2 | 61.3 | 16.8 | 16.8 |
| Assets (BD$ billion) | … | 125.5 | 133.4 | 142.6 | 142.7 | 140.4 |

Source: FSAP Report 2014, IMF

* 1. Life insurance companies account for 77 percent of the industry, most of which is driven by one entity (see Figure 10). The largest insurance group has both life and non-life operations and accounts for 60 percent of the industry. Moreover, its operations span several territories (including the US) and include companies providing mutual funds, asset management and financing.

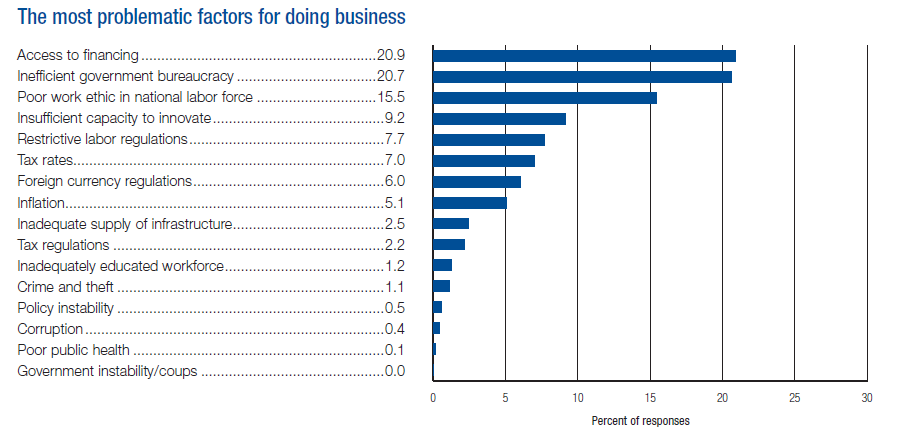
**Figure 8. Asset Concentration – Insurance Sector**



Source: Central Bank of Barbados

1. Financing the Private Sector
   1. According to the analysis of the World Economic Forum’s Global Competitiveness Report on Barbados (2013-14) access to finance has been identified as the single most problematic factor for doing business. As shown in the figure below, access to finance is particularly an obstacle for small and medium enterprises (SMEs) in Barbados.

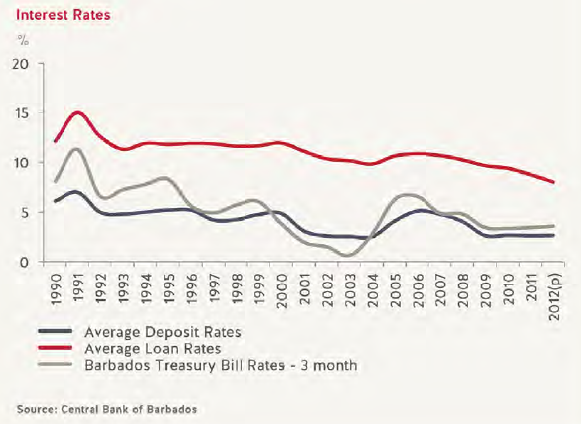
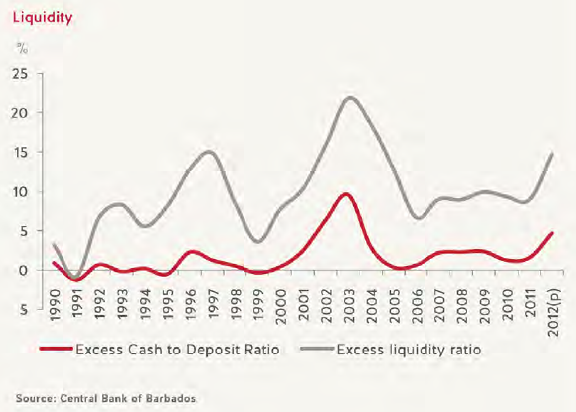
**Figure 9. Snapshot of the Business Environment in Barbados**



Source: The Global Competitiveness Report 2013-2014

* 1. In Barbados as in the Caribbean, banks often complain of a lack of bankable projects and confining their lending to large, well-established companies. Some of the reasons for this failure by financial institutions to lend to newer or smaller businesses are associated with factors that increase financial risk. The most important of these are[[22]](#footnote-22): asymmetric information, adverse selection, and moral hazard. Calculating the cost of these various components of risk for the region is difficult because of the small size of markets, distortions, and the lack of benchmarks against which to measure specific risk elements.
  2. Since September 2012 to March 2013, the financial system has remained generally stable and well capitalised. Levels of liquidity across all financial institutions continued to be high and entities were generally profitable with compressed margins, with interest rates decreasing overall. However, these economic conditions have not been translated into higher volume of loans for the private sector, nor the SMEs in Barbados.

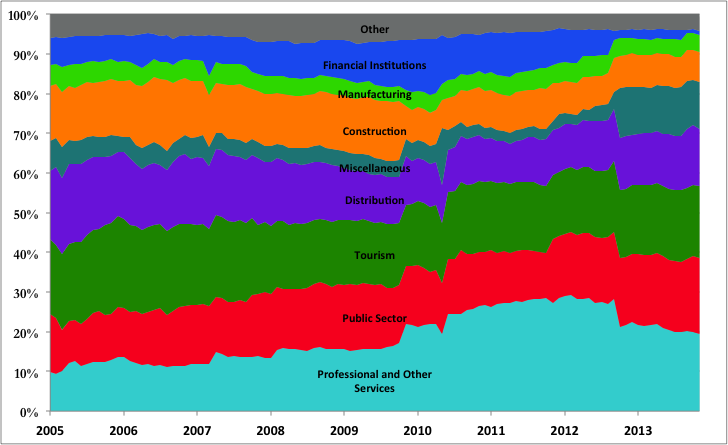
**Figure 10. Liquidity and Interest Rates in the Financial System**



Source: Annual Report 2012, Central Bank of Barbados

* 1. Since all of the commercial banks operating in Barbados are subsidiaries or branches of regional or international banks, for large loans they frequently source financing from their parent rather than use their own liquidity. This allows businesses that require extraordinarily large funding the ability to access it through the local banking system. Banks have also combined resources in the past to offer syndicated loans to those companies that have large, complicated financial needs.
  2. At November 2013, the business loan book was 45.2% of the total loan portfolio of commercial banks, 19.1% of which represented loans to the public sector (i.e. government and statutory bodies). The largest industrial categories are professional and other services (includes real estate development), tourism and distribution, which together accounted for 52% of the corporate loan book at November 2013 compared to 45.1% at the end of 2008. The increase was due to loan decreases to both the distribution and tourism industries during the period. Generally, banks were reluctant to lend to the tourism industry given the current weak performance and the large proportion of non-performing corporate loans. There is more interest in supporting other foreign-exchange earning industries such as agriculture and loans in the services industry, such as air conditioning repairs, where there was a stable market demand.

**Figure 11. Commercial Banks Business Loan Book by Industry**



* 1. The main risks considered by commercial banks when assessing business loans are the abilities of the management team, credit risk and market risk. Depending on the size and sector of the project, banks also consider environmental impact.
  2. Additionally, the barriers identified for low access to finance are commercial banks’ high risk perceptions for their customers, where firms may also lack the necessary guarantees and collateral to gain access to finance[[23]](#footnote-23).
  3. The inability to broadly use collateral is a major impediment to financial market development in the Caribbean region and firms. The general constraints are:
     1. The range of assets that can be used is limited, as are the types of legal entities that can pledge collateral within the legal frameworks of most countries in the region.
     2. Problems with outdated and outmoded laws, and the enforcement framework seriously impedes the use of collateral, in particular movable property, as security for the granting of credit.
     3. In many Caribbean countries, secured lending for firms is governed by the Companies Acts, requiring a charge over all assets of the company offering security interests .
     4. Registries in the region are chaotic, so that searching for prior pledges is difficult and enforcement of judgments is weak.
  4. The result of all these constraints are: (i) reduced access to credit except for large companies or wealthy individuals with substantial land holdings, (ii) smaller borrowers are excluded from the system, (iii) the credit chain is shortened with no borrowing against inventories or warehouse receipts.

1. Government Interventions
   1. The government, through the Central Bank of Barbados, offers services and guarantee schemes provided by the Foreign Exchange and Export Credit Department with a view to providing a substantial measure of support for credit and export promotion drive in Barbados. These products have had mixed results in terms of fostering their mandated sectors. There are different types of services provided by the Central Bank out in the market[[24]](#footnote-24), however this report will present the current status for the Enhanced Credit Guarantee Scheme (ECGS) and the Trade Receivables Liquidity Facility (TRLF), due to the available of data.
   2. The **Enhancement of Credit Guarantee Scheme** is a partial credit guarantee given by the Central Bank of Barbados to any credit institution that applies for it. It covers the risk for demand loans, term loans, overdrafts, discounts, letters-of-credit, acceptances, payment guarantees, tender bids and contract bonds. The risks covered under the guarantee are: (1) Insolvency of the borrower and, (2) protracted default by the borrower. It operates as follows:

Borrower meets eligibility criteria

CI grants loan after due diligence.

CI monitors loan.

Submits claims for non-performing loans.

CI grants loan. CBB guarantees 80% up to a maximum amount.

(90% for start-up businesses)

* 1. The guarantee is not irrevocable, which means that if the borrower fails to comply with the terms and conditions of any loan already granted to him by the credit institution, such ensure that the repayment schedule is up to date, the CBB can recall the guarantee to the credit institution.
  2. The ECGS works with enterprises in the foreign exchange earning sectors. This facility restricts the credit institutions to charge, as the interest of the facility, more than the cost of funding plus 350 basis points for a margin. Moreover, there is an annual guarantee premium of 150 basis points payable monthly, along with an additional rate of 150 bp per annum on the amount in case of overdraft or use of the facility, which might restricts the pricing of the interest rate for the lender.
  3. There is also an ECGS for small and medium-sized businesses that is extended to the small and medium-sized enterprises that qualify as eligible under the guarantor criteria. The CBB will guarantee short-term as well as medium-term and long-term (3, 7, and 15 years respectively) credit facilities up to a maximum amount for either case. Technical assistance grants can be available for entities that qualify for it, up to a maximum amount. This facility charges, as the interest of the facility, an annual guarantee premium of 150 basis points payable monthly on the highest amount of the facility outstanding at any time during a calendar quarter.
  4. The current number of guarantees outstanding with the ECGS until March 2014 is 28, with a maximum liability of B$1.7 million and a total value of guarantees at B$2.2 million. Since 2009, there have been only 2 claims received for the Credit Guarantee Scheme, one in 2010 and one in 2014.

**Table 9. Enhanced Credit Guarantee Scheme for Business (new guarantees issued)**



Source: Central Bank of Barbados

* 1. The Trade Receivables Liquidity Facility is a program that allows small businesses that have delivered goods or services to a Ministry or Department of Central Government to receive timely payment at a discounted rate. The provision it gives is that all outstanding invoices will be honoured within seven days.
  2. The TRLF Facility shows that up to March 2014, there were only 5 guarantees outstanding for that program, with a liability and value of guarantees of the same amount for B$0.27 million. We can possibly infer that this product has a broader demand in the market, but on average covers a smaller amount and the terms are shorter compared to the Credit Guarantee Scheme. The TRLF shows also a higher ratio of claims compared to the CGS, with 83% and 6% respectively, suggesting the presence of a higher risk guaranteeing receivables than credit lines.

**Table 10. Trade Receivables Liquidity Facility (new guarantees issued)**



Source: Central Bank of Barbados, 2014

1. Conclusions
   1. Barbados has been in the process of developing a more adequate onshore and offshore financial system, with international financial institutions serving resident and non-resident clients. In the past 2 years the financial system has remained generally stable and well capitalised with high levels of liquidity across all financial institutions but in general profitable with reduced margins, and with interest rates decreasing overall.
   2. However, these economic conditions have not been translated into higher volume of loans for the private sector, nor the SMEs in Barbados, where access to finance remains the single most problematic factor for doing business. Commercial Banks continue to be the key intermediary within the financial system in Barbados. Despite the increase of holdings of government debt in previous years, banks have been seeking alternatives to lending, especially corporate and business credit, as non-performing loans reached its peak in 2012 but have been declining.
   3. Given the fact that banks have a deeper oversight than other financial intermediaries, partly because their offer of more sophisticated products, they could develop a more stable SME lending portfolio, especially when additionally deliver the right incentives by using government interventions such as guarantees. These portfolios could potentially increment productivity within the businesses and sectors by mobilizing resources to investment projects, boosting capital inflows and productive capacity and strengthening competitiveness for SMEs.

1. Enactment of the Financial Institutions Act in 1997, the Asset Classification and Provisioning Regulation in 1998, and the International Financial Services Act in 2002. [↑](#footnote-ref-1)
2. Non Performing Loans ratios have three-fold in the past five years for Banks and Non-bank Financial Institutions, and increased more than 50% for Credit Unions. (Financial Stability Update 2013, CBB). [↑](#footnote-ref-2)
3. Central Bank of Barbados, Financial Stability Report 2013. [↑](#footnote-ref-3)
4. IMF FSAP 2014 [↑](#footnote-ref-4)
5. Central Bank of Barbados, Financial Stability Report 2013 [↑](#footnote-ref-5)
6. These institutions operate under the Financial Services Commission supervision, but data is not readily available for securities market and pension fund. Total assets under management for domestic mutual fund sector stood at B$ 971.1 million at the end of September 2013. [↑](#footnote-ref-6)
7. Roughly half of the personal loans are mortgages. [↑](#footnote-ref-7)
8. .The FOMC provides for mutual assistance, exchange of information, and monitoring of the financial and coordination of financial policies to preserve the stability of the system. [↑](#footnote-ref-8)
9. The BDIC is a statutory corporation which was established under the Deposit Insurance Act (2006) [↑](#footnote-ref-9)
10. Central Bank of Barbados, 2013 [↑](#footnote-ref-10)
11. Commercial banks are legally required to hold at least 10% of their deposits in government securities. [↑](#footnote-ref-11)
12. Central Bank of Barbados Financial Stability Report 2013. [↑](#footnote-ref-12)
13. Prior to this period, the highest the nonperforming loans to total loans ratio had been was 13.5% in 1996. [↑](#footnote-ref-13)
14. This ratio was 43% in 2012 but one large non-performing loan to a hotel was resolved in 2013 [↑](#footnote-ref-14)
15. In 2012 non-performing personal loans accounted for 29% of all non-performing loans [↑](#footnote-ref-15)
16. Central Bank of Barbados Financial Stability Report 2013 [↑](#footnote-ref-16)
17. Following the regularization of a large corporate non-performing loan in the hotel sector, this loan shaved off about 2.3 percentage points from the total classified loans. [↑](#footnote-ref-17)
18. The industry was initially regulated by the Office of the Registrar of Cooperatives in the Ministry of Finance, but that unit was transferred to the Financial Services Commission (FSC) in 2010/11 when the FSC began operations. [↑](#footnote-ref-18)
19. Recently there has been discussion in the media that the larger credit unions may consider applying for a banking license but there has been no concrete evidence to support this claim [↑](#footnote-ref-19)
20. Data confirmed in interviews with these institutions, May 2014. [↑](#footnote-ref-20)
21. The CL Financial Group experienced a deposit rush following the deterioration of the global economy in 2008 that had widespread repercussions for its operations throughout the Caribbean. In Barbados the two affected subsidiaries were Colonial Life Insurance Company (CLICO) and British American Insurance Company (BAICO). The Government of Barbados is currently deciding how to restructure these two entities and the aim is to ensure that there is no financial impact on traditional policyholders. [↑](#footnote-ref-21)
22. Paul Holden, 2011. “Enhancing Access to Finance in the Caribbean” IADB Discussion Paper. [↑](#footnote-ref-22)
23. Financial Stability Report 2011, Central Bank of Barbados [↑](#footnote-ref-23)
24. Other products listed available by the Central Bank of Barbados are: Tourism Loan Guarantee Scheme, Barbados Investment Fund, Export Credit Insurance Scheme, Export Finance Guarantee Scheme, Export Rediscount Facility, Industrial Credit Fund. [↑](#footnote-ref-24)